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To Mr Geoff Francis, Treasury

Consultation Paper: Options to address the design issues identified in the Petroleum Resource Rent Tax Review: Submission by ConocoPhillips

ConocoPhillips appreciates the opportunity to provide the enclosed submission in response to the Consultation Paper ('the Paper'), which canvasses issues associated with the design of the Petroleum Resource Rent Tax ('PRRT') through the 12 recommendations arising from report by Michael Callaghan AM PSM on 28 April 2017 ('Callaghan Review').

At an industry level, ConocoPhillips supports and endorses the principles raised in the separate submission on the Paper by the Australian Petroleum Production & Exploration Association ("APPEA"). Regarding Australia Pacific LNG (APLNG), of which ConocoPhillips is the downstream operator and shareholder, we also support the separate submission of APLNG.

We also attach a confidential submission, which contains economics relating to the advanced Barossa backfill project. **This part of the submission relates to the Darwin LNG and Barossa projects, and contains information that is regarded as commercial-in-confidence. ConocoPhillips ask that it be treated as confidential and is not published for public review.**

Background

Over the last 17 years operating in Australia, ConocoPhillips has invested more than $20 billion, in projects reaping over $20 billion in Government taxes. Significantly, ConocoPhillips has a proud legacy of delivering projects on time and without cost overruns, maximising returns to both contractor and Governments. We also note our ongoing contribution to the Australian energy market, with APLNG supplying more than 20% of the east coast's gas supply.

Right now, as our industry suffers a dearth of investment, we are unique as operating one of Australia's only advanced LNG projects; Barossa.

Projects in Train: Barossa

Barossa is a 'backfill' project, a ~$US8 billion undertaking required to keep DLNG running post-2021. ConocoPhillips and our partners have spent more than $1.4 billion exploring, appraising and early engineering for backfill options for Darwin LNG, with a decision on FEED expected in Q12018.

Backfill is critical to the future of Darwin LNG post-2022, an asset directly supporting over 1300 jobs, and will pay more than $5 billion in income tax to the Australian government over its 15 + year lifespan, and significant additional PRRT and company income tax payments if commodity prices recover. Barossa already has a growing project team working on pre-FEED engineering, and last month published our Offshore Project Proposal (OPP), the first under the new NOPSEMA environmental approval process and the culmination of more than 2 years' work.

However as detailed in ConocoPhillips' submission to the Callaghan review, Barossa is a marginal project in a challenging and highly competitive investment environment. Significant changes to the PRRT will render it uneconomic, costing thousands of jobs and billions in tax revenue. One of many consequences of the dramatic and sustained fall in commodity prices over the last several years is increased competition for new investment funding. In this environment, a stable fiscal regime will be critical to the viability of Barossa, which requires an investment of up to US$8 billion. Even minor changes to PRRT would signal to international investors, with shrinking capital budgets, that a market renowned for its high-cost but stable fiscal environment just got costlier and less stable and may mean Barossa fails to secure the required capital funding to proceed.

ConocoPhillips Recommendation 1: New Project Threshold

Barossa:

ConocoPhillips acknowledges the Callaghan Review's recommendations that major changes apply only to 'New Projects'. Given Barossa's advanced status in both a commercial and regulatory sense, we recommend ensuring that it be classified an existing project in the event of any changes to the PRRT.

Questions 29 and 30 in the Paper refer to the new regime applying to projects that have their production licenses come into force after amendments to the PRRT regime commence, and whether there should be a delay between when the new changes are announced and when the new regime comes into effect. ConocoPhillips recommends that the new regime apply from a start date (typically a new fiscal year) that occurs after the introduction of the relevant legislation. The new rules should NOT apply from a date of "announcement" prior to the introduction of the relevant amending legislation.

This approach is both logical and fair, and the most efficient way for government to achieve the objective expressed by the Treasurer for PRRT reform that 'care must be taken in making any changes that could impact important projects that have made advanced plans based on existing arrangements'.

APLNG:

In relation to what is considered a new project, ConocoPhillips refers to the submission by APLNG regarding the unintended consequences arising having the new regime apply only to projects that have their production licence come into force after any amendments to the PRRT regime comments. APLNG's CSG project is clearly a single commercial enterprise, however many production licenses have yet to be applied for due to the ongoing nature of the utilisation of CSG reserves. Any changes to the PRRT regime should ensure that production licenses which meet the existing criteria for combination in this project should not be considered new PRRT projects. For similar reasons, these subsequent production licenses should also be entitled to access the starting base applicable to the APLNG CSG project (ref question 33 in the Review Paper regarding Recommendation 2 of the Callaghan Review).

Recommendation 2: Changes Under Consideration

At the outset, the Paper notes that "the integrated nature of the PRRT means that all options need to be considered as a package in order to ascertain the interactions between changes to different elements of the PRRT and the effect on both PRRT payers and Government revenues". ConocoPhillips agrees with this position and therefore we make some general observations on the Paper's questions for consultation rather than individual and isolated responses.

In the event Barossa is classified as a new project, its finely-balanced economics are placed at great risk by the four categories of reform options presented. These impacts have been addressed in detail in our submission to the Callaghan review. In short, significant changes to transferability provisions, uplift rates, deductibility order or the GTPM will impose additional costs of up to $US2-4 billion, thereby reducing the rate of return by 1-2% and in many cases, render the project uneconomic.

Uplift Rate Changes

We note that the Paper raises a number of issues regarding the purpose of uplift rates - and whether they are intended to compensate for the risk borne in carrying on a project or to maintain the value of deductible expenditure and take into account the risk that the project will not produce sufficient returns to utilise its deductible expenditure.

The purpose of the carry forward rates is intended to tax the economic rent associated with projects, with the rent being a direct reflection of project risk. The Government does not pay 40% of ConocoPhillips' exploration costs, and it does not provide a 40% refund in the instance of an unsuccessful project. The theoretical notions of the low uplift rates applicable under a "Brown tax" (Brown 1948) are not reflective of our actual operating environment and the commercial reality faced by resource projects - including the issue that ConocoPhillips does not have any related PRRT projects and therefore transferability is not applicable and the risk of losing deductions is very high.

ConocoPhillips acknowledges Treasury's focus on exploration uplift rates of LTBR+15% and broad public perception as to their excessiveness in the current environment. In isolation, uplift rate changes in this category may be absorbable, but in combination with changes in any other category will be highly likely to render the project uneconomic. Particularly, ConocoPhillips notes that the General rate of LTBR+5% is substantially lower than project required rates of return and should be increased rather than decreased.

Transferability

This is longstanding feature of the PRRT system, and one which the Callaghan review did not explicitly raise as a design feature to be examined. The retention of the ability to transfer existing exploration costs is important to the Barossa project and should be maintained as this is the regime under which these costs were incurred. Changes to the rules to result in more consistent outcomes as noted in the Paper should be achievable.

Deductibility Order

The options for consideration regarding deductibility order raised in the paper appear to have the sole objective of increasing Government take. The ordering of deductions is inextricably linked with uplift rates in determining the overall outcome for a particular taxpayer. Ordering should be carefully considered as part of a holistic approach to the impact of the PRRT. Given the low uplift rates of the GDP deflator and LTBR+5% applicable to many costs (compared to risked returns on petroleum projects) and the high PRRT rate of 40% (payable in addition to income tax), ConocoPhillips believes that a rule based on deductible expenditure with higher uplift being deducted before expenditure with lower uplift is not appropriate and results in PRRT rendering otherwise viable projects uneconomic.

GTPM

ConocoPhillips wholly concurs with APPEA's submission on this issue, and notes particularly that:

- CUP's are extremely difficult to apply in practise unless they actually exist for a particular project (e.g. if an upstream gas producer is tolling through a 3rd parties LNG plant)

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- An extension of the project ringfence to include liquefaction is clearly not appropriate
- The RPM was considered appropriate by an independent consultant and was implemented after extensive consideration and discussions between industry and the Government. It has provided investors with certainty and enabled substantial investment.

Thank you for the opportunity to submit on this Paper. Please contact Patrick Hastwell with any queries on (08) 6363 2375.

Yours sincerely

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