Jake Spiering
General Manager, Finance and Compliance

14 June 2019

Mr Geoff Francis
Principal Advisor
Corporate and International Taxation Division
The Treasury
Langton Crescent
Parkes ACT 2600

Dear Mr Francis,

Petroleum Resource Rent Tax – Review of the PRRT Gas Transfer Pricing arrangements

Chevron is one of the world's leading integrated energy companies and through its Australian subsidiaries, has been present in Australia for more than 60 years. Chevron Australia operates the Gorgon and Wheatstone natural gas projects which represent an investment of $80-plus billion and are creating enduring economic benefits on a scale never before seen in Australia. The company also manages its equal one-sixth interest in the North West Shelf Venture, operates Australia's largest onshore oilfield on Barrow Island, and is a significant investor in exploration.

We welcome the opportunity to comment on the review of the PRRT Gas Transfer Pricing (GTP) arrangements. We support the comments made in the APPEA submission that the case for major changes to the Residual Pricing Method (RPM) has not been made and that current market evidence further supports the current rules. Below we have provided some additional thoughts on specific key issues we would like to bring to the attention of Treasury.

<u>Date of Effect</u>

The effective date of any proposed rules should be prospective and only apply to new projects which apply for a Production Licence (PL) from a date after the conclusion of the review. Unlike the expenditure changes, we recommend that careful consideration is given to how pre-existing combined projects could be impacted if combined with new PLs to which the proposed rules may apply and request further consultation in this area (see section below).

<u>Combination of Projects</u>

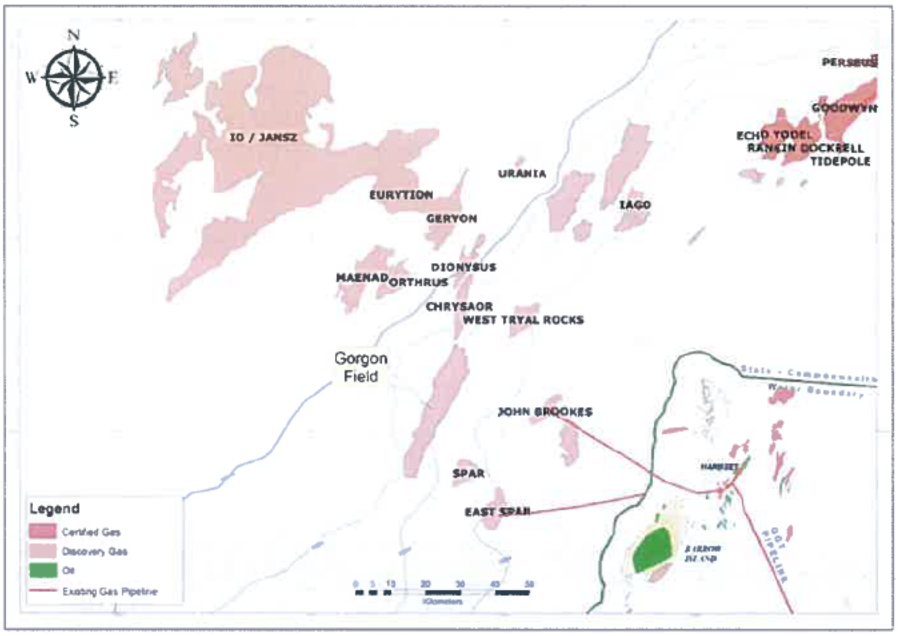
It is essential that any GTP changes recognise the lifecycle of long-term, multi-field LNG projects and how these projects are sanctioned for development. Unlike the expenditure augmentation changes, any GTP changes should not taint projects sanctioned prior to the effective date of the changes by subjecting them to new provisions if these projects are combined with PLs issued after the effective date for the changes. We are concerned that if this is the case, PRRT project combinations would no longer be feasible, causing a series of administrative, practical and tax technical issues and complexities.

Projects are sanctioned to commence production in multiple stages, which results in PLs being applied for and granted over a period of time. In Gorgon's circumstances, on 14 September 2009, the Gorgon Venturers made the Final Investment Decision (FID) for the three train LNG development and Domestic Gas facility on Barrow Island. This decision was based on the resources contained not only within the foundation fields PLs, but on the suite of resources contained within the portfolio of Retention Leases (RLs) already held in the Greater Gorgon Area.

The resources within those RLs, which were held at the time of the first PL application, are an integral part of the Gorgon Project. They were included in the project economics considered as part of the FID and were included in the 2008 Gorgon Field Development Plan submitted to the Australian Government as part of the approval for the Gorgon Project. The Gorgon Field Development Plan outlined that the development of Gorgon Project may be in multiple stages. The initial step was the development of the Gorgon and Jansz/Io fields, over which PLs were subsequently granted in 2009. This was the first step in unlocking the Greater Gorgon Area gas resources contained in the RLs, in which most of the discoveries individually lacked the robust economics to allow stand-alone development.

The foundation fields comprised of the Jansz/Io and Gorgon Fields, which covered five production license areas: WA-36-L, WA-37-L, WA-38-L, WA-39-L and WA-40-L. For PRRT purposes, a combination certificate was granted for these PLs in 2009. The Greater Gorgon RLs which were included in the FID and the 2008 Gorgon Field Development Plan were initially granted in the early 2000's (apart from one RL).

The below diagram which been extracted from the 2008 Gorgon Field Development Plan submitted to the Australian Government depicts that these Greater Gorgon RLs are located between the Jansz/Io and Gorgon Fields for which PLs and a combination certificate have already been granted:



We also note that we are required to submit an Annual Title Assessment Report to the Australian Government for each of our permits and in this report each year, for these specific RLs we have stated our position that these fields have been integral to the FID of the Gorgon Project since 2009.

We contend that:

a) Any proposed GTP changes should apply prospectively (i.e. to PLs granted following completion of the review) such that there should be no impact to existing PLs or PLs granted prior to the completion of the review; and
b) In situations where:
    a. a project has reached FID (initial FID)
    b. original PLs have been granted; and
    c. original project combination certificate was obtained prior to any GTP changes

    Then, any new PLs granted should not be subject to the new GTP rules where the PLs are added to the original combination certificate and the new PLs originated from RLs held at the time the initial FID was made.

We are concerned that if this is not the case, it will result in a significant barrier for the combination of these projects for PRRT purposes despite economically and operationally being viewed as one project and will undermine the basis of the investment decision for this multi-billion-dollar project which has just commenced operations. If this project cannot be combined, there are several practical and administrative difficulties and technical uncertainties in how the RPM will operate, including:

- Production from each individual field will need to be tracked separately;
- Currently, when products are sold, sales are not allocated to each individual field, but treated as one. Without project combinations, a singular sales invoice will need to be split by PRRT project. As sales contracts do not exist for individual fields, the split of revenue between PRRT projects could be based on an arbitrary method and depending on the PRRT profile of each individual taxpayer, split methodologies may even be different for each joint venture partner;
- Capital and operating costs would require allocation to individual fields, which is contrary to operational reality;
- Significant increase and duplication of work for taxpayers and ATO due to the increase in uncertainty in tax lodgement positions due to the additional complexities;
- Taxpayers IT systems will need to be redeveloped, significantly increasing the cost of compliance.

If project combinations did not exist, the calculation of PRRT revenue would be extremely complex and impractical, as explained in the examples above. It is for these reasons why the concept of combining is pivotal to the practical operation of the PRRT Act.

<u>Third Party Tolling Arrangements</u>

We support the comments made in APPEA's submission, and specifically, that further consideration is required for situations where common owners use an existing plant to process gas and no tolling payment is made. Technical uncertainties arise as common owners will use the pre-existing LNG facilities to process their hydrocarbons, however, unlike a new third-party arrangement, commercially no tolling fee will be charged. Based on the current regulations, the subsequent Integrated Gas to Liquid (IGTL) projects have no mechanism of recognizing the costs that would be attributable to them, however, the original IGTL costs will be reduced due to the processing of non-project product. This results in an asymmetric system and does not achieve the policy objective that the RPM should reflect the market value of the gas at the taxing point. The solution in achieving symmetry may involve allowing the subsequent IGTLs costs to be reasonable apportioned with original project's costs, achieving a similar outcome as if they were one IGTL operation. As these LNG arrangements are complex, we request further consultation with Treasury in this area to ensure no unintended consequences arise.

RPM Certainty (formulaic approach)

We believe that the formulaic approach of the RPM provides greater certainty for both taxpayers and the ATO and reduces the cost of compliance as opposed to a non-formulaic, difficult to reliably determine transfer pricing methodology. As PRRT is a key consideration in investment decisions, an RPM based on a rigid formula allows for more reliable investment decision information, as opposed to a non-formulaic transfer pricing method.

In addition to increased certainty at the investment decision stage, a formulaic approach will provide more ongoing certainty throughout the life of the PRRT project, which will reduce the tax and financial reporting risks and tax penalty exposure faced by companies. The tax and financial reporting risks are magnified by the structure of the PRRT due to the compounding effect of augmentation and the impact this has on when a project becomes PRRT payable.

We also anticipate that the administration of a formulaic approach would be simpler as there is less room for various interpretations (e.g. no need for transfer pricing expert opinions) which should ultimately result in less burden on the Australian judicial system.

Please contact Michael Fenner [redacted] if you would like to discuss any matters raised above.

Yours sincerely

Jake Spiering
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Chevron Australia Pty Ltd