



Financial assurance framework reform

australian petroleum production & exploration association limited

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the voice of Australia's oil and gas industry

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Introduction

The Australian Petroleum Production & Exploration Association (APPEA) is the peak national body that represents companies engaged in oil and gas exploration and production operations in Australia. APPEA's members account for the vast majority of Australia's oil and gas production and petroleum exploration and the companies that provide services to the industry.

The oil and gas industry is an integral part of the Australian economy, particularly in Queensland, including through:

- the supply of reliable and competitively priced energy
- the investment of hundreds of billions of dollars of capital
- the payment of taxes and resource charges to governments
- the direct employment of tens of thousands of Australians, many of whom are in Queensland, and
- the generation of significant amounts of export earnings.

The industry is ending a decade of unprecedented capital investment, with potential to capture more opportunities to supply global and domestic gas markets. The sector is truly global in nature and each Queensland project must compete against other Australian and global projects for investment from a limited pool of funds for both exploration and production activities. Oil and gas funding that is lost from the Queensland industry will not be spent in other parts of the Queensland economy - it will be redirected to other Australian jurisdictions or to overseas competitors.

The final report of the Finkel Review into the Future Security of the National Electricity Market highlighted the importance of gas to Queensland and Australian households and industry:

"Access to a reliable and affordable gas supply is in the interest of all Australians for its direct use for heating, as a feedstock chemical for industrial processes and as a fuel for electricity generation. In the NEM, gas-fired generation can provide a reliable, low emissions substitute for ageing coal-fired generation, and can provide essential security services to complement variable renewable electricity (VRE) generation."

The Queensland Government's Gas Supply and Demand Action Plan has been developed to support the goal of maximising exploration, driving development, keeping gas costs down and getting maximum economic and job benefits for Queensland.

APPEA strongly supports these objectives and it is of great concern that the proposed changes to the financial assurance system do not appear aligned to them and will potentially more than offset any cost reductions arising from the Action Plan. Significant damage may be done to the ability of Queensland to attract the new supply projects needed to bring more gas to market to meet strong demand for the State's natural gas.

We urge government to reconsider applying the proposed reforms to petroleum activities and instead work with the industry and all stakeholders to lower the cost of gas production in Queensland.

Financial assurance reform – key points

Urgent	Need to reduce regulatory costs and identify and develop new gas supplies in eastern Australia – a major increase in financial assurance costs will undermine this objective in order to fix a problem that doesn't exist in Queensland's petroleum industry.
30%	Queensland Government estimate of the cost of regulation as a percentage of the cost of producing natural gas – without increasing financial assurance costs.
Up to 750%	Increase in costs under the 'tailored solution' compared to existing arrangements. ¹
Up to 500%	Increase in costs under the 'tailored solution' compared to ensuring <u>zero risk for government</u> under existing arrangements. ²
3%	Just 3% of land disturbed by the petroleum industry and not being used for operations remains to be rehabilitated.
Less than 2%	Less than 2% of land rehabilitated by the petroleum industry has been certified by government, for a number of operators this figure is 0%.
0	There are no legacy petroleum projects in Queensland and no petroleum projects among the 15,000 projects in the Queensland Government's Abandoned Mine Lands Program.
\$0	The Queensland Government is not spending any money to rehabilitate legacy petroleum production projects.

¹ Assumes normal performance discounts and use of government-approved/company-specific rehabilitation calculators.

² Assumes no performance discount and use of the government financial assurance calculator.

Executive Summary

1. Petroleum projects should not be forced to participate in an inefficient and costly rehabilitation fund

Petroleum operators can provide the same level of protection for government as the proposed rehabilitation fund for up to 80% less cost. Allowing for alternative forms of security to bank guarantees and cash would enable industry to further reduce costs.

The proposed \$32m in administrative costs for the rehabilitation fund accounts for 13% of contributions made. The \$16m for administration of the Selected Partner Arrangement (SPA) is even higher at 20% of total contributions.

These costs are excessive. For comparison, administration fees for investment funds are in the order of 0.5% - 1.5%, which includes a profit margin for the fund manager and covers the cost of actively managing an investment portfolio.

We believe there is no justification for any administrative costs for the SPA given there is nothing to manage other than the qualification process. The SPA will only cover a small number of very low risk projects and all contributions will be spent on unspecified 'other initiatives'.

A further concern is that the \$19m in interest earned from the rehabilitation fund and SPA will be 'used by the State' rather than reinvested to reduce future contributions or fund administrative costs.

2. There is an urgent need to lower the cost of regulation to support increased natural gas exploration and production, which is now only available from more expensive fields.

Regulation currently accounts for 30% of the cost of producing gas in Queensland which inevitably adds to exploration and development costs, and therefore the cost of gas for industry and households.

3. The proposed reforms will increase the cost of exploring for and producing gas

Analysis by APPEA members indicates the proposals will increase financial assurance costs by 50% - 750% (outcomes vary by project). A significant impost for will be created for exploration companies.

4. The proposed reforms are premised on incorrect assumptions

In the context of petroleum activities there is no evidence to support the discussion papers' claims that the status quo is not protecting the State's financial interest or promoting good environmental outcomes.

Progressive rehabilitation is already standard practice in the petroleum industry, there are no legacy petroleum projects in Queensland, and government is not expending any

money to rehabilitate legacy petroleum projects.

The discussion papers also assume that petroleum and mining activities and their rehabilitation are the same when clearly they are not. To be efficient and effective rehabilitation policy must recognise these differences.

5. Government is failing to progressively certify rehabilitated land

Government does not certify rehabilitated land until the overlying resource tenure is relinquished. In many areas land rehabilitated by the petroleum industry is being farmed, but government will not certify this land as safe, stable, not causing environmental harm, and able to sustain post petroleum land use until end of project life.

Government's reliance on the financial assurance system to ensure rehabilitation is therefore significantly greater than it needs to be - rather than confirming that effective rehabilitation is taking place on an ongoing basis, government is choosing to leave the entirety of this task until the end of project life which could be years or decades after rehabilitation.

Recommendations

1. Government should ensure financial assurance reform reduces cost for petroleum producers and explorers.
2. The acceptable forms of financial assurance should be expanded beyond cash and bank guarantees to include equivalent instruments.
3. Petroleum should be excluded from the 'tailored solution' and considered separately to mining as government's rehabilitation exposure is fundamentally different for each industry.
4. Petroleum exploration companies with a rehabilitation liability less than \$1,000,000 should be exempt from financial assurance requirements.
5. Government should progressively certify rehabilitated land prior to the surrender of the overlying tenure.
6. The effect of the *Environmental Protection (Chain of Responsibility) Amendment Act 2016* in lowering government's rehabilitation exposure should be explicitly accounted for in the design of the financial assurance system.
7. Alternative financial assurance options for the petroleum industry should be examined jointly by government and industry in a timeframe that is consistent with other Government policies aimed at increasing gas supplies.

Detailed comments

1. Industry concerns with the existing financial assurance system

APPEA has consistently raised two key concerns with the existing financial assurance system.

a. Quantum

Financial assurance levels in Queensland do not accurately reflect financial and environmental risks and are too high for low risk projects.

The primary purpose of financial assurance is to provide confidence to both government and the community that money will be available in the event that a resource activity operator defaults on their rehabilitation obligations and all other avenues to enforce obligations under the *Environmental Protection Act 1994* have been exhausted.

In this context Queensland's LNG projects are at an early stage of project life with substantial remaining reserves, long term sales contracts, and high levels of progressive rehabilitation. These facts are evidence the risk to government that financial assurance will be called on for Queensland's larger petroleum projects is minimal.

There is also minimal risk to government from smaller scale exploration and production projects. Such projects have small footprints, limited impacts, and exploration activities are temporary unless they are successful and lead to production. Exploration activities may also be conducted under government's Standard Approval which only authorises activities considered by government to be low risk.

There are also factors beyond regulation that provide a strong incentive for all explorers and producers to minimise impact and progressively rehabilitate. Most petroleum activity in Queensland coexists with private landholders. The compensation paid for landholder impacts and the need to maintain positive landholder relationships act as a major incentive to ensure timely and effective rehabilitation.

Further evidence that the rehabilitation risk to government from the industry is very low is the absence of any petroleum projects within the 15,000 legacy projects covered by the Abandoned Mine Lands Program.

APPEA submits that a more considered risk-based assessment of petroleum operations would significantly reduce the overall quantum of financial assurance required of the industry.

Any increase in the cost of the financial assurance system will increase the cost of exploring for and producing gas and, inevitably, the cost of gas for Queensland industry and households.

Recommendation 1

Government should ensure financial assurance reform reduces cost for petroleum producers and explorers.

b. Capacity

Government should allow for other forms of financial assurance equivalent to cash and bank guarantees to increase the overall capacity for financial assurance instruments. Increasing capacity in this manner will assist in lowering costs for industry without altering the outcome for government.

We note and support government proposals to expand the acceptable forms of financial assurance beyond bank guarantees and cash.

Recommendation 2

The acceptable forms of financial assurance should be expanded beyond cash and bank guarantees to include equivalent instruments.

2. Comments on proposed 'tailored solution' to financial assurance

a. 'Tailored solution' not supported

We do not support the proposed model as it would increase costs for petroleum companies operating in Queensland by 50%-750%, create a new impost on petroleum exploration activities, but would not materially change government's already low rehabilitation exposure for petroleum activities.

Further, while we do not consider this to be a reasonable position, if government's policy objective is to avoid any rehabilitation exposure it is evident that industry could achieve this outcome via bank guarantees and similar instruments at far lower cost than the proposed rehabilitation fund.

Petroleum operators can provide the same level of protection for government as the proposed rehabilitation fund for up to 80% less cost via bank guarantees. Allowing for alternative forms of security to bank guarantees and cash would enable industry to further reduce costs.

b. Administrative costs are excessive

The proposed \$32m in administrative costs for the rehabilitation fund accounts for 13% of contributions made. The \$16m for administration of the Selected Partner Arrangement (SPA) is even higher at 20% of total contributions.

These costs are excessive. For comparison, administration fees for investment funds are in the order of 0.5% - 1.5%, which includes a profit margin for the fund manager and covers the cost of actively managing an investment portfolio.

We believe there is no justification for any administrative costs for the SPA given there is nothing to manage other than the qualification process. The SPA will only cover a small number of very low risk projects and all contributions will be spent on unspecified 'other initiatives'.

Of further concern is that the \$19m in interest earned from the rehabilitation fund and SPA will be 'used by the State' rather than reinvested to reduce future contributions or fund administrative costs.

c. Mining and petroleum should not be in a combined fund

Petroleum and mining are significantly different industries:

- Petroleum activities typically coexist with other land uses, most notably agriculture
- Petroleum has a relatively low impact in a given area but a larger geographical footprint
- Larger petroleum projects typically have a moving footprint over the long term meaning that many elements will be fully rehabilitated prior to the end of project life and surrender of tenure
- Rehabilitation activities are different, and
- None of the 15,000 abandoned mines in the Abandoned Mine Lands Program are petroleum projects, and none of the more recent examples of legacy issues (eg Linc Energy¹, Texas Silver) are petroleum projects.

All of the above factors are separate considerations to the risk of financial failure and are material factors in determining the risk of financial failure and rehabilitation exposure for the State.

d. Proposed fund combines petroleum and mining but excludes other industries

Government has historically recognised that not all activities are the same in its application of the financial assurance framework. There are many industries and activities that cause

¹ To avoid any confusion with regard to the Linc Energy project - underground coal gasification (UCG) projects do not involve any petroleum exploration or production activities. UCG projects target coal, the resource production activity is authorised under mining legislation, and burning coal underground is an activity that is fundamentally incompatible with the production of natural gas from coal seams.

disturbance to land but are not subject to financial assurance at present and are not proposed to be included in the rehabilitation fund.

If, as suggested by government, the only risk relevant to financial assurance is the risk of financial failure then government should apply this rule consistently and extend the proposed new financial assurance model to cover all industries and activities that cause disturbance to land.

If government continues to recognise the substantive differences between industries and activities – a position we strongly support – then petroleum should not be combined with mining within a single rehabilitation fund.

e. Proposed contribution rates will increase costs

Under existing arrangements larger petroleum operators typically provide financial assurance in the form of a bank guarantee equal to the assessed rehabilitation liability less any discount the operator may be eligible for.

Smaller exploration companies typically provide cash-backed financial assurance which means that these companies must prove they hold the funds needed for rehabilitation.

All APPEA members operating in Queensland face significantly increased costs under the proposed fund model.

Several petroleum operators are currently able to secure bank guarantees in local and global financial markets at a cost ranging from 0.1% - 0.5% of assessed rehabilitation liability. Proposed contribution rates for the fund are much higher than these market rates, ranging from 0.5% to 2.75%.

For exploration companies the contribution rate represents a new impost. However, given that such companies are typically required to demonstrate funds are available for rehabilitation, and also hold insurance policies to cover unanticipated outcomes (as do larger operators), the proposed new arrangements will not reduce risk for government.

f. Removal of the discount system will increase costs

The proposed removal of the discount system will increase financial assurance costs by up to 43%, with a typical increase in the order of 15% - 25%.

The discount system is in place to support sound policy objectives and should not be abolished. Discounts are provided in recognition of an environmental authority holder:

- being in sound financial health and adequately budgeting for rehabilitation
- avoiding impacting areas of remnant vegetation or proactively rehabilitating or revegetating areas, and

- demonstrating they are not undertaking high risk storage activities or have implemented measures that reduce the amount of waste that would otherwise be stored in onsite high risk storage activities.

The above objectives continue to have merit and should continue to be recognised in a reformed financial assurance system.

g. Removal of project specific calculators will increase costs

Under existing arrangements proponents can develop project specific calculators that are accepted by regulators and more accurately reflect the cost of rehabilitation than the government calculator.

Project based calculators typically provide a reduction in assessed liability of 15% -25% but would not be acceptable under proposed reforms.

Industry's experience with financial assurance calculators developed by government is that costs are consistently overinflated. A move to a single government calculator is therefore likely to significantly increase cost for industry.

h. Government has a low rehabilitation risk for petroleum activities

As noted above, there is clear evidence that the risk that government will incur costs associated with petroleum rehabilitation is very low:

- There are no petroleum projects within the over 15,000 projects covered by the Abandoned Mine Lands Program.
- None of the more recent examples of legacy issues (eg Linc Energy, Texas Silver) are petroleum projects.
- Queensland's LNG projects are at an early stage of project life with substantial remaining reserves, long term sales contracts, and high levels of progressive rehabilitation.
- There is minimal risk to government from exploration and smaller scale production projects. Such projects have small footprints, limited impacts, and exploration activities are temporary unless they are successful and lead to production. Exploration activities may also be conducted under government's Standard Approval which only authorise activities considered by government to be low risk.

Given the government's already low rehabilitation risk from petroleum activities, the proposed reforms will not materially change government's overall risk exposure.

i. Risk assessment should consider more than just credit ratings or the risk of financial failure

The discussion paper proposes that government will set contribution rates according to a company's credit rating and establish credit ratings for non-rated companies.

In some cases, small and mid-sized operators have made a conscious decision to not have a credit rating in order to facilitate bilateral financing discussions without pre-determined outcomes. The potential for a credit rating to be imposed is a significant concern as it would undermine this objective. Some production joint ventures are also not credit rated albeit for different reasons.

Following industry feedback, we understand the Government is considering moving from a credit rating to an assessment of the 'risk of financial failure'. It is unclear on what basis this risk of would be assessed, however we consider the concept too narrow given the variety of factors that influence government's rehabilitation exposure.

It is also essential that the starting point for any assessment be that petroleum companies are no worse off given the absence of any legacy petroleum issues in Queensland. This outcome should be enshrined in the assessment process.

j. Small operator threshold is too low

Few if any petroleum exploration companies will have rehabilitation liabilities below \$50,000, yet exploration activities are low risk and straightforward to rehabilitate.

Given the very low risk of exploration activities, petroleum exploration companies with a rehabilitation liability less than \$1,000,000 be exempt from financial assurance requirements.

Recommendation 3

Petroleum should be excluded from the 'tailored solution' and considered separate to mining as government's rehabilitation exposure is fundamentally different.

Recommendation 4

Petroleum exploration companies with less than \$1,000,000 in rehabilitation liabilities should be exempt from financial assurance requirements.

3. Progressive rehabilitation is standard practice in the petroleum industry

The discussion papers indicate the government's view is that progressive rehabilitation is not currently occurring to the extent possible within the petroleum industry. In discussions with government it was also suggested the petroleum industry could significantly reduce financial assurance costs by increasing progressive rehabilitation.

With respect, these suggestions are not correct and highlight a concerning lack of understanding of petroleum operations. The petroleum industry has limited scope to undertake rehabilitation above and beyond that which is already occurring.

The case study example below is based on a Queensland operation and illustrates this fact. While the precise split between rehabilitated vs operational land varies between projects, we have confirmed with our members that the example below is representative of progressive rehabilitation rates in the petroleum industry.

CASE STUDY

Figure 1 shows the total area disturbed by Project A since activities commenced. As at the end of the latest annual return reporting period the operational area of the project accounted for 56% of the total area disturbed, and 41% of the total area disturbed has already been rehabilitated.

As land cannot be rehabilitated instantaneously projects that are actively constructing infrastructure will always have some yet-to-be rehabilitated land. For Project A, this yet-to-be rehabilitated land accounts for 3% of the total area of disturbed land.

Project A therefore has little or no opportunity to reduce financial assurance liability by increasing progressive rehabilitation.

Figure 1 – Project A Operational Area vs Rehabilitated Area

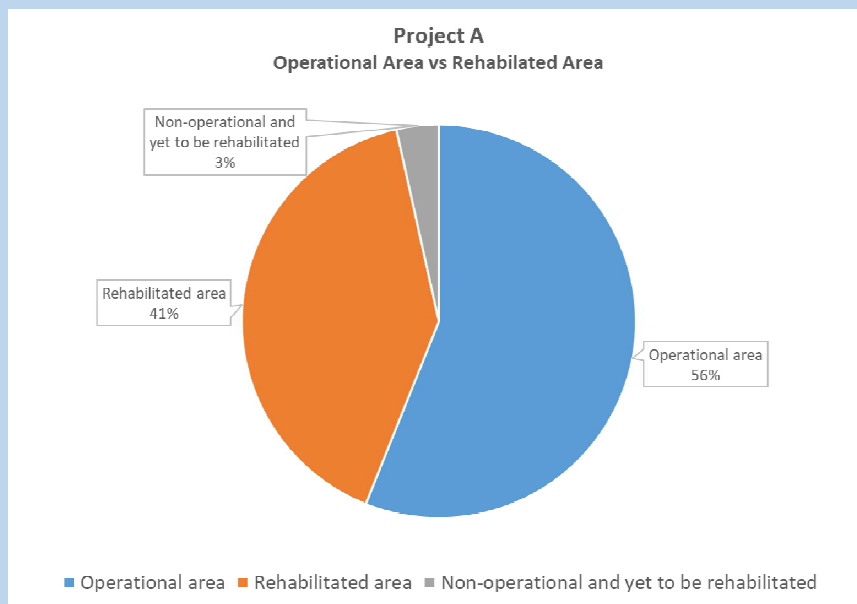
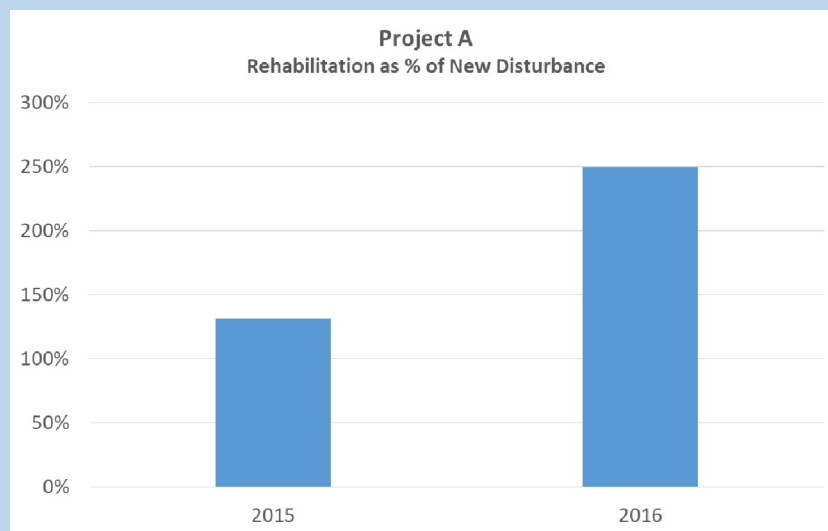


Figure 2 indicates that during the past two years Project A has in fact rehabilitated a greater area of land than it has disturbed.

During the twelve months to the end of the annual return reporting period in 2015, 132% more land was rehabilitated than was disturbed, and for the same period in 2016 250% more land was rehabilitated than was disturbed.

Figure 2 – Project A New disturbance compared to rehabilitation



There are multiple reasons for the outcome shown in the above Case Study.

a. The petroleum industry coexists with other land uses

Petroleum operations often coexist with other land uses on private land with an associated legal obligation to pay compensation to landholders for areas disturbed. This means that:

- there is a strong financial incentive for petroleum companies to complete rehabilitation as soon as practicable so that compensation can be reduced, and
- there is a strong social licence incentive to complete rehabilitation as soon as practicable so that productive land can be returned to the landholder.

Examples of the industry's coexistence are shown in Figure 3 and 4 below. In both examples, compensation is payable to the landholder until activities are fully rehabilitated.

Figure 3 – Coexistence with grazing



Figure 4 – Coexistence with cropping



b. Exploration and production testing are low impact

Exploration for petroleum typically comprises seismic data collection, core hole drilling, and production testing wells with associated infrastructure (eg small dams).

Seismic and core holes are transient and short term in their impact with rehabilitation occurring immediately after the activity is completed.

Production testing wells will be in place until a field is proven economic, in which case the well will likely remain in place until the production phase is completed, or proven uneconomic in which case it will be rehabilitated.

c. Rehabilitation of infrastructure is relatively straightforward

Rehabilitation of petroleum infrastructure is relatively straightforward and has been successfully completed many, many times in Queensland. Petroleum production in Queensland typically involves construction and rehabilitation of:

- Gas wells and groundwater bores
- Ponds and dams
- Buildings and processing facilities
- Buried pipelines and gathering lines
- Electrical and communications infrastructure (eg 4G telecommunications towers)
- Roads, access tracks, lay down areas, and hardstand areas, and
- Borrow pits and quarries

A significant proportion of the industry's infrastructure may be left in place for the benefit of the landholder and broader community including for example ponds and dams, groundwater bores, communications infrastructure, roads and access tracks.

The figures below show just a few examples of the industry's rehabilitation activities and there are many more available. The industry undertakes this work on an ongoing basis and will continue to do so.

Figures 5 and 6 – This was the location of an exploration well where the surrounding area was being cropped. Upon decommissioning of the well, the well pad was removed and the area again put under cultivation by the landholder.

This is an example of the industry returning land to a safe and stable condition that is not causing environmental harm. The land is now being farmed and by any reasonable measure has been fully rehabilitated. However, government will not certify this land as rehabilitated until the end of project life which is likely to be several decades from now. This issue is discussed further below.

Before rehabilitation



After rehabilitation



Figure 6 and 7 – This was the location of an exploration well where the surrounding area was being grazed. Upon decommissioning of the well, the well pad was rehabilitated and the area returned to grazing by the landholder. As for the example above, land is now being farmed and by any reasonable measure has been fully rehabilitated but government will not certify the rehabilitation until the end of project life.

Before rehabilitation



After rehabilitation



Figure 7 and 8 – This was the location of an aggregation pond which was decommissioned and rehabilitated. The land has been returned to its past use but will not be certified by government until the end of project life.

Before rehabilitation

After rehabilitation



Figure 8 and 9 – This is a photo of a gathering pipeline and access right of way. Upon construction completion, the pipeline right of way is rehabilitated and an access track is maintained throughout the operational life.

In this case, the land has been rehabilitated to the extent possible but upon decommissioning of the pipeline the land will be returned to its surrounding land use of remnant vegetation. While the pipeline is operational this cannot occur in order to ensure pipeline integrity.

Before rehabilitation

After rehabilitation



Figure 9 and 10 – This was the location of a work camp. Due to project phasing the camp was no longer required and was decommissioned and rehabilitated to the surrounding land use which was grazing. Government will not certify this land as rehabilitated until the end of project life.

Before rehabilitation

After rehabilitation



4. Government is failing to progressively certify rehabilitated areas

Under current arrangements government will not certify and accept liability for rehabilitated areas until surrender of the overlying tenure. Given that surrender of the tenure may not occur for several decades the lack of certification means:

- Government is failing to minimise its rehabilitation exposure – certification and oversight is being left until end of project life when it could be managed on an ongoing basis, and
- Government is impeding the ability of private landholders that coexist with natural gas production to fully reclaim use of their land.

As shown in the figures above in areas where an operator has fully rehabilitated land, the landholder has agreed the land is properly rehabilitated, and the landholder has actually recommenced farming activities Government will not certify until the end of project life that the land is rehabilitated in accordance with the definition stated at page 6 of the *Better Mine Rehabilitation for Queensland* discussion paper:

'land will be considered to be rehabilitated when it can be demonstrated it is safe, stable, will not cause environmental harm and is able to sustain the post mining land use'

It is unclear why, given Government's policy objective to increase rehabilitation rates on an ongoing basis, Government does not also wish to confirm that its policy objectives are actually being achieved on an ongoing basis by checking and certifying that land has been rehabilitated.

Petroleum operations are distinct from mining in this context. Petroleum typically has greater coexistence with private landholders, and a relatively lower impact in a given area but a larger geographical footprint. Production projects typically also have a moving footprint over the long term meaning that many elements of the project will be fully rehabilitated prior to the end of project life and surrender of tenure.

APPEA has previously sought to engage government to achieve reform in this area without success. Government should make it a high priority to establish processes that support progressive rehabilitation by progressively certifying rehabilitated areas prior to the surrender of the overlying tenure.

In support of this objective a rehabilitation checklist and process should be prepared as part of a statutory guideline. Petroleum and agriculture groups and government could develop collaboratively the required standards for rehabilitation and the process for achieving progressive certification. The checklist should include a process for landholder sign off of rehabilitation. Development of a streamlined process for determining residual risk, if any, is also required.

Recommendation 5

Government should progressively certify rehabilitated land prior to the surrender of the overlying tenure.

5. The *Chain of Responsibility Act 2016* should be accounted for in the financial assurance system

The Chain of Responsibility Act 2016 (CORA) was passed by government with the stated purpose of ensuring that 'companies and their related parties bear the cost of managing and rehabilitating sites'² but there is no reference to CORA in the discussion papers.

The fact that CORA has reduced government's rehabilitation exposure should be accounted for as part of any new financial assurance arrangements.

It is unclear whether the proposed rehabilitation fund will be relied on in place of CORA in the event of default, whether potentially liable parties under CORA will be pursued in preference to expenditure from the fund, or whether the fund's parameters were set with reference to the benefit to government of CORA.

² *Government moves to enforce 'chain of responsibility' system for costly environmental clean-ups*, media statement by the Honourable Steven Miles, Minister for Environment and Heritage Protection and Minister for National Parks and the Great Barrier Reef 15 March 2016

Recommendation 6

The effect of the *Environmental Protection (Chain of Responsibility) Amendment Act 2016* in lowering government's rehabilitation exposure should be explicitly accounted for in the design of the financial assurance system.

The way forwards

APPEA would welcome the opportunity to work with government on alternative options to deliver the stated objectives of:

- Delivering a high level of environmental performance
- Protecting the state's financial interest
- Providing an incentive to invest in the resources sector
- Providing an outcome that satisfies community expectations

As we have detailed throughout this submission there is extensive evidence that in the context of the petroleum industry existing regulation is already achieving these objectives, but could be enhanced to lower the cost of gas production in Queensland.

We would support further work on:

- The Risk Evaluated Financial Assurance model
- A petroleum specific rehabilitation fund structured to ensure no increase in costs, and developed and implemented with reference to the Queensland and Australian Government's broader gas supply policy, for example implemented after the Australian Domestic Gas Security Mechanism has been removed
- Allowance for alternative financial instruments to bank guarantees and cash
- Basing financial assurance on a demonstration that sufficient funds have been provisioned for rehabilitation taking account of project lifecycle (as demonstrated by remaining contracted reserves for example)
- Options that leverage the industry's ability to source low cost financial assurance instruments

Recommendation 6

Alternative financial assurance options for the petroleum industry should be examined jointly by government and industry in a timeframe that is consistent with other Government policies aimed at increasing gas supplies.

Further questions

At **Attachment 2** we have set out a number questions identified during our review of the proposals.

To assist the industry in working with government to achieve joint objectives we seek responses to these questions.

ATTACHMENT 1 - Case study examples of cost impact

The case studies below represent expected percentage increases across a number of scenarios. APPEA members have confirmed these examples as accurately representing the range of expected increases in costs as a percentage of current liability.

An 'assessed rehabilitation liability' of \$1,000,000 has been used for comparative purposes. Actual rehabilitation liabilities vary across projects.

Case study 1

<i>Existing FA system</i>	<i>Existing system</i>	<i>FA 'tailored approach'</i>
Assessed rehabilitation liability	\$ 1,000,000	\$ 1,000,000
Reduction in liability from more accurate FA calculation via own FA calculator	20.0% \$ 800,000	0% \$ 1,000,000
Good performance discount	20.0% \$ 640,000	0% \$ 1,000,000
Bank Guarantee rate	0.3%	1.0%
Financial assurance cost to company	\$ 1,920	\$ 10,000

Percentage increase under new system

421%

Case study 2

<i>Existing FA system</i>	<i>Existing system</i>	<i>FA 'tailored approach'</i>
Assessed rehabilitation liability	\$ 1,000,000	\$ 1,000,000
Reduction in liability from more accurate FA calculation via own FA calculator	20.0% \$ 800,000	0% \$ 1,000,000
Good performance discount	20.0% \$ 640,000	0% \$ 1,000,000
Bank Guarantee rate	0.1%	0.5%
Financial assurance cost to company	\$ 640	\$ 5,000

Percentage increase under new system

681%

Case study 3

<i>Existing FA system</i>	<i>Existing system</i>	<i>FA 'tailored approach'</i>
Assessed rehabilitation liability	\$ 1,000,000	\$ 1,000,000
Reduction in liability from more accurate FA calculation via own FA calculator	20.0% \$ 800,000	0% \$ 1,000,000
Good performance discount	20.0% \$ 640,000	0% \$ 1,000,000
Bank Guarantee rate	0.5%	2.75%
Financial assurance cost to company	\$ 3,200	\$ 27,500

Percentage increase under new system

759%

Case study 4

<i>Existing FA system</i>	<i>Existing system</i>	<i>FA 'tailored approach'</i>
Assessed rehabilitation liability	\$ 1,000,000	\$ 1,000,000
Reduction in liability from more accurate FA calculation via own FA calculator	15.0% \$ 850,000	0% \$ 1,000,000
Good performance discount	0.0% \$ 850,000	0% \$ 1,000,000
Bank Guarantee rate	0.5%	2.75%
Financial assurance cost to company	\$ 4,250	\$ 27,500

Percentage increase under new system

547%

Case study 5

<i>Existing FA system</i>	<i>Existing system</i>		<i>FA 'tailored approach'</i>	
Assessed rehabilitation liability		\$ 1,000,000		\$ 1,000,000
Reduction in liability from more accurate FA calculation via own FA calculator	20.0%	\$ 800,000	0%	\$ 1,000,000
Good performance discount	15.3%	\$ 677,600	0%	\$ 1,000,000
Bank Guarantee rate	1.0%		1.00%	
Financial assurance cost to company		\$ 6,776		\$ 10,000

Percentage increase under new system

48%

Case study 6

<i>Existing FA system</i>	<i>Existing system</i>		<i>FA 'tailored approach'</i>	
Assessed rehabilitation liability		\$ 1,000,000		\$ 1,000,000
Reduction in liability from more accurate FA calculation via own FA calculator	20.0%	\$ 800,000	0%	\$ 1,000,000
Good performance discount	15.3%	\$ 677,600	0%	\$ 1,000,000
Bank Guarantee rate	1.0%		2.75%	
Financial assurance cost to company		\$ 6,776		\$ 27,500

Percentage increase under new system

306%

Case study 7

<i>Existing FA system</i>	<i>Existing system</i>		<i>FA 'tailored approach'</i>	
Assessed rehabilitation liability		\$ 1,000,000		\$ 1,000,000
Reduction in liability from more accurate FA calculation via own FA calculator	0.0%	\$ 1,000,000	0%	\$ 1,000,000
Good performance discount	0.0%	\$ 1,000,000	0%	\$ 1,000,000
Bank Guarantee rate	1.4%		2.75%	
Financial assurance cost to company		\$ 14,000		\$ 27,500

Percentage increase under new system

96%

ATTACHMENT 2 – Further questions

One of government's stated objectives is to protect the State's financial interest. In the scenario of a project that:

- Calculates rehabilitation liability using a government approved calculator
- Provides financial assurance for 100% of that liability
- Can source a bank guarantee for a cost of less than 0.5% of the assessed amount

Question 1. Would the above project nevertheless be required to pay the fund premium of at least 0.5%?

Question 2. If so, how is the increased cost for the project justified given the State's interests are protected to the same extent under either the fund or a 100% bank guarantee calculated according to a government approved methodology?

By definition, rehabilitation costs incurred by the State are due to insufficient financial assurance held against higher risk projects.

Given the one-size-fits-all approach under current arrangements, meaningful reform should therefore result in higher risk projects paying more financial assurance and lower risk projects paying less.

Question 3. Does government agree that lower risk projects should pay less and higher risk projects should pay more under a reformed financial assurance system?

Question 4. If so, will the fund design guarantee an equal or lower cost outcome for lower risk operations as compared to current arrangements?

Petroleum is a different industry from mining:

- The nature and scale of projects is different, with petroleum in Queensland being less concentrated but spread over a larger area
- Rehabilitation activities are different
- None of the 15,000 abandoned mines in the Abandoned Mine Lands Program are petroleum operations, and none of the more recent examples of legacy issues (eg Linc Energy, Texas Silver) are petroleum projects

All of the above factors are separate considerations to the risk of financial failure but are material factors in determining the potential for rehabilitation liability to be transferred to the State.

Question 5. How have the differences between petroleum and mining been accounted for in the design of the fund?

Government has historically recognised that not all activities are the same in its application of the financial assurance framework. For example, there are many activities in industries other than petroleum and mining that cause disturbance to land but are not subject to financial assurance at all.

Question 6. Is it now the government's policy position that only the risk of financial failure is relevant to financial assurance with no regard for the industry undertaking the activity?

Question 7. If the above is correct, is it also the case the government will extend the proposed rehabilitation fund to cover all environmentally relevant activities that cause disturbance to land?

The Chain of Responsibility Act 2016 (CORA) was passed by government with the stated purpose of ensuring that 'companies and their related parties bear the cost of managing and rehabilitating sites'.³

Question 8. Will proposed rehabilitation fund be relied on in place of CORA in the event of default, or would potentially liable parties under CORA be pursued in preference to expenditure from the fund?

Question 9. If the fund will be relied on in preference to CORA, will CORA be abolished?

Question 10. If CORA will be used in preference to the fund, how have the fund's parameters accounted for the lower total funds needed given expected recoveries under CORA?

Government has suggested that the petroleum industry could reduce FA liability by increasing progressive rehabilitation activities.

APPEA believes this to be incorrect given existing progressive rehabilitation activities.

Further, the industry's experience is that government will not certify progressively rehabilitated land until the overlying tenure is surrendered.

Question 11. What is the basis for government's view that progressive rehabilitation is not already occurring in the petroleum industry?

³ *Government moves to enforce 'chain of responsibility' system for costly environmental clean-ups*, media statement by the Honourable Steven Miles, Minister for Environment and Heritage Protection and Minister for National Parks and the Great Barrier Reef 15 March 2016

Question 12. What is the government's estimation of the area of land that could be, but has not been, rehabilitated by the petroleum industry?

Question 13. What is the policy rationale for government not progressively certifying rehabilitated land?