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15 July 2022

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(via email:)

Dear Sarah,

RE: Northern Territory Petroleum Royalty Review

The Australian Petroleum Production & Exploration Association (APPEA) welcomes the opportunity to provide a submission to the Department of Treasury and Finance (DTF) in relation to the draft legislation currently being consulted on as part of the Northern Territory Petroleum Royalty Review.

APPEA is pleased to see that the regime will be legislated rather than requiring individually negotiated agreements. This provides a clear and transparent regime that will deliver certainty, efficiency and equity for industry, regulator and the community.

With the right settings, the Territory's highly prospective resources can be developed. This will deliver jobs and income to Territorians and ensure that a secure supply of energy can be provided. It also ensures that the Territory receives an appropriate return for the extraction of its non-renewable resources, increasing the government's capacity to invest in essential economic and social infrastructure consistent with the Territory Economic Reconstruction Commission's final report.

To support this, APPEA submission at ***Attachment A*** of this letter provides some commentary and suggestions for your consideration. These comments and suggestions draw on the experience of APPEA members in terms of their operations across all jurisdictions in Australia (and in some instances, globally) to ensure the Territory's regime is best placed to attract investment and deliver significant economic gains to Territorians through royalties, employment opportunities and other socio-economic benefits.

We would welcome the opportunity to discuss this submission with you further. If you have any queries or for further information in relation to the contents of this letter and our submission, you can contact me on or at .

Yours sincerely

Cassy Schmidt
Director – Northern Territory

ATTACHMENT A

APPEA Submission | Northern Territory Petroleum Royalty Review

The comments provided below relate to the Draft Petroleum Royalty Act 2022 ("draft bill"). Where relevant, we have also made some suggestions that we think will support the efficient administration and operation of the regime by adjusting the Frequently Asked Questions documents that accompany the draft bill.

PART 2 - INTERPRETATION

Section 4 – Deduction cap

APPEA notes that the cap under the royalty regime is set at 75 percent. We would encourage the government to consider increasing this cap to 80 percent as a mechanism to attract investment and ensure the regime is comparable and competitive with other jurisdictions in Australia.

Whilst on the surface this would seem marginal, we submit that caps can potentially impose a significant royalty cost on marginal projects, and those in the early or declining phases of their production lives. Furthermore, caps can act as a disincentive to investment, defer the go-ahead of projects, lead to the premature shut down of projects and lead to the deferment of new incremental investments to extend the life of producing projects.

Section 5 – Meaning of gross value at the wellhead

APPEA observes that the centrepiece of the draft bill is to determine the ***gross value at the wellhead***, with much of the application and administration of the draft bill flowing from this section. We note that paragraphs 5(1)(a) and (b) of the draft bill refer to petroleum sold at the wellhead or a comparable sale at the well head.

It is not common for petroleum to be sold at the wellhead and it is therefore unlikely that a comparable sale in the period will also exist. Similar challenges exist when using benchmarks at this time as there is no open market reflective of operations in the Territory.

We cannot see paragraphs 5(1)(a) and (b) operating at this time. Whilst we understand these provisions were included to provide flexibility and "future-proofing", we recommend that the wording in paragraph 5(1)(c) which states that the netback approach can be used "in any other case" be removed from the final bill.

Alternatively, the drafting of this provision could place the netback method as the primary method for determining the gross value at the wellhead with alternatives able to be chosen to simplify administration and compliance should the circumstances exist.

APPEA notes that the accompanying *FAQ – The Calculation* document should also be updated to reflect that the methodology is a choice of the petroleum producer. This choice does not impact the overall operation of the draft bill given the various check points and Commissioner approvals throughout the draft bill.

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Section 7 – Meaning of comparable sale

APPEA recommends that this provision be adjusted to reflect that the comparable price will be from the licencee's operations within the Territory and not the operations of another. This ensures that the royalty payable is reflective of the value of petroleum otherwise sold by the petroleum producer and not from another petroleum producer's operations given that the investment and operations of petroleum producer will vary in scale and size.

Paragraphs 9(1)(d) and (e) - Meaning of market value

APPEA notes that paragraphs 9(1)(d) and (e) are two provisions that apply a benchmark price or a value determined by the Commissioner to ascertain the ***market value*** petroleum sold.

We observe that applying benchmark prices to the Territory are unlikely to be complimentary to the operations of petroleum producers in the Territory nor reflect prices that petroleum producers would receive. In doing so, petroleum producers would be liable for royalties that do not necessarily reflect the price and operational scale.

We recommend that paragraph 9(1)(d) be removed given that the Commissioner can determine a price and that it is expected this should rely on certain benchmarks. Guidance as to the criteria being used by the Commissioner in applying paragraph 9(1)(e) should also be published.

Alternatively, should no changes be made to this provision, APPEA recommends that more detailed guidance and clarifications be provided to petroleum producers as to the benchmarks[1] the Commissioner would consider applying and how they are relevant to operations in the Territory, and the circumstances and criteria the Commissioner would use to determine a value or price[2].

Subparagraph 11(1)(a)(i) – use of the word "reasonably"

APPEA recommends that the word "reasonably" be removed from Subparagraph 11(1)(a)(i). The use of ***reasonably*** leads to a degree of uncertainty when it comes to the administration of the regime, and it is not required given the application of the deduction cap[3].

We note that the guidance in the *FAQ – The Calculation* document are welcome as it provides a comprehensive list of the types of costs that are considered deductible for the purposes of the regime. We submit that the wording "reasonable in amount" should be removed from this guidance document given the application of the deduction cap.

Subsection 11(3) – approval to carry over deductible costs more than the deduction cap

It is unclear as to why the Commissioner is required to provide approval of carrying over excess deductions and how it will apply in practice. To ease the administrative burden of the regime and to

[1] Refer to paragraph 9(1)(d) of the draft bill.
[2] Refer to paragraph 9(1)(e) of the draft bill
[3] As defined in Part 2 Section 4 ***deduction cap*** of the draft bill.

make it more efficient, APPEA recommends that this section be removed given the numerous other Commissioner approval check points throughout the draft bill.

Alternatively, APPEA recommends that further guidance be developed or that the *FAQ – The Calculation* document be updated to include factors that the Commissioner will use to grant the relevant approval.

Subparagraph 13(1)(a)(iv) – Excluded costs include decommissioning, rehabilitation or abandonment

APPEA recommends that this subparagraph be removed from the draft bill.

Decommissioning, rehabilitation and abandonment costs are a significant part of the life cycle of an oil and gas project. APPEA is concerned that the exclusion of these costs for deductibility may increase the risk of poor environmental outcomes.

Ultimately, disallowing a deduction is a cost of doing business and we do not want to see provisions included that may lead to circumstances that may result in poor choices or transactions that see petroleum producers not taking their obligations seriously. APPEA would also support partial closing down expenditure be included in the scope for deductibility. This ensures that petroleum producers can proactively manage their decommissioning and environmental obligations as efficiently and effectively as possible.

Sections 11,12 and 13 – use of the word "directly", "wholly" and solely"

APPEA is concerned with the use of words "directly", "wholly" and "solely" throughout these provisions without these words being defined in the draft bill. We recommend that they be defined or appropriate guidance be provided by the administrator.

APPEA is concerned that the context of these words if left undefined are likely to lead to significant disputes between petroleum producers and the administrator. These disputes are likely to be costly and burdensome for both the government and petroleum producers to resolve.

Section 13 – definition of "extended shutdown"

APPEA would appreciate some further clarification as to what is meant by "extended shutdown".

Section 13(p) – denial of expenditures without grounds and appeal rights

It is unclear as to whether there are appeal rights that would apply to the denial of a deduction where there is *'any cost or expense the Commissioner is not satisfied is a deductible expense'*. We query whether the Northern Territory Civil and Administrative Tribunal or Supreme Court can hear disputes of this nature given the appeal provisions in the Tax Administration Act 2007.

This is just one example of our concerns and APPEA requests that further guidance and information is provided as to how the Commissioner sees appeal rights applying to the regime.

PART 3 – PETROLEUM ROYALTIES

Paragraphs 17(1)(a) and (b) – Application

APPEA seeks further clarification as to whether royalty agreements or determinations by Ministers will end when the new legislation comes into force or at a time otherwise agreed between the Commissioner and the petroleum producer.

Section 20 – Payment of royalty instalments

Whilst APPEA understands that current arrangements see payments made on a monthly basis, we see an opportunity to ease the administrative burden of the regime by amending the draft bill so that royalties are payable in quarterly instalments. Quarterly statements and payments should be lodged within 30 days of the end of a quarter.

Petroleum producers should make monthly payments where the royalties payable for a project are likely to exceed $20m per annum.

Section 21 – Royalty discount for manufacturing

APPEA notes that the discount for manufacturing only applies where petroleum is incorporated into a new product and will not apply in circumstances where petroleum is used in the manufacturing process. For example, the discount does not apply where a brickworks manufacturer uses gas to heat a kiln to manufacture a brick because the brick itself does not include petroleum.

APPEA is concerned that this delineation will impact the Territory's potential to create a manufacturing hub. We recommend that this policy position be revisited with consideration given to an alternate manufacturing discount where gas is used in manufacturing but not in the final product.

Section 21 – Royalty Discount: Tracing and apportionment matters

APPEA welcomes the royalty discount provisions that are designed to support the objectives of the Territory Economic Reconstruction Committee's report. However, we observe that the draft bill is silent on when tracing and/or apportionment is required by petroleum producers for determining which discount to apply.

One such example of where this may arise is when a petroleum producer sells petroleum to an aggregator. In this instance, the aggregator of the petroleum would effectively collect the petroleum into one pool prior to the allocation between manufacturers and power generation. The aggregator is responsible for the allocation in line with their commercial contracts and agreements, and this information is unlikely to be provided to petroleum producers.

APPEA recommends that further consideration be given to how apportionment should occur. Alternatively, it may be simpler and more efficient to insert an additional discount category for petroleum sold to an aggregator, especially where a petroleum producer cannot access (for commercial reasons) how the aggregator allocates petroleum in their business.

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PART 4 – MISCELLANEOUS MATTERS

Section 25 – Annual Returns

Given that royalty instalment payments are based on data from the previous year, any accompanying guidance should make it clear that any shortfalls that have occurred during the current royalty year are not subject to penalties and interest when the annual return is lodged. We think that the annual return process should be treated as a reconciliation of the current year rather than a way to penalise petroleum producers for any shortfalls that may result.

Where subsequent amendments are made to the initial annual return, any shortfall arising from the amendment would then be subject to penalties and interest in accordance with the *Taxation Administration Act 2007*.

Section 30 – Review of Act

APPEA supports the review of the regime and looks forward to working with the government on this.

OTHER CONSIDERATIONS

APPEA notes that there are some practical matters with respect to the administration of the regime that require further consideration.

Transitional amnesty for existing producers

We understand that there will be changes to the way that these petroleum producers would determine royalties between existing arrangements[4] and the proposed regime. APPEA recommends that the government consider an amnesty for the first 12 months so that petroleum producers already subject to a royalty agreement before the commencement of the draft bill would not be liable for shortfall and interest payments as they manage the transition to a new regime.

Flared and/or vented gas

APPEA observes that the *FAQ – The Calculation* document makes it explicitly clear that "[p]etroleum consumed or lost through venting, flaring and other means will be subject to royalty. The value of flared and vented petroleum is to be calculated with reference to the market value".

We observed that flared or vented gas procedures are conducted for environmental purposes and do not have a commercially saleable value. If the preference is for a royalty to be incurred on petroleum that is flared or vented, then consideration should be given in the legislation for a discount or an exemption to a certain point of volume before a royalty is payable. This would ensure that Territorians receive a return for the extraction of their natural resources whilst maintaining some investment integrity in the provisions.

[4] Royalty agreement or determination by Minister under section 84(2) of the *Petroleum Act 1984.*

<u>Self-execution and certainty</u>

APPEA notes that the draft bill has a significant amount of Commissioner approval points or actions the Commissioner can take if “not satisfied”. This makes it challenging for petroleum producers to make investment decisions with any certainty as it is not clear when or how the Commissioner will make such a decision. APPEA recommends that the use of these approval points be reviewed, reconsidered, and those that are considered unnecessary be removed. [5]

[5] For example, approval from the Commissioner to carry over excess expenditure in subsection 11(3) of the draft bill.