ECONOMICS AND GOVERNANCE COMMITTEE

Members present:

Mr LP Power MP (Chair)
Mr RA Stevens MP (via teleconference)
Mr ST O'Connor MP
Mr TR Watts MP (via videoconference)
Ms KE Richards MP
Mr LR McCallum MP

Staff present:

Ms L Manderson (Committee Secretary)
Ms R Mills (Assistant Committee Secretary)

PUBLIC HEARING—EXAMINATION OF THE ROYALTY LEGISLATION AMENDMENT BILL 2020

TRANSCRIPT OF PROCEEDINGS

TUESDAY, 28 JULY 2020

Brisbane

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The committee met at 11.23 am.

CHAIR: Good morning. I declare this public hearing open. Today's proceeding is being conducted using videoconference and teleconference facilities, so I ask all of our participants and anyone watching the live broadcast on the parliamentary website to please bear with us if we encounter any technical issues. I would like to begin today's proceedings by acknowledging the traditional owners of the land on which we participate today and pay my respects to elders past and present. My name is Linus Power, the member for Logan and chair of the committee. Other members today are Ray Stevens MP, the member for Mermaid Beach and deputy chair, who, along with Trevor Watts MP, the member for Toowoomba North, is joining us via teleconference; Lance McCallum MP, the member for Bundamba; Sam O'Connor MP, the member for Bonney; and Kim Richards MP, the member for Redlands.

The purpose of today's hearing is to assist the committee with its examination of the Royalty Legislation Amendment Bill 2020. The hearing is a proceeding of the Queensland parliament and is subject to the standing rules and orders of the parliament. It is being recorded and broadcast live on the parliament's website. Provided you are not joining us via the videoconference connection on your mobile phone, I ask everyone participating to please turn off their mobile phone or at least switch it to silent. Also, please place microphones on mute when not speaking as this helps prevent any audio interference and background noise.

BENNETT, Ms Lauren, Chief Executive Officer and Co-Founder, Bennestar Group Ltd (via videoconference)

CURTIS, Mr Kevin, General Partner, Texas-Tickalara Holdings (via videoconference)

SNELLING, Ms Lucy, Head, Corporate and Commercial, State Gas (via videoconference)

CHAIR: Thank you for making yourself available to assist the committee today. Before I invite you each to make a briefing opening statement, I ask that you identify yourselves by name when speaking, particularly when speaking for the first time or in answer to a question not directed to you. The committee members will also endeavour to ensure they clearly identify themselves when asking questions to minimise any confusion for yourselves and for members of the public watching the broadcast as well as, of course, to assist Hansard in their transcribing of the proceedings. We invite you to make statements in the order in which you are listed on the program. After your statements, committee members will have some questions for you.

Mr Curtis: Good morning, Mr Chairman and members of the committee. Thank you for inviting us to participate in this hearing. We are honoured to be here and trust that the committee will find our perspective constructive. Our intent is to come before you this morning as an amicus to this process. We have over 40 years experience in the oil and gas industry, having successfully and safely conducted conventional horizontal drilling operations primarily in Texas. In addition, we have over 25 years of doing business in Queensland. I have been involved in Queensland since 1995, beginning with a small interest in what was then a permit located west of Windorah, and that led us into a much deeper involvement in what has now become ATP1056, located a couple of hours west of Thargomindah. Although we are a small company, my partner and I have personally invested millions of dollars in the permit and have attracted over $40 million in foreign and domestic investment.

We have read the OSR responses to the commentary and our submissions to its staff, the minister, the Treasury and now the committee. We continue to stand by the validity and cautionary nature of those comments. The many written submissions offered up to now by industry speak to these issues, and more, and quite eloquently. As elected representatives, you are familiar with the dire nature of today's economic conditions. It is clear that jobs are of paramount importance. This legislation as drafted will likely have a negative impact on many people involved by the industry and the regions supported by our activity. These people include your friends, neighbours and constituents, and they all are voters. Among the likely consequences is operators prematurely shutting in wells and

fields that are either marginal, in a low-price environment or nearing the end of their productive life, particularly in periods of extreme low product prices such as we are having to work through today. The trickle-down effect on regional businesses that support these operations is that they will find their profits impacted, which puts further pressure on jobs. As these regional areas are already struggling due to COVID, it is hard to see how additional economic stress will be helpful.

The legislation may well also have a chilling effect on much needed outside investment in Queensland's energy industry. The changes that took place last year were noticed by investor groups that we were talking to at the time. The OSR pointed out in its just released response to our submission that the government's prerogative to change royalty is at its discretion—and this is the case—but it does not inspire confidence in those people looking to strategically deploy capital.

The one-size-fits-all royalty scheme may have been intended to update the collection revenues from CSG and LNG operations—and admittedly those operations have rapidly expanded over the years—but it is adversely affecting petroleum liquids, especially in remote areas like the Cooper and Eromanga basins where we operate. Our costs are intrinsically higher out there. It may well cause other remote basins that are in the early stages of exploration or that need infrastructure to simply shut down, and that does not benefit the citizens of Queensland, either.

Your economy enjoys a diversity of agriculture, mining, tourism and other industries in addition to petroleum, and I am very fond of Queensland. My long experience with the people of Queensland is that you are winsome, tough, smart, resourceful and more often than not a pleasure to do business with. My plea to you guys is to unleash your economy. It will take courage to cut taxes and reduce regulations, but I think you will find that the benefits are enormous. I appreciate your time and we truly wish you the best outcome for Queensland in all of this because we are fully invested.

CHAIR: I like to tell Americans that my home state is 2½ times the size of Texas. They are always very shocked by that. Unlike yourself, they do not have an understanding of the size. We will turn to Ms Bennett for an introductory statement.

Ms Bennett: I am speaking on behalf of Bennestar Group. We thank you for the opportunity to appear today. We appreciate that there is a need to simplify the wellhead model and we recognise that these amendments go a long way in doing that. However, we feel that simplicity has come at the expense of smaller operators such as Bennestar who, up to this point, have relied on aspects of the wellhead value model. A government royalty should not be a factor in profitability. We are concerned that the introduction of the volume model introduces this, especially with respect to oil projects which may be marginal and/or mature in nature.

Bennestar is a newly formed exploration and production company. We are focused on investment in South-East Queensland. Whilst I am not at liberty to disclose more about our interests, I can say that the proposed royalty amendments place us at a disadvantage in a number of ways, primarily in the timing of the implementation and in the ambiguity in calculating volumes.

It has been our experience that when screening assets it is necessary to make a raft of assumptions to model the economic viability of the investment. The assumptions we made about future profitability and commerciality of the assets were based on wellhead value. These assumptions were used to produce a financial model that third-party investors can reasonably rely on. It may be that in time volume based royalties can be absolved, but implementing a completely new regime on 1 October this year prejudices any incoming investment into companies like Bennestar, not just through mathematical adjustments to our financials but also in investor sentiment.

I would like to elaborate on this for a minute as it has been an important point for us to date. Bennestar has the aim of commercialising marginal assets which may get left behind by larger companies with higher overheads. Having screened assets all over Australia and South-East Asia, we specifically chose South-East Queensland for the abundance of opportunities it held and the promising sentiment it showed towards industry investment. This has been a point of difference for us and our investors. We fear that introducing these amendments now will serve to diminish the confidence we have been able to build.

Continuing with this point, I would like to draw a point we made in our submission around the treatment of capital in operating deductions. We would ask the committee to consider the capital intensity of establishing exploration projects and seek to limit the royalty to profitable production only. Whilst it might be true that during the early stages of project establishment production is low and the volume based royalties will naturally also be low, these early stages are when margins are most vulnerable. Stressing a project at this stage could turn projects subeconomic, which in turn would leave molecules in the ground, thereby defeating the purpose of a simplified royalty regime.

The matter of volume definition and calculation is naturally central to the proper implementation of the proposed model. We understand that the OSR is in the process of releasing this information to the public. However, I would respectfully again draw on my earlier point of the implementation date of 1 October, which is fast approaching. It will take some time for us to work through the practical steps to implement the new regime, especially in situations where impurities cannot be accurately accounted for. We are concerned about the capital investment we would need to make to get the assets and infrastructure to a standard where accurate volume monitoring can be achieved.

Bennestar Group thanks the committee for the opportunity to offer these comments today. As a company we are focused on investing in South-East Queensland, turning that investment into jobs for the local community, droughtproofing agricultural landholders and ensuring meaningful contribution to east coast domestic gas.

Ms Snelling: Thank you for the opportunity to appear before the committee. This bill proposes fundamental changes to the royalty regime which will have a significant impact on all petroleum industry participants. We appreciate the opportunity you have given us to raise our concerns.

I would firstly like to note the consultation that has been done through the royalty review process and also by OSR. The government has made some significant changes to the proposed regime which will be important and will certainly improve the model both in the implementation for OSR and for us. The adoption of actual sale prices and the exclusion of GST in particular were of concern to us. However, the very fact that I am here tells you that we think there is more to go and we think the issues that we are raising are very much in the long-term interests of the state.

State Gas is a small, new entrant in the sector, but we have big ambitions to become a significant new supplier of gas into the east coast market and to compete with the incumbents. This has been done before. Our executive chairman, Richard Cottee, was managing director of QGC. He took that company from one which is on a par with the current State Gas to the second largest listed company in Queensland, a major industry competitor before it was taken over by British Gas for $5.7 billion. We would like to do this again and, in doing so, bring more gas and more competition into a highly concentrated market. It is harder now than it was and this proposed changed will make it harder again.

The objectives of the royalty review were to ensure greater certainty, equity and simplicity for all parties while providing an appropriate return for the resource and also promoting domestic gas. Let me just say that we have no argument with providing a return to the state. We take a state asset in the gas and we should pay for it. The question is not, ‘Do we pay?’ The question is, ‘How do we work it out and how best can that payment be calculated?’

I would suggest, however, that there should have been an additional objective—namely, of encouraging or at least not discouraging new development and economic growth. I think this is particularly important in the current economic context. The petroleum industry is not just a key plank of the Queensland economy; it is also a key enabler of other industries, in particular manufacturing. More supply and more competitive supply provides opportunities for more jobs and economic growth in both Queensland and the wider Australian community.

The changes proposed by this bill move the royalty regime from one that is essentially based on profit—that is, through sales price less certain categories of cost—to a commodity tax which is determined by the volume produced. Is it simpler? Yes, it definitely achieves that objective. Is it more certain? Probably yes, and certainly for OSR in its administration I think it would be. Does it promote domestic gas? Yes, I think there is a significant element of the model which provides the discount for domestic gas and, yes, that does promote domestic gas, which we absolutely support. However, is it equitable? We think it is only equitable if you assume that all projects and all industry producers are the same or equal, and we are demonstrably not. Does it encourage new development? This is where we think it fails. It does not. The proposed regime disincentivises new developments and growth because it raises hurdles for economic viability and impedes a project's capacity to compete when it is new.

My written submission outlines a bit more on this. I am happy to elaborate further, but we have limited time here now. Ideally, we would have preferred the new royalty model to apply only to export gas with the current model continuing to apply to domestic gas and liquids. We understand this was considered but discarded because it would be less simple. We would argue that the benefits of not discouraging new projects and smaller players would outweigh the disadvantages of additional complexity. However, I think this ship has sailed and so we are focusing on other changes.

The key change we are advocating for is the capacity to provide some concessions to new development for growth projects, particularly for the smaller players. In our submission we suggested a 12-month period of no royalties, but it could be some other combination. In its response last night,

OSR suggested this was inequitable to the existing producers. I would argue that that is simply not true. Under the current regime every existing project has had the benefit of an effective royalty holiday on startup. We would argue that providing something along those lines to new projects would be far more equitable. OSR has also said the royalty paid in these circumstances will be low, but I can assure you that every cost at that early stage of a project makes a big impact. The fact that it is low is, in fact, an argument for relief. The impact on the state's finances will be negligible, but the impact on the project will be much more significant.

A secondary change we would like to see is to allow a single deduction for transport costs. This has been discussed by a number of the written submissions and I do not want to use more time on it here. These costs can be significant, and not allowing them to be deducted has the potential to distort the market.

Mr STEVENS: My question is to the panel in general. We have heard a lot from the panel in relation to the revenue impacts et cetera. However, as part of this bill—whether or not it was a petroleum royalty review—as a trade-off, if you like, for the increased revenue measures there was to be a reduction in compliance costs for the producers. Would the panel like to comment on whether there has been any reduction in compliance costs for producers as a result of this royalty bill?

CHAIR: Some of the projects are not producers as yet, although they might have knowledge of producers.

Mr STEVENS: They will have no knowledge of the cut in compliance costs by doing—

CHAIR:—or anticipated costs. Who would like to give a response to that?

Mr Curtis: I think we are the only ones who have paid royalties on this panel—

CHAIR: That is what I thought.

Mr Curtis:—and we have paid royalty. We have not had an opportunity to assess what the compliance cost of this is going to be. This has come on rather suddenly. It is being pushed through pretty quickly. Until we actually know what all the final elements are going to be, how much of a change there will be in terms of filing the royalty returns—and my partner Lisa Gourley prepares those on behalf of our joint venture including the non-tenure holders—I do not know that there is a way of answering that in advance.

Ms Snelling: I would say that there is not a huge difference in terms of the reduction in costs. That is because when you set up your accounting system for a project you itemise all of the various items. You do that for your own purposes, because you need to know what you are spending on various items. For the purposes of paying royalty, you tag the various items within your accounting system. Then when it comes to royalty time, you push the button and the list of deductions comes out. Those deductions are the ones which have been tagged in your accounting system that you already set up for your own purposes. There will be some compliance reductions because no longer do you have to go through certain administrative processes, but they are not going to be hugely significant.

Mr Curtis: They will be incremental at best.

CHAIR: That is the first time I have heard of businesses arguing against a more simplified system. I will have to use those quotes in future when we add regulations and accounting costs.

Mr STEVENS: How will the price differential between the domestic product and the export product affect their viability of operations?

Ms Snelling: It will be important. Most domestic players primarily produce to the domestic market and in that market we compete with other parties. They are by and large the big incumbents, because they are also producing to the domestic market and they produce most of the gas in Queensland so we are on an even playing field there. The domestic market suits us for a number of reasons, and one of them relates to exchange rates. All of our costs are in Australian dollars. We do not have to deal with exchange rates if we are selling and getting revenues in Australian dollars—also the sorts of customers that we are likely to deal with. It is mostly surplus gas I think that goes to export. Yes, the discount for domestic gas makes a difference and that is definitely a bonus. However, we are competing against the bigger players for the same sales and there is a common royalty rate across all the domestic gas.

Mr McCALLUM: My question is to the Bennestar Group. Thank you for your opening comments. You mentioned that you look for 'marginal assets' in South-East Queensland. Could you elaborate a little on that? I am just trying to get a sense of exactly what kinds of resources your company is targeting.

Ms Bennett: Marginal assets, as we see it, refers really to projects which may have a higher cost of operation or a higher cost of development compared to some of the larger placed resources. These costs might come out of difficulties in location, difficulties in production technology. For instance, the resource might not be as prolific or sized as largely so as to attract some of the bigger players. They could be mature or marginal conventional oil projects, tight or deep gas projects.

Mr O'CONNOR: How much notice would you realistically require when it comes to the changes in how volumes of gas will be measured for royalty purposes? How much notice in advance of commencement would you require?

Ms Snelling: As much as possible.

Mr O'CONNOR: Realistically, though, do you have an idea of how much?

Ms Snelling: The concern here is that, with the calculation at the wellhead as being proposed by OSR, our systems that are set up at the wellhead are absolutely not suited to do that. They are not precise. The other thing is that all gas comes out with impurities, in particular water, because there will be water in gaseous form which comes out with the petroleum gas and the measurement system does not record that. Very often it is only at the point of custody transfer, which is sale. The amount of time, really, depends on the individual company's structure, their organisation and all of those things. I do not know the answer to that because it is going to be different for everybody.

Mr Curtis: We are in a part of the basin that does not produce gas—we are all crude oil—but when we transport our crude from our production facility up to Santos's terminal at Jackson we are producing what comes out of our separator and our heater treater. When it gets to Jackson is when it is accurately measured and it is also where we get the net volume. In every load of crude that we send up there, there is a certain amount of water and what is called BS&W. One concern we have is how things are measured. We do not particularly want to pay a royalty on produced water and BS&W. We need some clarity, if this is going to be a volume model, on how that volume is going to be accurately measured. If it is measured at the wellhead, all we can do is give you an approximation based on the actual figures that we get from Santos, generally a month in arrears.

CHAIR: We have had this report for some time. The government had not put forward legislation, but the consultation process about the principles of wellhead volume pricing and Mr Weatherill's report had been out for some time. Post that point we have seen Arrow Energy make a $10 billion final investment decision to progress their Surat Gas Project. We are still seeing some confidence to make further investments from new investors in the market. Why are those investors showing confidence in the new model of royalties and perhaps, from the information you have given us, others are having concerns about it?

Ms Snelling: I cannot speak for Arrow, obviously. What I can say is that, as a general principle, in the acreage that the likes of us are dealing with, the rocks are less prospective or they are more difficult to access. On the whole, the sorts of projects that we are looking at are the projects that the big players have overlooked. They do not like them because they do not think they are as prospective or they are further away or there is something wrong with them on the whole. Maybe we will get lucky and we will find something that has come out of the blue and it is going to be a huge thing, but that is not the most likely scenario. We are dealing with more marginal projects, I think. That is why we are more concerned about the impacts of this project.

The other thing I would say about Arrow is that they have a very big business which is operating on other bases and maybe they can subsidise the new project. One of the impacts of this legislation is: because everybody is treated the same and operating costs are no longer relevant, the players that have low-cost operations, either because they have streamlined their operations or because their gas projects produce more because they are better, are essentially advantaged; they pay a lower effective rate. The actual rate is the same, but because their costs are lower they are paying a lower effective rate and the companies that have higher costs are paying a higher effective rate because they have less profit to pay it with.

CHAIR: We are also seeing new investments from smaller companies like Senex.

Ms Snelling: Yes, and we are trying to invest ourselves. We are not saying it becomes impossible. We are not saying it will not happen, because obviously we are all still here and we are all still trying and we all still want to make it work. What we are saying is it just makes it a bit harder. It raises the bar.

CHAIR: We all agree that the Queensland people own the resource of the gas and oil underground. We have seen that Queensland has taken the step of allowing development of these resources and there is a social licence attached to that. We have seen southern states unable to

overcome community opposition to build that social licence. Is it really important that we see that every producer, especially those that have interrelated or overseas partners, actually pay for the resource they are extracting as they extract it from the ground by volume rather than undermine that social licence by having companies not pay because they have unclear interrelated parties that decrease the apparent profitability that they receive?

Ms Snelling: I do not think transfer can be supported in any context. That is essentially what you are talking about.

CHAIR: Yes.

Ms Snelling: I think everyone would agree that there have been issues. The royalty regime was designed before the CSG to LNG industry. This has raised issues and we are perfectly comfortable with changes being made to the regime to address those issues. We are just concerned that, with the focus on what is admittedly the vast majority of the industry, there are unforeseen consequences which affect the smaller players. Those big guys are big enough to present their arguments themselves. We are not arguing for that. What we are saying is that around the fringes of this there are some impacts on smaller players that we think are important.

Mr Curtis: If I might add to that, Texas-Tickalara Holdings is the operator of ATP1056 and we are the holder of record but we are not the only party to this. We are a joint venture of small companies, trust partnerships, domiciled in the US, Australia and New Zealand. We are a small player. We are in a very good area but we are a small player. We do not have a multibillion dollar balance sheet to wash some of these costs through. Some of us are writing cheques to support this out of our own pockets. We do not have a cadre of shareholders that we can go out and raise capital from. Impacts are significant to us, large or small, but in a low-cost and a low-profitability environment like this one it is particularly tough because the new regime is now going to impose a royalty on every barrel produced, whether it is profitable or not.

Mr WATTS: I have a couple of issues. I think we can all agree that transfer pricing is what is trying to be dealt with here. I would be interested in a comment as to whether that has been achieved effectively by this and whether this kind of regime exists anywhere else in the world. More importantly, I am interested to understand how this may consolidate closer to infrastructure because of transportation costs and the lack of deductibility and because of where certain assets in Queensland might sit on the cost curve versus other assets. I am concerned that this may inhibit small and more regional exploration and/or development because it just pushes them out of the marginal category into 'we can't make a buck; it's not worth investing the money'. I would be interested in your comments on both of those issues.

CHAIR: Who are you directing your question to?

Mr WATTS: To the panel. Does a regime like this exist anywhere else?

CHAIR: We have the question. Does anyone want to answer the question?

Ms Snelling: I suggest that you ask Andrew Garnett, who I think is appearing later. He has done a comprehensive review of royalty regimes in other parts of the world. I suspect that none of us are in a position to answer it nearly as well as he is.

Mr WATTS: In terms of the cost and the potential for exploration and small developments being away from existing infrastructure, would anybody like to comment on that?

CHAIR: Member for Toowoomba North, I think that was really clear in their previous answers and also in their submissions. I will give people a chance to answer that quickly, but we are trying to move through the timetable and the time for this session has expired. Does anyone want to make a quick comment on that?

Ms Snelling: I think you will see distortions in the market. I think what will happen is that you might see people trying to negotiate. You cannot move the resources. It will certainly favour projects that are closer to infrastructure. I think the other thing that might happen is that people will try very hard to sell gas at the wellhead and ask the purchasers to pay transportation costs wherever possible.

CHAIR: The time for this session has expired. Thank you for participating. I note that no questions were taken on notice.

MAYO, Ms Georgy, Queensland Director, Australian Petroleum Production & Exploration Association Ltd (via videoconference)

McCONVILLE, Mr Andrew, Chief Executive, Australian Petroleum Production & Exploration Association Ltd (via videoconference)

STAPLES, Mr Simon, Director—Commercial, Australian Petroleum Production & Exploration Association Ltd (via videoconference)

CHAIR: Good afternoon and thank you for joining us today. When answering a question or speaking, especially for the first time as well as when adding information, please identify yourselves to assist Hansard and those watching online and listening. Committee members will endeavour to do the same and clearly identify themselves when asking questions to minimise confusion for yourselves and for people watching. I now invite you to make some opening remarks.

Mr McConville: Thanks, Chair and committee, for the opportunity to talk with you today. APPEA represents the predominance of Australia's upstream oil and gas production and exploration industries. As part of that process, we have worked very closely with the Queensland government and the Office of State Revenue to work through the process of royalty review and now into the implementation of the new model. As an industry association, our focus is very much on ensuring that the royalty regime, as it has been put forward, is simple, equitable and efficient and that, importantly, it does not present any barriers to new development, provides certainty for investment and growth, and ensures that Queensland receives an appropriate and fair return for the use of its substantial resources.

We would like to acknowledge the efforts of the department and Treasury, the OSR, in working with industry through what has been a very tight time frame. These issues are extraordinarily complex, as I am sure the committee is coming to understand, and the legislation itself is also complex. It is our commitment to hopefully continue that process of collaboration and engagement as we move forward. The submission that we have put forward to the committee is designed to do exactly that—to focus on a couple of areas where we think further clarity is required. We are committed to working with the OSR and the department in order to do that. The other point I would make is that, whatever regime we have before us, it is very important that we work to ensure that the operation of the market is as efficient as it can be and to ensure that we are able to resolve the outstanding issues and points of clarity in a very open, transparent and collaborative manner.

I think it is inevitable that there will be unforeseen issues which come up. We are very keen to work with the government to make sure that those issues are addressed and worked through. I think important to that point is when we start to look at mechanisms that might be available. Looking at how we transition and the potential for some sort of amnesty as we work through these issues and get them resolved could be very important.

Chair, I think the real value is in perhaps having some dialogue and answering any questions that the committee members might have. There are a couple of points of clarification that we have sought in our submission around determination of volumes and simplification of the relevant entities. We would be very keen to see the Treasurer's remarks around the exclusion of GST be legislated in this bill. We would be seeking some level of clarification particularly around liquid petroleum and also, to my point around lodgement time frames, some flexibility there. We have some suggestions that some of our members have put forward in terms of transportation costs. I am happy to get into trying to answer those questions and take any other questions that the committee might have.

CHAIR: Thank you, Mr McConville. Deputy Chair, do you have a question for APPEA?

Mr STEVENS: Yes, I do. Queensland was always quite famous for its investment strategy as the place to do business, yet I note in the QRC's submission that the Fraser Institute Annual Survey of Mining Companies 2019 found that Queensland was now ranked 15th on its investment attractiveness and fourth of all Australian jurisdictions behind Western Australia, South Australia and the Northern Territory.

CHAIR: Deputy Chair, are you moving to a question?

Mr STEVENS: Yes, I am. The question will follow on from that submission we have received on the bill, Chair.

CHAIR: Certainly, but I do note that APPEA emphasised that they wished to respond to some of the detail that their members have put forward. Do you have any question for APPEA that would be useful?

Mr STEVENS: We want to hear about the bill completely, Chair. I think it is very important that APPEA get the right to answer a question about what this bill will do to their industry.

CHAIR: Thank you, Deputy Chair. Continue, please.

Mr STEVENS: Thank you, Chair. My question is: do APPEA believe that this royalty legislation will further diminish our position in relation to investment attractiveness for the mining industry, and do they agree with the QRC that a royalty freeze should be legislated?

Mr McConville: I think the key issue here is to ensure certainty. What we want to do is move through the process of this review as quickly as we can and bed down any outstanding issues so that industry can move forward. When we talk about investment attractiveness, that is really the key element—to make sure there is clarity and certainty. That is why we have worked collaboratively with the government to try to get through this as quickly as we can and why there are a couple of elements that we think require some further resolution or further clarity from the OSR through the drafting process. If we can get through those and move forward, that would be very helpful and should help with ongoing investment. We have seen considerable investment in the industry in Queensland over the last decade. We are certainly keen to see that continue. That is helped by making sure there is clarity.

To your question of a royalty freeze, clearly that is a question for the government of the day. Again, if whatever decisions are made can be made with absolute transparency then that is helpful and business can adjust and plan accordingly.

CHAIR: New South Wales and Victoria have often banned completely exploration and investment in gas production. In that way, is Queensland more favourable when it comes to these aspects of the natural gas industry?

Mr McConville: It is the case that New South Wales and Victoria have been importing a large amount of gas from Queensland. In fact, New South Wales is currently importing about 96 per cent of its gas. You are right that with the moratoriums that have been in place on all forms of exploration and drilling in Victoria and what has really been a go-slow—it has not been a formal moratorium—in New South Wales, Queensland has been able to move forward in terms of supplying gas into those markets in the south and into export markets as well.

Recently the Victorian government announced the lifting of the moratorium on conventional drilling in Victoria. That will be lifted from 2021. We would expect that there would be some time, given the length of exploration processes, before we would see extensive resource development in Victoria. In New South Wales the situation is slightly different. Members of the committee might be aware that the Independent Planning Commission in New South Wales is currently considering the development of a resource in Narrabri which could supply up to 50 per cent of New South Wales's gas needs.

It is the case that, yes, at the moment Queensland is perhaps advantaged by the opportunities that have been presented by the markets in New South Wales and Victoria given the situation there. We have seen gas flowing south in the same way that we have seen the development of a strong export industry.

CHAIR: In the last session I cut off the member for Toowoomba North's question. I wanted to give the member for Toowoomba North the opportunity to ask a question.

Mr WATTS: My concern—and we have spoken about it today with the department—is with some of the issues around smaller players, exploration and people who may find themselves away from infrastructure—in other words, unleashing the development of the rest of Queensland. The question is around the effectiveness of the Brent spot price being calculated in and the lack of deductibility of transport costs for those who may be away from infrastructure and how that might affect jobs in regional Queensland going forward.

Mr McConville: I might ask Simon Staples, our Director—Commercial, to address the question around rent. Then I can come back to the member in relation to the question on jobs.

Mr Staples: In terms of the Brent price being selected, we know that that is in the bill. That is a matter for government. Selection was another decision for government. It is not for us to comment on that specifically. In relation to transportation costs, I note that this issue has been raised by some of APPEA's members. I note also that it does not impact all of APPEA's members. It is a concern for some to the extent that, if you look at a final sales price, it is possible to incorporate some transportation costs in the final sales price.

The issue around transportation costs is that, depending on the commercial price struck between two parties to get gas, petroleum or oil from one part, say, of the Cooper to the east coast where the refineries are, they can vary considerably. As we note in our submission, across the three or four different petroleum commodities captured by this royalty regime, the costs can be significant depending on how far away from the market they are. For some, the real issue around transportation costs is a levy or royalty potentially on costs that are not necessarily petroleum or the resource but that may lead to the potential for market distortion where petroleum is sold potentially close to the wellhead. They may need to find other arrangements to get an actual sales price that is relative to the petroleum coming out of the ground.

In terms of reflections on jobs and the broader Queensland economy, as an industry association it can be difficult for us to see the true picture. The three participants who appeared before APPEA gave some reflections. Some of the investment decisions made previously, and potential future developments, are probably best answered by our member companies.

Mr McCALLUM: I note that in your submission to the review process you raised some concerns around maintaining the confidentiality of commercially sensitive information that might be used in determining royalty liabilities. As the bill is presented, have those concerns been allayed somewhat?

Mr Staples: Yes. The consultation paper released by the OSR in preparation for the bill drafting did raise some concerns and red flags around that. The current version of the bill has allayed those concerns in that it removes the mandatory need to share confidential information that would be potentially in breach of competition laws under the ACCC. If you cannot provide that information (inaudible), so that is definitely an outcome that has been resolved to date.

Mr O'CONNOR: You raised some concerns in your submission about the proposed lodgement time frame for quarterly returns, which the bill proposes to align with other revenue time frames. Can you expand on the practical challenges—what it looks like to lodge these quarterly returns and how time consuming it might be?

Mr Staples: I think as we reflect on the comments made in APPEA's submission, we are dealing with a regime that is new for a lot of petroleum producers. One of the features of the old regime which was very beneficial to members of APPEA was the lodgement of annual returns. The lodgement of annual returns was a process used effectively as a true-up. That was an important feature for a lot of our members because, with the nature of sales contracts, quarterly returns can become difficult around ascertaining certain volumes with the veracity needed to verify sales transactions. Sales prices are potentially lagged by the nature of commodity prices being published. The annual return process offered an opportunity for members to effectively do that true-up in line with the auditing of their systems of accounts with preparation of year-end returns for a range of lodgement obligations, not just for royalty purposes. It was allowed to do so without the automatic application of the 75 per cent penalty.

The concern around the lodgement time frames is if there is a shortfall on a quarterly basis and you have only 30 days to prepare that return whereas for the annual process you have a 60-day period, you have the whole year to prepare for that process and you would have external help around auditing and the veracity of those accounts. It places increased pressure to get those quarterly returns right, especially with the potential for the application of the 75 per cent penalty.

The initial time frame for that, that was asked for in the submission, has been backed by all APPEA members. We are dealing with something new. We are asked to provide a lot of information that would have been completely taken care of in the annual return process now four times a year, effectively. The concern hanging around the sporadic application of a 75 per cent penalty—the uncertainty of how that will apply and whether it is automatic application—strikes a little bit of fear into our members.

Mr McConville: I think the broader point there is: given it is a new regime, there is potential for teething challenges. I think it is very important, if we can—we noted that in our submission—to have the potential for a transitional amnesty period whilst these issues are worked through. To make sure we are able to work with the government under the new model, we would seek the adoption of, essentially, a 12-month administrative concession which would then avoid the automatic application of that 75 per cent penalty. I think that will help engender some level of confidence as we try to work through these issues collaboratively with the government and with our members as well.

Ms RICHARDS: In your submission you raise some concerns—we just heard from some of the other submitters—in terms of the measurement of volume and some of the discrepancies. I am not

sure if you have had a chance to read Treasury's response to that. Are you comfortable that with the royalty ruling that sets out guidelines you will be able to work through some of these issues?

Mr McConville: The first answer to your question is, no, we have not had the chance to read through Treasury's reply. Of course, we absolutely do need to do that. We have been working with them to try to address questions around determination of volume, because it is quite challenging in terms of how to accurately do that. We certainly want to see the criteria that will be applied and then see if there is an adjustment that needs to be made. I think there is still a deal of work that needs to be done there. Of course we will want to work in with OSR. Simon, do you have an additional comment?

Mr Staples: The measurement of volume is a critical feature of this regime, given it is the title of the regime. Clear verifiable volumes will be a very central element to this. The way that volumes are determined and the clear or transparent nature with which they are determined, without any dispute, will also lead to reduced disputes. It is a very critical function. APPEA and its members would be very committed to working with the OSR over the coming weeks to work through those concerns.

CHAIR: Sorry, Simon, we just had a bit of trouble there. Maybe just project a little bit more because Hansard and I were having some problems. Unfortunately from where Mr McConville referred to you, if you could just repeat some of your answer to ensure that Hansard gets it accurately?

Mr Staples: Sorry, Chair. Is that clearer?

CHAIR: That is much better.

Mr Staples: What I was saying is that obviously volumes, given the title of the new regime, is a very critical factor in determining the royalty liability. In relation to the volume determination, we have been discussing with the OSR and Queensland Treasury around upcoming guidance and they have been very collaborative in that process. It needs a sense of certainty in how to determine, but also whether those volumes can be determined in a very clear and precise manner, to reduce disputes. We heard from the three panel members who presented prior to APPEA around the challenges in verifying volumes due to different measurement techniques and where measurement apparatus is located across the chain. We would be committed to working with the OSR to work out the most reliable and verifiable way to work through that challenge and await their guidance.

Mr WATTS: We have been over this ground a little bit. I am trying to ensure that this regime, as it is implemented, will not stifle the development in other parts of regional Queensland because it is away from infrastructure and/or because it is more marginal in relation to the cost curve. I would be interested in your comments. Obviously, a resource left in the ground does not earn any royalties, so I would be interested in your comments on how this structure might affect some of those smaller and more marginal things and things that are away from infrastructure.

Mr McConville: With the model as it is currently designed, we need to be able to move quickly through it and quickly through the adjustment process. That is going to be the first and most important step. I think industry is about to step back and has adopted a slight wait-and-see approach to what the new regime will look like, and we need to be able to move through that quickly. I think there is a commitment on all sides. We have moved through this process in 11 months.

In terms of the smaller producers, it has been noted that there are differential rates, which I think is a positive in terms of gas that might flow into the domestic market versus alternative uses. I think that will certainly be helpful. If we can get some clarity around some of the issues that have been raised around transportation costs and work with Treasury and the OSR on that, that will also be helpful. If we can move through and look at the rates and tiers and also issues around lodgement time frames—again, if we can get some clarity and flexibility around that then that will certainly help. Georgy, do you have an additional comment in relation to some of the smaller producers?

Ms Mayo: I was listening to the panel earlier and it is exactly as Lucy Snelling commented: all of our members have different operating models, different investment structures and commercial structures. You heard from Kevin that Cooper Basin petroleum producers knew the transport issue was quite significant. We have other members who are less concerned about it. I do not think one size fits all. As Lucy said, there are aspects of this model which are very simple and that adds value, but members have already sat here this morning and talked about what the impacts are going to be for them. In line with what Andrew was suggesting, an amnesty for 12 months or a consideration particularly of the junior sector might be appropriate to look at, given that this is a new model and with any new model you are always going to have potential unforeseen issues which arise. It would be good to be nimble enough to be able to address those quickly.

CHAIR: Thank you very much. Our time has expired. We thank APPEA for your submission and for detailing the issues that affect your various members, because obviously you represent the

entire spectrum of members. I note there were no questions taken on notice. I thank you for your assistance to the committee today.

Proceedings suspended from 12.28 pm to 12.40 pm.

ANDERSON, Mr Kirby, Director Strategy and External Relations, Queensland Resources Council (via videoconference)

BARGER, Mr Andrew, Policy Director Economics, Queensland Resources Council (via videoconference)

MACFARLANE, Mr Ian, Chief Executive, Queensland Resources Council (via videoconference)

CHAIR: Good afternoon and thank you for joining us today. As I have said to other witnesses at these proceedings, I ask that you identify yourselves by name, particularly when speaking for the first time or when adding to a question directed to another. The committee members will also endeavour to ensure they clearly identify themselves when asking questions. I now invite Mr Macfarlane to make some opening remarks.

Mr Macfarlane: Thank you very much, Chairman, and good afternoon to committee members. Thank you for the opportunity to speak to you today in support of the Queensland Resources Council's submission on the Royalty Legislation Amendment Bill 2020. I start by paying my respects to all Indigenous leaders past, present and emerging and also to all community leaders past and present who have made Australia into the great country that we have today.

My name is Ian Macfarlane and I am the chief executive of the Queensland Resources Council. Today I am joined by Andrew Barger, QRC'S policy director of economics, and Kirby Anderson, the QRC's director for strategy and external relations. As you know, the QRC is the peak representative body of the Queensland minerals and energy sector, including LNG producers. We are here today because we need every member of this committee to fully appreciate how important Queensland's resources industry is to all of our futures and the futures of generations to come. It is through the stability, confidence and opportunity—and that all means just one thing: jobs—provided by the resources industry that Queensland is in the strong economic position it is today compared to other states in Australia, in spite of everything that COVID-19 has thrown at us.

Today we are asking the committee to consciously and conscientiously make decisions about royalty payments that support the continued responsible development of our industry and to consciously and conscientiously not make decisions that will stifle the industry. Because big business needs big time frames to plan big projects, government needs to fully understand that offering long-term certainty in the form of a stable royalty regime will literally make or break future job opportunities in Queensland at a time when we need them the most. A resources-led recovery is not just a punchy catchphrase; it is a reality for Queensland as long as the right policy decisions are made by committees such as yours.

The Royalty Legislation Amendment Bill 2020 is complex. It combines two separate reform agendas in a way that will amend six different acts and three associated but markedly different sets of regulations. These are complex and technical sets of amendments. With around $5.4 billion in royalties collected in the last Queensland budget, the RLAB is literally a multibillion dollar bill. Queensland's royalty payers are relying on the committee to scrutinise the bill intently in the limited time available for the review. Petroleum royalty payers have been besieged by uncertainty since the last Queensland budget. Firstly, they endured a 25 per cent increase in the royalty rate and then a pressure cooker review of the petroleum royalties under the steady hand of the Hon. Jay Weatherill. While all that regulatory turmoil has raged, COVID appears to have transformed the balance of supply and demand in the global gas market. As Professor Andrew Garnett from the University of Queensland notes in his excellent submission, the time is not ideal for bold royalty reforms. To paraphrase what he said, I would not be doing this and I would not be doing it now if I were to do it.

To draw a line under the upheaval of royalty arrangements over the past 18 months, the QRC requests that the committee recommend that the bill be amended to deliver a decade of royalty certainty for all commodities. As a number of company submissions have called out, royalty uncertainty is anathema to the investment in Queensland that Queensland needs from the Queensland resources sector to help it steady our economy as we start to recover from COVID-19.

In the limited time that we have to provide the context for your questions today, I set out five key aspects of the bill that the QRC supports. We support the RLAB's intention to modernise royalty administration and its intention to specify royalty discounts for domestic gas. We support the new Treasurer's commitment to industry consultation and a five-year freeze on petroleum royalties. The treatment of gas swaps is also supported as transportation arrangements that can be netted off. The Treasurer's decision to exclude GST from the petroleum sales price is also supported, along with the amnesty period for the first two quarterly returns after the commencement.

Just as importantly, the QRC has six key requests to raise with the committee. We ask that your report recommend legislating a 10-year royalty freeze for all commodities and encourage Treasury to engage with industry as soon as possible in the development of an operational definition of how petroleum volumes will be measured. We ask that you also support amendments to the bill to clarify the GST-exclusion status of the sales price and amendments to the bill to clarify the status of gas swaps. Also, we ask your committee to support the proposal to lower middle royalty rates of nine per cent for liquid petroleum, currently at 11.5 per cent, in section 148K(b). Finally, we ask that you support the proposed amendment to ensure that the gross value royalty decisions process—the GVRD process—is workable.

In conclusion, I note that the QRC members have done their best to provide constructive feedback on the bill in the week that it has been available for review. Despite our best endeavours, there will still be important issues of drafting and interpretation that have been missed. We appreciate the efforts of the OSR to provide feedback on the industry proposals and will continue to work closely with them as the legislative reforms are implemented. We now welcome any questions that you and your committee may have about our submission.

CHAIR: Thank you, Mr Macfarlane, for that statement and the detailed submission that you have given to the committee for our consideration.

Mr STEVENS: Welcome, Mr Macfarlane, to again consider legislation concerning your industry. This bill relates to royalty arrangements. Your submission is very clear and your opening statement alluded to the issues that you have with the bill. The bill does not talk about the opportunity cost. We understand the revenue side et cetera that has been provided by the bill. However, the opportunity cost may well be in the risk for future investors and, more importantly, future Queensland jobs. Could you expound on the possible cost, if you like, to this increase in royalty arrangements and the difficulties for your industry in relation to more jobs being available in the mining sector?

Mr Macfarlane: To contextualise the impact of the 25 per cent increase in gas royalty rates, the committee should also be aware that gas was generally trading as little as eight months ago at somewhere around US$8 spot. There are reports at the moment of trades being done at US$2 spot. As you can tell from that, any profit margin that may have existed—and that is 'may' because of the high cost of establishing the LNG industry in Queensland—has certainly evaporated.

Secondly, the fact that this increase was not discussed at all with the industry before it happened and in fact came within weeks, if not 10 days, of the Premier meeting with one of the global leaders of the APLNG project in Queensland and not mentioning the fact that she was intending to put up royalty rates has left a very bad impression on the international gas investor market. The reality is now that Queensland is being considered as an unreliable state, in terms of its royalty regime, in which to make long-term investments.

An LNG plant will last, at first blush, for at least 25 years, but, as most of you will know, in fact that life span can be extended to at least 40 years and potentially double. People are not going to make investments if they think that out of the blue, with no discussion, the royalty rate is suddenly going to be lifted by such an enormous percentage. That investment will go to Mozambique, to the Caribbean or to Canada—anywhere but here—as a result of sudden changes in royalty rates.

CHAIR: After we saw the LNP make increases to the coal investment rate we saw big investors such as Olive Downs continue to make investment in Queensland. Further to that, after the report was brought down by Jay Weatherill we saw big investments from Arrow gas and small investments from small players such as Senex. I understand that you stand up for the industry and want to see as low a rate as possible, but is it not true that we have seen some significant investments since these announcements?

Mr Macfarlane: In terms of Arrow gas, that development has been in train for 15 years. I would hate to guess—you can ask Arrow—how much they have invested in that. In terms of Senex, again, that has been in train for at least five years. Senex is predominantly targeting the domestic market where your bill is providing a discount. It is the investments a decade out that start with an exploration permit that are being put in danger by this legislation. Companies are now seeing Queensland as erratic in terms of its royalty-setting policies.

Mr STEVENS: I had a follow-up question to Mr Macfarlane in relation to his answer. I did not get time to jump in.

CHAIR: No doubt. Would you like to ask your follow-up?

Mr STEVENS: Yes, thank you. In relation to your answer where you said that you were very concerned about those matters, I believe the terminology used for countries, such as African countries, that have legislation that changes regularly is 'sovereign risk'. Would you care to give an opinion whether this legislation further enhances Queensland's reputation as a sovereign risk?

Mr Macfarlane: The legislation certainly decreases our attractiveness as an investment destination on the basis that it increases the sovereign risk profile of Queensland. That is reflected also in the statistics that are collected internationally by the REaD Group which has seen Queensland fall to 16 in comparison to Western Australia, which is No. 1 in the world in terms of investment destination for royalties. I should add: we are now below some African countries as an investment destination.

CHAIR: I thank you for advocating for industry for as low a royalty rate as possible. We understand that that is your job. One of the participants pointed out that in the past three years a particular company has paid 62 per cent of Queensland's petroleum royalties despite producing only 44 per cent of the state's gas. Locking this in for the next 10 years would continue—and presumably this company is a members of yours—the inequity in terms of what they are paying. Would that be a good outcome for companies, some of which have arrangements where they have vertical integration and sales that reduce their tax burden and others that are facing a greater burden of that tax?

Mr Macfarlane: Can I say two things. Firstly, we are not arguing for low royalty rates. Queensland has the highest royalty rates in Australia. I just want to be clear on that. Secondly, when we began this process, which has culminated in this bill, we had hoped that there would be royalty reform that would avoid the circumstance you have just highlighted, but that has not been achieved to the degree we think it should have been. Whatever we get out of this process, we do not want to be back here next year discussing another royalty regime with this committee because that is the sort of uncertainty which will see us fall further down than 16 on the REaD index.

CHAIR: To be clear, though, you agree that there needs to be changes to the regime to reflect fairness for the various players in the industry?

Mr Macfarlane: There needs to be changes to the regime. There does not need to be a 25 per cent increase in the royalty rate. That is water under the bridge. Andrew Barger is going to add a comment.

Mr Barger: To the two parts of your question and Ian's clarification, what we are arguing for with the freeze is certainty. We are not arguing for as low a rate as possible. We are happy to endorse the objectives of Jay Weatherill's review about a fair share for royalties. You heard that from the panel earlier this morning. Nobody is saying that there should not be a return to the state for the use of resources. That is a really important revenue source. It helps pay for teachers, schools, nurses and police. They are really important, particularly in this time of recovering from COVID.

The freeze is about certainty. We had the question from the deputy chair about sovereign risk. That is risk of change. The risk that Ian was talking about—the risk of churn; the risk of waking up to a royalty increase—is what frightens away investors. What we are talking about is not a royalty tap being turned on and off, because you are right: there have been major investments made in Queensland. The phrase that Lucy Snelling from State Gas used this morning was that we have raised the bar. We have increased the risks that investors have to price in when they are looking at Queensland if they think there is going to be some sovereign risk.

We are not talking about hardwiring in the status quo that APLNG has paid for the last three years. We are saying that part of the mandate for the royalty reform for petroleum royalties was to do away with the petroleum royalty decision process that has delivered those inequitable responses. You will see in our submission, and also from members like Glencore, quite a bit of concern about the parallel process for the gross value royalty decision that still exists for minerals. There is still a bit of uncertainty in the industry about how this bill will apply to that. There is a direct parallel between the complexity of the petroleum royalty process that the Treasurer spoke about in his first reading speech and the existing GVRD process—the gross value royalty decision process—that exists for petroleum players. To answer the different arms of your question, it is very much focused on paying a fair share but having some certainty around how that fair share is calculated and being able to project that forward with confidence when you are making investment decisions in projects that have long capital and operating lives.

Mr WATTS: I have two questions. I think the Resources Council might know the answer. The chair has now stated a couple of times that Arrow made their final investment decision being aware of the Weatherill report, but my understanding is that the Weatherill report came out in June and the financial decision was made in April. I want to first of all clarify whether you are aware of the timing, because that statement has been made and recorded by Hansard a couple of times now and I am not sure it is accurate.

CHAIR: Just to emphasise, there are various newspaper reports about the broader industry release earlier than its official release. They would have had some industry awareness, member for Toowoomba North.

Mr WATTS: My main question relates to the Weatherill report itself and the royalty review. I want to seek some comment as to whether, in the opinion of the QRC, it has actually increased certainty, equity, simplicity, transparency and compliance, as were some of the objectives when it started.

Mr Macfarlane: The short answer is no, it has not. That is disappointing, because Jay Weatherill did an excellent job in chairing the discussions around this. In terms of Arrow's decision, I should mention that you are both probably right but, as I said earlier, Arrow had expended an extraordinary amount of money before it made that final decision, so it was unlikely that it would abort the decision for a diminution of further profit. When you are starting afresh, you certainly would not continue in a process where royalty rates had gone up 25 per cent. To get back to the member for Toowoomba North's question, no, it has not. I am going to ask Andrew to give you a bit of further detail around where we think it has failed.

Mr Barger: In answering the question it is probably relevant to point out that you are right about the time frame. The two Weatherill reports were released 8 June, so that was the first time we had seen them. There was some speculation in the media earlier in the year, but the first time we laid hands on the report was when the current Treasurer released it on 8 June.

The Weatherill report had 10 terms of reference, so it had a pretty rigorous set of ambitions. The list that the member for Toowoomba North mentioned at the end was certainty, equity, simplicity, transparency and compliance—that was the 10th—so there were five criteria there. A lot of it remains to be seen, to be honest—that is the genuine answer—until we have a ruling from Treasury that sets out the measurement metrics. We know some pieces of the puzzle, but we really do not know how the system will apply. You heard this morning from the panel some of the complexities of measuring volumes of gas at point of production and the difficulties in making the transition from a regime that is currently based around sale price. I fully acknowledge there have been some changes in the volume model.

In his first reading speech the Treasurer was at pains to point out some of the requests from industry around having an individual sale based benchmark apply to the volume model. That will do a lot for transparency. That will make it a lot simpler. Until we have seen all the pieces of the puzzle, until we have all of the rulings and until we understand how the full new regime will operate, it is really difficult to run a report card against those five criteria.

Mr Macfarlane: On the basis of certainty, Mr Chairman, there is no certainty because a number of key components of the way the new royalty regime will operate are still unknown to the industry.

CHAIR: Just giving you the platform to emphasise some of those things that would be a priority to get more clarity on, are there a couple of specifics that you wanted to give information to the committee on?

Mr Barger: In Ian's opening comments he talked about some of the particular issues. The greatest priority was called out in the Office of State Revenue's briefing note to the committee that came through last night. I commend the committee and OSR for making that available. That is really helpful background to understand the thinking as Treasury officials are responding to the submissions. That document called out an urgent priority, and you heard from the Treasury officials this morning about the meeting with Natural Resources and Mines this afternoon to start work on the determination about how to do the volume measurement. Clearly, that is the most important next step, and it will be really important to have that clarity for operations about how the volume—the base on which the new regime operates—will be measured.

We would like to see the committee make some recommendations back to parliament around some clarity on the GST status and on the status of gas swaps, where the bill is currently silent. It does not align with the way the Treasurer described the policy intent when he introduced the bill. The more certainty we can get for mineral resource royalty payers around that gross value royalty process, the better. There was some important new information in the Treasury response last night, but clearly users of the system are still grappling with the implications of these new reforms.

CHAIR: Thank you. I think that will help inform both the department and the minister, who will be listening, along with what you have given us.

Ms RICHARDS: They have noted ongoing industry and stakeholder engagement in developing that sort of (inaudible).

Mr Macfarlane: We cannot hear you.

CHAIR: We just noted that an ongoing process is of high importance to yourselves and the industry to develop greater clarity and flesh out the principles involved in change.

Ms RICHARDS: The OSR noted last night in that paper that they would continue with industry engagement in developing the guidelines, particularly around the measurement piece.

Mr Macfarlane: Thank you.

CHAIR: The time allocated for this portion of the hearing has expired. Thank you for your responses today and for your comprehensive report. We note that we have not asked you to get back to us with any information.

GARNETT, Professor Andrew, Director, UQ Centre for Natural Gas (via videoconference)

CHAIR: Good afternoon, Professor Garnett. Thank you for joining us today. I will now invite you to make an opening statement, after which the committee will have some questions for you.

Prof. Garnett: Thank you for your time today. I would like to also start by paying my respects to the traditional owners of the various lands on which we sit today and to their leaders past, present and emerging.

Having been the director of the UQ Centre for Natural Gas, I have a couple of things to say up-front about that. Firstly, a full and open disclosure: we are partly industry funded. That is clear in the submission. We are also funded by Queensland and federal government sources. I think most importantly for this discussion is that I am not representing the views of any of the industry members of the centre. I am actually representing the views which emerged after a request by Mr Jay Weatherill to look into this matter.

Back in November I had an initial discussion with the chair about the so-called compensation document on the volume model. Based on that initial discussion I made a preliminary submission then and offered to look into what other jurisdictions in the world were doing with respect to royalties in the hope that would inform some of the discussion in some way. The advice I put together was very much advice for the state; it was not advice for the industry. It was also advice based really on what I could find in the academic and government literature. It was basically framed around the various policy settings of the day, downward pressure on prices increasing supply and so on, but very much gleaned from what I could source out of the various literature. The various literature really speaks much more widely than just royalty payments in terms of cash. It talks about the wider benefits, for the most part, so benefits in terms of investment, jobs and royalties and, of course, throws gas energy into the economy.

What I am not going to do here is go into the nuts and bolts and some of the minutiae of the current draft act. What I will try to do is just recap a couple of impressions I got from the consultation document and the review, because I think that is an important framing for the subsequent discussion.

The first thing I noticed on the consultation document was that it was sort of driven by a consternation and almost a surprise that royalty cash flows were not smooth and that, furthermore, they varied between operators. Then there was an apparent desire to fix this and smooth things out and come out with something ‘simpler'. The word inequitable comes up, and that is often the case. I would just remind you that inequity and non-equal are not the same. It is very true that different companies end up paying non-equal amounts, but that is not necessarily inequitable. It really depends on the costs of development they are sinking in.

It is also somewhat counterintuitive, but the fact that cash flows are not smooth and the fact that people are paying different amounts is actually a sign that the previous model was working. What it means is that you are getting different size players and different types of entities and different technologies at play in different plays and different areas. You are getting some people up at the sort of high cost, at the remote end, and some people more in the core area. It is sort of what you would expect from a well-designed rent based royalty system. It should produce quite a varied amount of activity because they are actually designed to attract investment more than to smooth royalties.

I would also suggest that the other framing which I have seen, which is absolutely through the literature, is that no-one doubts that resource owners deserve fair and large amounts of royalty revenue, but it is not a true framing of the problem. The situation we are in with resource development is a little more complicated. It is actually what the Alberta Royalty Review calls a mutually dependent partnership insofar as we, the state—we, the taxpayer—require industry to come in and spend their capital at their risk to develop our resources so that we benefit from them. We want them to do that because we do not want to spend taxpayers' money at that sort of risk level. That is the initial framework.

Within that context, what is a fair return for the state? Then we end up arguing about what is the primary design for building a resource based industry. Is the primary design smooth cash flow or is the primary design continued investment and therefore continued jobs, employment and so on? I felt that the original consultation document was somewhat framed one-sidedly on a revenue focus rather than on what should have been more like a balanced scorecard between the revenue and an investment focus.

The real question that came up in the various literature reviews I did was: the argument is not whether the state should take royalties at a certain time; it is whether it should take them while the company is still making a loss, having already invested large amounts. That is really the overriding royalty model versus the so-called rent based model.

If you have had a chance to skim through the literature review that I did, effectively the literature is pretty clear, all the way from academic writers to the institutions, that royalty models based on rent rather than on volumes of sales revenue are better. The judgement of 'better' is that they incentivise investment. As you see from the various testimonies today, whether it is better or worse very much depends on what type of company you are and what area you are in.

There is no uniform model in this, but there is a fairly uniform idea that comes out of the literature. That is, basically, you should go for a rent based model and, therefore, after having made large investments, the company breaks even and then as soon as the break-even happens—and that is an arguable point of course—the state's take starts to go off. That means that the break-even price is as low as possible and, therefore, the industry is as robust as possible and there is less risk of shut-ins. That is basically how that works.

It is all pretty clear. It is obvious why there are different views in the industry. It is also obvious that the state has a difficulty in managing through this sort of massive change of pace and this massive variability, but the practice out there amongst the major entities and major institutions is fairly clear. It is recognised that it is very difficult to implement.

Since writing those reports I have been dealing somewhat with the International Energy Agency, looking at its so-called sustainability documents and where the oil price and gas price internationally are going. It is very clear that, compared to the time when this whole model was put together and the review was happening, the world has somewhat changed and we actually do not know how it has changed. The worry for Queensland is that we do not have a clue what is going to happen to those international prices and to the robustness of the industry. Those risks are still playing out, so demand destruction is still playing out for example. We are not sure how long that is going to be. We do not know if we will get the so-called V-shaped recovery or a sinusoidal, up-and-down recovery. That has a major impact. I am not sure that we are able currently to assess those COVID related recovery risks. I will leave it there rather than take too much time rambling on, which is my wont, and hand it back to you to see if I can answer any questions.

Mr STEVENS: Professor, I have read your submission. I am trying to draw from your submission your opinion, if you like, in relation to this bill before the House. Are you saying that this new royalty regime could put at risk our gas and petroleum industry? Do you support a freeze on any new royalty regime, as the LNP opposition has committed to?

Prof. Garnett: I cannot speak in terms of how this pans to individual companies, and of course they are differently exposed to it. I would say that the overriding royalty model—that is not so much the rates—is in principle less favourable than an economic rent based model, so a model where royalty is based on revenue minus allowable costs, like the old model. In principle, it is a less attractive investment model. That is one element. Then it depends how low you can get those effective royalty take rates below a break-even cost. The big difference is those low prices. For example, if I am producing gas at $5 and I can sell it at $5, that is a wonderful step. In the old model, I would not pay royalty until I had broken even and then that share happens. In the new model, if I am producing gas at $5 and then there is a royalty of 50 cents on top of that, now I need to attract $5.50 for my price in order to break even. That is harder. It is sort of a simple model, but that is sort of how it works. In principle, as long as you are putting an extra cost at the end where the companies are still losing, that makes it harder to invest.

Ms RICHARDS: Given your description in terms of the volatility of the market and the industry itself in locking into 10-year freezes, what are your thoughts on that given, as you have just described, the uncertainty in the market making that sort of long-term decision?

Prof. Garnett: I think it depends entirely on what you look into, and then you stress test that with some price scenarios on oil and gas effectively. You stress test that with a view to what out there in that price market will start to shut in Queensland's gas. That would be the sort of stress test I would do. It is absolutely clear that a stable model is extremely attractive. The guarantee of freezing something for 10 years is very attractive from an investment point of view.

Ms RICHARDS: There would definitely need to be more rigour in terms of determining what that point sits at?

Prof. Garnett: Indeed. Certainly, the implication of the government taking a return when the industry is losing just inherently increases the risk of shut-in.

Mr WATTS: My question is in relation to world's best practice. Ultimately, we are looking for a regime that delivers for the taxpayer of Queensland and yet is effective and efficient from an industry point of view. Loosely termed, it is world's best practice in how to get our royalty payment. I am interested in your views from the literature as to how close we are to achieving that with this bill.

Prof. Garnett: It is important to recognise first that when we say 'delivers' for world's best practice, it is not purely royalty; it is a stable industry and a stable employment environment. For something like gas, it is actually one way that the reserves get replaced and preferably grown given the role it has to have going forward. 'Deliver' means more than just 'delivers royalties to Queensland; it is about delivering sustainable industry, jobs, investment and so on. With that in mind, the previous model, which was an economic rent based model, effectively, with certain description of allowable costs, was about where the literature ends up. It recognises that there cannot be full cost recovery, partly because it is a (inaudible) figure, but there is a certain degree of costs which are easy to define and you end up with that model.

There are a couple of things which we have not looked at here but which other jurisdictions do look at. We have looked at different royalty settings depending on end use, for instance whether it is export or domestic. Other jurisdictions have sort of turned it on its head and have looked at different royalty settings depending on the resource quality. For somewhere where it is remote, high cost and perhaps more potential, they have a different royalty setting than somewhere that is in the middle of a core area, it is all plumbed in and the wells go gangbusters.

The other way to look at the royalty settings is by resource quality and challenge, because what the state wants to do is incentivise investment in those tough areas. What they do is set royalty and, for that matter, tax settings in those different challenging areas. That is some of the stuff you heard this morning, I think, from some of the smaller companies. Because they are smaller companies, they are in higher cost, more challenging areas. There is an overlap among smaller companies and challenging areas which other jurisdictions have handled by doing royalty schemes or fiscal schemes tailored to the resource challenge.

CHAIR: I am amused by the LNP's sudden conversion to interest in our resource rent tax. Whatever theoretical benefits the rent based model has, there must be things in the literature that show it can be easily undermined by transfer pricing, internal capital loans and other issues that make the clarity of finding final price for the company on the ground in Queensland very difficult in order to ensure there is equity across the various payers of royalties.

Prof. Garnett: You are absolutely correct. That is the main criticism of it. You are absolutely right. In theory, it is the model which protects the downside for the sector's investment in jobs. Then the problem is: how exactly do I define what are costs and which are so-called allowable costs? Transfer pricing is the other issue.

CHAIR: The cost of internal capital loans is another issue.

Prof. Garnett: Indeed, yes. That is indeed well documented. The answer seems to be to spend more effort on making those as transparent as possible. What tends to happen is that the jurisdictions basically take some costs off. In other words, it is not full break-even. They say, 'Well, because there is some noise in the system here and some element of gaming, we go back to that.' Effectively, it is similar to what we in Queensland have ended up with in terms of allowable wellhead costs. It does not have the full cost recovered by any means, but it is a sort of a halfway house. You are right: that is indeed a criticism. That is the cry for simplicity, if you like, which is understandable from the OSR.

CHAIR: Further, it often discriminates against those supplying to domestic suppliers. Because of the nature of all of their transactions being contained within a sovereign nation, they often are unable to utilise the system of transfer pricing and capital loans external to the nation in order to minimise the royalties they pay to the owners of the resource, the Queensland people.

Prof. Garnett: I would say that it does not disadvantage the domestic suppliers so much as it advantages the larger international firms if they can play those games. The domestic firms are much easier to play a straight bat with, if you like that analogy. Back to your original point, yes, it is complicated, and it can only happen where you go back to the partnership idea whereby government and industry agree that the principle is that these costs have to be so transparent and then work through it that way.

Mr WATTS: I am trying to understand which jurisdictions have dealt with this transparency issue best and minimised the ability for a large multinational to manipulate the system, again, in reference to their structure in comparison to what is being proposed here?

Prof. Garnett: That is a really good question. It is difficult to pin down, of course, because it is mostly not written in papers; it is actually in the practice of how governments deal with each other. I probably would point to Alberta, which has recently finished a major review where this was brought up. I would go fishing into the Alberta regulator file. They manage it. The other one—I am more familiar with that because I have worked there—is the UK, where they have also managed to deal with this. In fact, in the UK, at least when I was there, they were much more sophisticated in that they were in places where they have different tax regimes depending on how challenging the area was—so different royalty takes, different allowable costs and so on. I would go for those two, but I would not expect to find very much written down about it unless it is within the regulator themselves.

CHAIR: You do not fill us with hope that we have a model to copy on such a rent tax?

Prof. Garnett: I suspect we do have a model to copy. It is just that you will not find it in literature; you will find it by your colleagues in Alberta and so on.

Mr O'CONNOR: Professor, the single most important bit of advice within your submission was to delay the implementation of this legislation.

Prof. Garnett: Yes.

Mr O'CONNOR: Would putting it in place now put at risk investment in Queensland and jobs for Queenslanders?

Prof. Garnett: I might step back. Why is that my most single important point? Because I find the future demand environment, to use that word that is used a lot these days, absolutely unprecedented for obvious reasons, so that is where my nervousness comes from. To go to your second point, because I am nervous—and it is actually uncertainty—why am I suggesting that? If the price swings in the wrong direction because China closes down again, we have a big problem. The risk we are talking about is really that COVID swing; it is not really inherent in the market. China went down, they closed down completely, and they opened. If they start closing again, which is a significant demand, we will see that coming. That will play out, one way or the other, in the next year or so—maybe before. That is really what it is. There is a risk that is caused by a non-economic rent system, but the biggest risk at the moment is: hell's bells, what's happening with COVID?

Mr O'CONNOR: And that is why you suggested the delay?

Prof. Garnett: Yes, mostly. I would then use that delay to really do some rigorous modelling on the impact of both rent based and the new one and see how to stress test that with price scenarios.

CHAIR: Professor, I take it you are not investing in gas futures with any certainty?

Prof. Garnett: I am, actually.

CHAIR: I will not ask you which way. You might influence their prices. One of the things is that we always have uncertainty about prices. You can tell us in six months whether you made money on that bet or not, but there is uncertainty. If we made that argument, couldn't we say that there is almost never a time to make a change? For instance, one of our submitters has said that after the last three years they have paid 62 per cent of the Queensland petroleum royalties despite producing 44 per cent of the state's gas. Should we be leaving that to continue when we know about some of those things that the member for Toowoomba North talked about with multinationals—their ability to do transfer pricing, internal capital loans and other devices? We know that those things are going on. To simply leave this for years is to continue that process of not having clarity and not having a reasonable return on the use of the resource for Queenslanders.

Prof. Garnett: Let me clarify what I said about investing in long-term gas. It is not money, I would suggest, because being an academic I do not have any. What I mean is that, if you look at the outlook for gas in the sustainable development scenario of the International Energy Agency, long-term gas has a reasonable outlook. It has a really important space to play in in reaching those climate targets. That is what I meant by that.

Secondly, is that always the case? No, not in this case. The demand destruction in energy, particularly oil and gas, this year has never been seen before. Even in the war it was not seen like this. I think your question is reasonable because there are actual fluctuations, but I think the last time anything like this happened was probably the Arab oil embargo when the prices went in the other direction, of course. Maybe it is my own conservatism, but this is a nervous time because of COVID.

CHAIR: This is only slightly related to the bill: why is the gas price so tightly tied in to the oil price, given that coal and other energy sources seem to fluctuate on a different curve?

Mr STEVENS: Oh—

CHAIR: The deputy chair is right that that is not part of the bill.

Prof. Garnett: I am happy to talk about that.

CHAIR: I am interested in it, but it is not part of the bill.

Mr McCALLUM: Going back to regimes in other jurisdictions, if we could get back to that topic, with particular reference to resource rent tax, we have heard from other submitters, and indeed you made some remarks, where everybody acknowledges that the people of Queensland, in this case, deserve fair recompense for the resources they own, but that is normally followed by a caveat and then we talk about tax reform for the industry. Looking at the federal petroleum resource rent tax and some of what we have seen since it has been implemented where, apart from transfer pricing et cetera, we have actually seen large multinational companies end up with tax credits that they will carry over in the billions—hundreds of billions—for years ahead, I am wondering why there still seems to be a leaning towards a rent tax, particularly when we are looking to make sure that the people of Queensland, who own these resources, are getting their fair share.

Prof. Garnett: To be clear, when I say a royalty based on economic rent, that is not the PRRT equivalent. It simply means that Queensland earns its royalties as long as the company is not losing money on that asset. In other words, in order to protect the asset from closing in or, if you put it another way, in order to get them up that curve as quickly as possible so that it is a sustainable business—because, of course, you will not keep producing; if it is costing you $5 and you are selling it at $4, you cannot keep going like that forever, although you can play that game for a little while. When I say rent based, it is not the PRRT model. It is just a royalty model where there is a percentage royalty that is revenue minus some allowable cost, effectively like the one we have, so that is not the PRRT. You are right about anomalies in the PRRT, which I do not think I can go into here because I would have to really look into it. PRRTs are notoriously difficult to get right.

Mr McCALLUM: I guess that goes to demonstrate, certainly for me, the difference between the theoretical design of a tax versus how it is actually implemented in reality.

Prof. Garnett: There are implementation difficulties, as we discussed before. When you have a royalty based on rent it is very clear, when you model that through, that it is, generally speaking—depending on your corporate structure and so on—a more favourable investment environment than an overriding one.

CHAIR: Thank you very much, Professor.

Mr O'CONNOR: The chair should visit UQ with some of his further questions, I think. They have a large apparatus there that resembles a recreational device that you might find in Mermaid Beach.

Prof. Garnett: I would invite you out. Please come and visit us.

CHAIR: I have never been there, but I hear it is quite nice.

Mr STEVENS: Come and visit your mum sometime, Linus.

CHAIR: Professor Garnett, I thank you very much for the information you have given us and for your report, which really brings a different perspective compared to some of the industry ones. Also, it gives the academic perspective on how these resources should find their royalties. I note that no questions were taken on notice. As this was the last of the witness sessions for the proceedings, I conclude today's hearing. Thank you to all of our witnesses for the information they have provided. Thank you to our Hansard reporters and parliamentary broadcast staff for their assistance. A transcript of these proceedings will be available on the committee's parliamentary webpage in due course. With that, I declare this public hearing closed.

The committee adjourned at 1.38 pm.