

25 November 2013

Mr Ian Blayney
Chairman
Economics and Industry Standing Committee
Parliament House
Perth WA 6000

Dear Mr Blayney

Inquiry into the Economic Implications of Floating LNG: Request for Further Information

On 1 November 2013, CME was pleased to appear before the Economics and Industry Standing Committee to assist the inquiry into the economic implications for Western Australia of floating liquefied natural gas (LNG) operations.

At the conclusion of the hearing, and in subsequent correspondence, the Committee requested additional information to address questions unable to be covered during the hearing. Please find attached CME's response to these questions.

Should you have any additional queries, please arrange for the Committee's staff to contact Benjamin Hammer, Policy Adviser – Infrastructure, on (08) 9220 8527 or b.hammer@cmewa.com.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Reg Howard-Smith', written in a cursive style.

Reg Howard-Smith
Chief Executive

Information from CME in Response to Subsequent Questions

1. CME's submission states that LNG development is becoming less competitive in Western Australia, with several projects in the state 'estimated to be among the most costly to deliver the required rates of return on capital invested'. The Committee acknowledges that this statement is based on APPEA research, but would appreciate CME's advice on what it understands to be the required rates of return for LNG projects.

In CME's submission, figure 3 was drawn from information contained in APPEA's submission on the Commonwealth Government Treasury's Business Tax Working Group discussion paper in 2012. Figure 3 indicates the estimated gas price to deliver a required rate of return of 12 percent.

CME does not engage in commercial discussions with member companies, nor does it consider there to be a single 'appropriate' required rate of return for an LNG project. The required rate of return will vary from company to company depending on a variety of commercial considerations such as the risk profiles of particular proponents, risk profiles of investors and financiers, capital structuring requirements and conditions specified in financing arrangements.

Western Australia must endeavour to remain attractive for foreign investments in an environment where capital is limited and the state competes with emerging, resources-rich investment destinations around the world. CME considers it important rates of return reward the risk of investing the significant foreign capital required to develop LNG projects and, in turn, delivering economic benefits for the state.

2. CME's submission calls for a 'renewed, cooperative focus between governments and industry to arrest growing costs and declining productivity'. Could you please expand on that idea and advise what such a renewed, cooperative focus might involve? Please also advise what initiatives CME has undertaken to begin or foster such a focus, and what has been achieved to date.

CME considers it important for State and Commonwealth Governments and the resources sector to work collaboratively to address growing costs and declining productivity. For example, CME supports the Commonwealth Government's proposal to establish a 'one stop shop' for environmental approvals and the State Government's *Mining Legislation Amendment Bill*, which was recently introduced to parliament, aimed at streamlining Department of Mines and Petroleum environmental regulation processes and improving transparency and efficiency in approvals and compliance.

To foster this cooperative focus CME is engaging with State Government departments on issues such as the development of bilateral approval agreements and is a member of the Industry Government Working Group on Environmental Offsets and the Reforming Environmental Regulations (RER) Advisory panel, which is working to implement RER reforms.

CME has also recently undertaken direct collaboration with members and the government in preparing its submission and subsequent roundtable meeting relating to the Department of Mines and Petroleum's policies and guidelines review, which is identifying opportunities to reduce the cost of doing business in Western Australia.

CME, in collaboration with other state chambers and the Minerals Council of Australia, is engaging with the Commonwealth Government on reform of environmental approvals processes under the *Environment Protection and Biodiversity Conservation Act 1999* and the implementation of its one stop shop policy.

CME also acknowledges the cost pressures faced by governments and industry in delivering infrastructure to support resources sector projects. CME commissioned PwC to develop an infrastructure investment report to review existing State and Commonwealth Government processes, incentives and barriers for private sector infrastructure investment, and identify potential infrastructure investment frameworks that can be applied across industry, governments and private sector financiers.

The report, which included extensive consultation with resources sector and government stakeholders, will identify ways for both to efficiently and collaboratively deliver economic infrastructure through optimising commercial and financial structures. The report is now expected to be released in late December 2013.

CME notes the Commonwealth Government has recently tasked the Productivity Commission with investigating ways to “encourage private financing and funding for major infrastructure projects, including issues relating to the high cost and the long lead times associated with these projects.”¹

Ensuring a cooperative and collaborative approach between the resources sector and State and Commonwealth Governments is vital to all CME advocacy.

3. Does CME have any data on the likely impact of Woodside’s decision to proceed with Browse using FLNG technology? If CME undertook forecasting on Browse gas coming onshore at James Price Point the Committee would be pleased to receive that from you.

CME does not have any data pertaining to Woodside’s decision to propose floating LNG technology for the Browse project.

4. Your submission states that the measures in place to support local content in the resources sector are effective. Could you please advise how CME determines the effectiveness of these measures? Is CME able to provide a breakdown of local content for the various sections of the resources sector, for example, the LNG sector?

CME considers the semi-annual Department of Commerce local content reports to be an indicator of the effectiveness of existing measures to incorporate local content, such as through the state agreement acts under which resources companies are already required to ensure local suppliers have full, fair and reasonable opportunities to tender for contracts.

The trend in the local content reports is of continued improvement in rates and value of local industry participation. It is understood the November 2013 report, which is expected to be released in early December 2013, indicates:

- in the period from April to October 2013, the value of publicly announced, locally awarded, contracts since July 2011 increased from \$43 billion to around \$55 billion;

¹ Productivity Commission, 2013. *Public Infrastructure*. www.pc.gov.au/projects/inquiry/infrastructure.

- operational spending increased to \$18.65 billion², up from \$1.86 billion in May 2013 and despite the significant increase in operational spend, the overall local content percentage has not decreased; and
- estimates of 76% local content in operational spending and 74% local content in expansion and construction spending.³

5. Your submission points to a number of areas that policy development should focus on, such as government/opposition/resources sector collaboration; government investment in common user infrastructure; accessing higher value areas in supply chains via building R&D capacity; and aligning state and federal initiatives. What involvement has CME had in assisting with such policy developments? Have there been any recent developments that you could point to in any of these areas?

CME's State Growth Outlook is a biennial report into expected growth in the resources sector aimed at supporting planning and policy making by governments and resources sector companies. The 2013 State Growth Outlook identifies implications for the state's international competitiveness, investment, planning and liveability through to 2023 by assessing demand for key economic enablers: energy, people, water, roads, rail, ports and airports. Demand forecasts for these enablers are modelled from data provided by CME members and also include consideration of government policy settings.

The infrastructure investment report, detailed in response to question two, is another example of CME's involvement in assisting policy development to foster collaboration in the delivery of infrastructure. Common use infrastructure is a particular example whereby new investment models and procurement processes may assist in ensuring cost effective project delivery. The recommendations in the infrastructure investment report are expected to assist in leveraging government and industry investment to deliver such infrastructure projects.

As indicated by project proponents in several hearings, common use infrastructure, including marine facilities and supply bases, would be considered for use were they to prove economically viable solutions.

The establishment of university research positions and training partnerships demonstrates the opportunities apparent to support research and development capacity building. These partnerships aim to leverage and expand on the existing strong skills and knowledge base in the state by bringing together world class expertise, research and collaboration. Examples of such collaborative efforts include the recent appointment to the position of Shell Energy and Minerals Institute Winthrop Professor of Offshore Structures at the University of Western Australia and the establishment of the Australian Centre for Energy and Process Training.

² The Department of Commerce has indicated the magnitude of the change is not inconsistent with the expected trend and that the difference can be attributed to the annual (rather than quarterly) cycle of operational reporting, the shift from construction to operation phase for many projects, and the potential for reporting anomalies.

³ Department of Commerce, 2013. *Local Content Report, November 2013*. Perth.

6. We understand that Woodside is leading an application for seed funding for the Oil and Gas Industry Innovation Partnership to foster collaboration and make the local supply chain more competitive. Are you able to tell us what the status of that funding is and whether the Partnership is operational at this time?

CME is not aware of the current status of the application for the proposed Oil and Gas Industry Innovation Partnership, which was submitted under the previous Commonwealth Government. However, CME understands this initiative remains subject to the consideration of the new government.

7. The former federal government announced its support for funding a National Floating Systems Research Centre, a collaboration between the CSIRO and the Australian Institute of Marine Research. Are you aware of the status of this funding and this research centre?

CME is not aware of the current status of the proposed National Floating Systems Research Centre, an election commitment of the former Labor Commonwealth Government.

8. CME suggests there is a need to align federal and state initiatives as there is some duplication. You provide the *Australian Jobs Act 2013* as an example of duplication of state initiatives and obligations. Could you please provide us with some other examples and how this impacts on local content? Is it possible to determine the level of this impact?

CME supports the main objective of the *Australian Jobs Act 2013*, to create and retain Australian jobs, and efforts to create full, fair and reasonable opportunities for local companies to bid for the supply of goods and services for major projects.

However, many other initiatives, such as the Industry Capability Network, the State Government's Local Industry Participation Framework and state agreement acts, and the Commonwealth Government's Buy Australian at Home and Abroad program and Resources Sector Supplier Advisory Forum, all provide a network and collaborative environment to enhance supplier capabilities.

CME is not supportive of policies imposing or mandating local content requirements for projects and considers efforts should instead be made to foster local opportunities and increase supplier competitiveness and capacity. For example, Australian Industry Participation plan requirements are administratively onerous and will increase compliance costs. It is also unlikely to translate into the stated aim of improved local content uptake.

CME is currently working with the Department of Industry on the Act to address these concerns by providing feedback on drafts of the compliance report, Australian Industry Participation plans and category breakdowns prior to the implementation of legislation on 28 December 2013. While this consultation will not fundamentally change the Act, there is an opportunity to improve its workability and seek to reduce the administrative burden that compliance with the Act will create.

CME is unable to quantify the administrative burden from duplicative local content initiatives; however, initial member feedback is that it will be significant.

9. CME states that the introduction of NOPSEMA has resulted in a consistent regulatory approach to safety and environment regimes in offshore operations. Is this an indication that the duplication that APPEA's research found is now reduced?

CME's study into the escalating costs of doing business in the resources sector, which considered cost drivers across iron ore, gold and LNG projects, identified regulatory burden and approval inefficiency to be one of the key drivers of the high cost to do business in Western Australia. In particular, costs were incurred through delays in approvals processes, ongoing compliance requirements, lack of parallel processing and increasing levels of duplication in approvals processes across the different levels of government.

Other drivers, as referenced in CME's written submission, include changes to the taxation regime; the carbon pricing mechanism and royalty payments; challenges in attracting and retaining specific expertise and labour, and managing business systems; the move towards cost recovery for government services; greater distances to infrastructure, given the remote locations of projects; higher fuel, transport, logistics and materials costs; and increasing pressure on social and community infrastructure.

McKinsey and Company estimated regulatory approvals inefficiency and delays account for around 1.2 percent of the difference in required breakeven price for LNG landed in Japan between the Australian and the Canadian LNG project case studies.⁴

Feedback from CME members indicated the introduction of NOPSEMA had resulted in a consistent approach to the safety regime.

10. Your submission mentions several key barriers to local content participation.

- a. First, CME points to a lack of scale to develop detailed design centres. Could you please clarify what CME means here as it seems counter-intuitive given Perth's experience in LNG design over the years and the amount of activity currently being undertaken in Perth?

CME's submission cited a Department of Commerce commissioned report, which used interviews and questionnaires of individual engineers and engineering and petroleum companies to identify opportunities and barriers for local engineering participation in the first three stages of petroleum project development: concept or visualisation, front end engineering design (FEED), and detailed design.

⁴ McKinsey & Company, 2013. *Extending the LNG boom: Improving Australian LNG productivity and competitiveness*, May 2013. Perth.
www.mckinsey.com/locations/australia/knowledge/pdf/extending_lng_boom.pdf.

The findings of the report indicated several trends have impacted the global LNG sector and Western Australia's competitiveness in the sector. These trends include increasing project complexity, global cost pressures, the emergence of engineering, procurement and construction management (EPCM), the modularisation of construction and the internationalisation of supply chains. For Western Australia's local industry to be a viable option in these stages of project development, and through these trends, it needs to be competitive in terms of price, quality and expertise in addition to having the scale of projects in the pipeline to ensure continuity of work to attract and retain the appropriate skills and expertise.⁵

Despite the comparatively limited opportunities for the Western Australian engineering sector in the early stages of project development, overall local industry participation remains strong, as indicated in the Department of Commerce local content reports.

It is also important to consider the local content contribution of LNG projects, including that anticipated for floating LNG projects, over the long operational life of the projects. During operations, CME members have indicated substantial opportunities for maintenance services and research and development roles, as well as supporting industries such as catering and air transport.

- b. Second, we understand that time and cost overruns can lead to negative perceptions of projects in Australia. However, these also can be the result of poor planning and project management or a developer not understanding the environment in which they are working. Is CME able to offer any insights into how these types of issues are factored into statements and reports on the challenges of working in Western Australia?**

High project development costs and cost overruns can be attributed to many factors including long and delayed approvals processes, logistics and distances to infrastructure, and changes and uncertainty in the taxation regime, as identified in more detail in response to question nine and in CME's submission, as well as due to issues from planning and project management processes. CME notes the importance of collaborative efforts to address all cost drivers identified and opportunities are apparent to improve project management and planning. For example, in October 2012, the University of Sydney established the John Grill Centre for Project Leadership, which aims to be the world leader in project leadership executive education.

⁵ West, M. & Department of Commerce, 2011. *Assessment of the Engineering Design Capability and Capacity in the Oil and Gas Sector in Western Australia, September 2011*. Perth.
www.commerce.wa.gov.au/scienceinnovation/PDF/Publications/Engineering-DesignCa.pdf.

There are several reports comparing Western Australia or Australia against other investment destinations. The annual tax comparison from PwC's report, *Paying Taxes 2013*, shows that amongst the resources rich countries identified only Brazil and Democratic Republic of the Congo had a higher total tax rate than Australia.⁶ This is alarming for the resources sector in Western Australia given the importance of competing internationally for capital and project development dollars. When investment jurisdictions are analysed by investors, the total tax rate is a key factor in determining project attractiveness.

Similarly, since 2011, Australia has decreased by five spots to a ranking of 21 on the World Economic Forum's scale of global competitiveness.⁷ While this ranking is still an overall satisfactory result, the significance of the decrease over a short period of time, and the tax specific areas where Australia did not rank highly, are of concern as they all impact on the perception of Australia as an attractive place to do business.

- c. **Third, difficulty in recruiting skilled engineers is also listed as a barrier. Would it be fair to say that this is a barrier everywhere in that skilled engineers constitute a highly mobile workforce and companies recruit in a global marketplace? What is it about WA that makes it a particular barrier?**

Recruiting appropriately skilled employees is a challenge for the resources sector internationally. There will be future opportunities to promote floating LNG operations as a career path for engineering students across Western Australia. While the skills required for floating LNG operations are highly multidisciplinary, the development of tertiary courses and short courses for floating LNG operations could assist in addressing challenges in the availability of appropriately skilled engineers.

It is important to ensure Perth and Western Australia remain attractive places to live for skilled engineers, which constitute a highly mobile workforce, and their families. While Perth rates well in many quality of life indices, challenges include the high cost of living in the state, comparatively high income tax rates and the remoteness of work locations.

11. **CME's submission states that one of the things local fabricators and manufacturers need to do to make the most of FLNG opportunities is to develop relationships with companies in global supply chains. What, at a practical level, is CME doing to assist local fabricators and manufacturers to do this?**

CME has been a member of the steering committee overseeing a study commissioned by the Department of Commerce for the Technology and Industry Advisory Council. The study investigated the barriers for small to medium sized enterprises in the supply chain for resources sector projects and the final report will recommend ways to increase involvement by these organisations, particularly focusing on the role of technology and innovation for attaining greater involvement.

⁶ PwC, 2012. *Paying Taxes 2013: The Global Picture*. London. www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2013-full-report.pdf.

⁷ World Economic Forum, 2013. *The Global Competitiveness Report 2013-2014*. Geneva. www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf.

As indicated at the hearing, publication of the report has been delayed. The question of when the report will be released should be referred to the Department of Commerce.

12. CME suggests that resources companies have made considerable efforts to promote local participation. What are some of these efforts and how do you measure their effectiveness?

CME considers the information contained in the Department of Commerce's local content reports provides evidence of resources sector companies' efforts to promote local industry participation. Many companies' websites also detail the additional programs and applications, over and above what is required through state agreement acts, companies undertake in support of local participation.

Promoting opportunities for local industry participation is an important aspect of achieving substantial spending on local content. CME is supportive of networks, such as the Industry Capability Network and ProjectConnect, to introduce small to medium sized enterprises to available project opportunities in the resources sector.

13. Please provide a copy of CME's energy policy principle paper and CME's report on potential infrastructure investment models when they are finalised.

CME will be pleased to provide copies of both the energy policy principles and the infrastructure investment report when they are finalised, which is anticipated to be in late November 2013 and early 2014, respectively.