



LNG Outlook Conference

John Boardman

Presentation Brief

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## PROLIFERATION VS COLLABORATION? THE FUTURE OF LNG PROJECTS IN AUSTRALIA

The development of Australia's large natural resources, particularly iron ore and natural gas, has always been a sensitive subject. Although I believe that there is a great deal of commonality between the issues and potential solutions, to the development of both iron ore and natural gas in an "optimal" manner I will confine the discussion to natural gas; it's an LNG conference and it's my area of expertise.

In Australia there are clearly defined Petroleum Regulations, Legislation and Guidelines for the grant of exploration permits, retention leases and production licenses. Monetisation of discovered resources is subject to government approval through a clearly defined licensing (and retention lease) process. This includes environmental and landowner compliance and approvals. The Guidelines<sup>1</sup> for applying for a Production License, Clause 4.2, specifically state that:

“..... these sovereign rights confer on the Australian Government *a responsibility* to ensure that present and future generations of Australians derive *optimal benefit* from the petroleum resources .....

“Community returns on petroleum development projects are provided for by the Petroleum Resource Rent Tax (PRRT) arrangements or, where applicable, the excise and royalty arrangements.” *(emphasis authors)*

Unfortunately neither these Guidelines nor any of the complementary Regulations and Legislation<sup>2</sup> provide guidance on the metrics to be used by the government for determining "optimal" nor require the applicant to demonstrate that the proposed development is "optimal". Equally, it is unequivocally accepted that, just as government has an obligation to its shareholders, companies have obligations to theirs. "Optimal", however measured, for one group may legitimately not be "optimal" for the other. Overlay equally valid and as likely wrong, perceptions of the future and "optimal" even for an individual group may change.

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<sup>1</sup> GUIDELINES FOR GRANT OF A PRODUCTION LICENCE AND GRANT OF AN INFRASTRUCTURE LICENCE

A GUIDELINE IN RELATION TO THE OFFSHORE PETROLEUM AND GREENHOUSE GAS

STORAGE ACT 2006 (COMMONWEALTH) : Prepared by Resources Division, Australian Government Department of Resources, Energy and Tourism, on behalf of the Commonwealth-State/NT Joint Authorities. Version 2 Issued July 2009

<sup>2</sup>Refer:

[http://www.ret.gov.au/resources/upstream\\_petroleum/offshore\\_petroleum\\_regulation\\_and\\_legislation/offshore\\_petroleum\\_legislation\\_regulation\\_and\\_guidelines/Pages/OffshorePetroleumLegislationRegulationandGuidelines.aspx](http://www.ret.gov.au/resources/upstream_petroleum/offshore_petroleum_regulation_and_legislation/offshore_petroleum_legislation_regulation_and_guidelines/Pages/OffshorePetroleumLegislationRegulationandGuidelines.aspx)

And the final complicating factor is the infamously spurious and specious trump card played by some investors; “sovereign risk”. To industry’s credit successive governments have immediately toned their rhetoric on “sensible resource management” whenever the two magic words are uttered. With only 8%<sup>3</sup> of the world’s hydrocarbon resources freely accessible to IOCs, the other 92% either directly or indirectly held by NOCs or off-limits, Australia holds a very special place in the future of the E&P industry. Australia also ranks in the lowest quartile for government take<sup>4</sup> under the offshore PRRT regime. For onshore developments only Ireland, that well known major oil and gas producer, affords better terms. “Sovereign risk” is relative!

So against this background what’s the issue? Simply, or simplistically stated, it’s this: “If it can be unequivocally demonstrated that the independent development of 2 major gas resources, as separate LNG projects, provides a substantially lower economic rent to the government over the life of the fields than if those fields were developed symbiotically through a single LNG plant, what should be done?”

To protect the innocent and/or the guilty and to preserve future sources of my income I have used a completely hypothetical example of two large offshore gas fields developed:

- a) independently
- b) collaboratively, in other words treating the two fields as if they had common title.

With all the necessary caveats about cost estimating uncertainties, market timing, etc the difference in life cycle costs between these two development scenarios is ~A\$9 billion. I note that I have used an identical cost base for both scenarios and as it is the relative difference between the two scenarios which is the principal concern, my cost estimating accuracy is not critical. This difference in life cycle costs generates an incremental economic rent, PRRT and corporation tax of ~A\$7 billion. The additional return to each investor group is also substantial, ~A\$16 billion undiscounted or ~A\$1.5 billion NPV10. The magnitude of these numbers provides a very large incentive for all parties to set aside egos and non-Australian strategies and to collaborate.

RISC and KPMG, our Alliance Partner, carried out a desktop study to identify the synergies which could be realised through collaboration between two parties proposing to develop CSG based LNG projects in Queensland.

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<sup>3</sup> EIA and BP Statistical Review

<sup>4</sup> Journal of World Energy Law & Business, 2008, Vol. 1, No. 1: Changing Fiscal Landscape; Daniel Johnston

Again we considered the potential for savings by postulating the way in which the resources would be monetised if there was common title through a single JV. We looked at the entire value chain, from appraisal drilling to prove up “contractible” reserves, through optimisation of field development, pipelines, common infrastructure such as roads, power generation, utilities, LNG storage and offloading to marketing. Some benefits we felt able to quantify, while others we left as real, but unquantifiable at the level of study undertaken. Across the entire value chain we identified ~A\$6 billion of value add which could be achieved if there was common ownership, or that could be achieved through collaboration. I also note that “only” \$1bn of this came from the LNG plant rationalisation, a value lower than has been quoted in the media.<sup>5</sup> And this additional value does not include the benefits we feel would be realised from factors such as:

- Strong signal of project strength to external stakeholders and the market
- Enhanced metrics for debt financing
- Greater ability to secure ‘A’ team contractors
- Reduced competition for limited human resources and services
- Simplified approvals process
- Increased credibility with LNG buyers and governments
- Insights gained from collaborators approach to development
- Sharing of risk
- Enhanced corporate reputation by achieving maximum benefit for shareholders despite recognised difficulties

Naturally there is an understandable desire to be “first cab off the rank”; to add *LNG Plant Operator* to a CV; to lead LNG marketing; to be in control of ones destiny. All real. However from my perspective I’m not sure that there is a business case for forgoing shareholders entitlement to a share of around \$6 billion dollars so that my company flag is on the highest flag pole. More importantly this is surely a secondary consideration to tax payers subsidising

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<sup>5</sup> AFR 30 March 2009: Comments attributed to David Knox, MD Santos and Merrill Lynch

developments which are not capital efficient. Sure, onshore Queensland is not covered by PRRT so the subsidy is only between 30% and 40% - Corporation Tax and royalties, but it still amounts to a couple of billion dollars of forgone economic rent.

Therefore if government does indeed have “*a responsibility to ensure that present and future generations of Australians derive optimal benefit from the petroleum resources*”, it begs the question:

*“Is there a case for a more proactive role by Government in the management of our natural resources?”*

Let me make it very clear that I am not advocating or even obliquely suggesting that Government involve themselves in the commercial decision making of private enterprise. However given the responsibility of government it does not seem unreasonable that if the government, through the advice of independent experts, were to form a view that the proposed development by the project proponents resulted in a substantial reduction in economic rent relative to another option, that this difference should be redressed over the life of the project. Simply put, “guys if you want to do it your way, fine. We are not going to interfere in your commercial decision making processes. However we are not subsidising your “sub-optimal” development either. You do it your way and make up the difference.”

Inevitably there is much greater complexity than this brief overview might indicate but the incentives are substantial.

Who will make the first move; industry or government?



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**RISC Pty Ltd**

Resource Investment Strategy Consultants

**AUSTRALIA  
HEAD OFFICE**

Level 3  
1138 Hay Street  
**WEST PERTH WA 6005**

Tel: +61 (0)8 9420 6660  
Fax: +61 (0)8 9420 6690  
E-mail: [riscsupport@risapl.com](mailto:riscsupport@risapl.com)  
Website: [www.risapl.com](http://www.risapl.com)

**AUSTRALIA  
BRISBANE OFFICE**

Level 2  
147 Coronation Drive  
**MILTON QLD 4064**

Tel: +61 (0)7 3025 3369  
Fax: +61 (0)7 3025 3300  
E-mail: [riscsupport@risapl.com](mailto:riscsupport@risapl.com)  
Website: [www.risapl.com](http://www.risapl.com)

**UNITED KINGDOM  
OFFICE**

53 Chandos Place  
Covent Garden  
**LONDON WC2N 4JF**

Tel: +44 (0)20 7484 8740  
Fax: +44 (0)20 7484 5100  
E-mail: [riscuk@risapl.com](mailto:riscuk@risapl.com)  
Website: [www.risapl.com](http://www.risapl.com)