Environmental Justice Australia

Fracking the Northern Territory

Environmental Justice Australia
Climate and Finance Program
www.envirojustice.org.au

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Executive Summary

In 2016 the Northern Territory government placed a moratorium on hydraulic fracturing and appointed a scientific inquiry to investigate the impacts. This report finds that inquiry defied its terms of reference to arrive at a palatable solution for industry, concluding that serious and otherwise unacceptable climate change risks could be managed. However, it would be up to government to determine how that would be done.

On 17 April 2018 the NT government lifted the moratorium on hydraulic fracturing, or fracking. A Chinese State-owned gas pipeline is set for a windfall as a result of the moratorium being lifted. The pipeline company freely admits to discussions with the NT government on the issue prior to the government's decision to lift the moratorium. Almost as proof of its influence, the company has secured an exemption from new, stricter rules for the Northern Gas Pipeline after 'working' with the NT government.

At the same time the company is being audited by the ATO for transfer pricing. The audit appears to relate to a tax dodging scheme that could see taxpayers miss out on $500 million. In addition to addressing these issues, this report raises questions about whether the company is involved in a particularly egregious form of tax evasion, a cross-border round robin financing arrangement.

This report is designed to assist the Australian public and decision-makers become aware of the actions of foreign state-owned enterprises and the influence some have on extractive industry regulation in Australia. The environmental context the industry's a significant contribution to greenhouse gases that exacerbate climate change.

Environmental Justice Australia welcomes Jemena's comments on this report and invites it to provide more information to the Australian public on its discussions with the NT government, its exemption from new national gas rules and its tax arrangements.

The laying of coal seam gas pipes across bushland in Tara, Queensland. Image: Jeremy Buckingham.

The failures of the NT fracking inquiry

In 2016 the NT government banned hydraulic fracturing and set up an independent scientific inquiry to investigate the risks of fracking in the Territory. In March 2018 the inquiry released its final report declaring risks of global emissions from burning NT gas as 'medium' to 'high'.[1] The scientists determined that risks classified as 'medium' and 'high' would be unacceptable for the moratorium on fracking to be lifted.[2]

However, the inquiry said those risks would be acceptable if emissions were offset. It concluded that the risks were manageable.[3]

In doing so the inquiry suggested a range of possible offset mechanisms. One of those was the unviable strategy of carbon capture and storage (CCS).[4]

Beyond finding that offsetting emissions 'may present a challenging task for government' the inquiry did not address the commercial viability nor effectiveness of offset mechanisms like CCS. Neither did the inquiry assess the risk of government failure to implement measures to mitigate emissions.[5] For the example of CCS, without a high price on carbon emissions, there is no regulatory nor market reason why any corporate would pursue a CCS project.

Instead, the inquiry said the decision to choose and implement offset strategies was beyond its scope.[6]

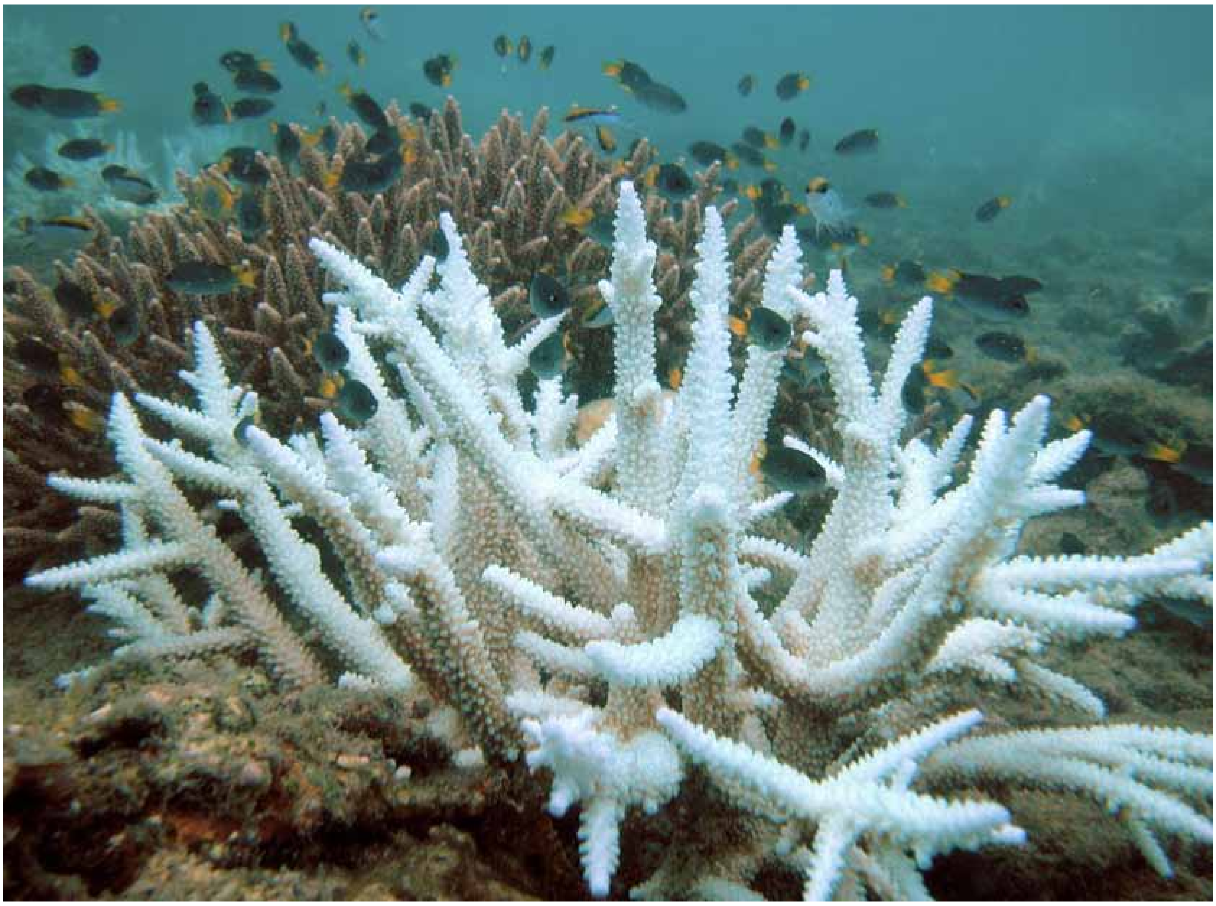
In stark contrast, the inquiry's terms of reference said the inquiry will "for every environmental risk and impact … advise whether such methods, standards or strategies can effectively and efficiently reduce the impact or risk" to an acceptable level. Climate change was one such risk.

In a world threatened by climate change, the scientific inquiry appears to use verbal sleight of hand to put forward a politically palatable solution on fracking in the Northern Territory.

The inquiry eschewed its terms of reference, passing the buck to governments while stating it had taken into account the community's distrust of industry and governments.[7]

Following the inquiry report, the NT government decided to lift the moratorium. According to the ABC, the government will release a draft offset and climate change policy by the end of the year. The government's current fact sheet is light on detail.

1 NT Fracking Inquiry Final Report, pp 220, 230
2 NT Fracking Inquiry Final Report, p 35
3 NT Fracking Inquiry Final Report, p 240
4 NT Fracking Inquiry Final Report, p 239
5 NT Fracking Inquiry Final Report, p 239
6 NT Fracking Inquiry Final Report, p 239
7 NT Fracking Inquiry Final Report p 237



The extent of coral bleaching in the Great Barrier Reef already demonstrates the impact of climate change and the importance to Australia of not increasing carbon emissions.

The future under fracking

If fracking proceeds in the NT it could lock in Australia's fossil fuel dependency for decades to come, by both the use of gas for energy, and government dependence on its extraction for general revenue from taxes.

Fracking all but guarantees a significant increase in carbon emissions, by fugitive methane emissions and burning the gas. There is no clear way of offsetting the damage. The inquiry recognised that Australia reducing its emissions in accordance with its 2030 targets would be 'a challenging task'.[8]

The serious real-world implications of the inquiry's final report conclusions will be felt by our children. There is a reason why climate change beyond 2°C is described by the Paris Agreement as 'dangerous'. It is dangerous for people and a vast range of other living creatures and eco-systems. One need only look to the Great Barrier Reef in Queensland where over half of the reef has died since 2016. Scientists say there is 'basically no way' the reef has been impacted naturally.

Before the inquiry published its final report 30 eminent scientists wrote to the inquiry citing a fracking scenario that foreshadowed emissions from fracking in the NT would contribute to 18% of Australia's total emissions. It is clear that the adverse impacts of lifting the moratorium are significant.

But corporate and sovereign interests are lining up to profit. In doing so they will externalise the costs back onto the Australian public. One such company is Jemena. It is the trading name of a company registered in Australia, SGSP Assets (Australia) Pty Ltd. The ultimate parent company is the State Grid Corporation of China, a Chinese State Owned Enterprise. It owns a controlling 60% of Jemena. The remaining 40% is owned by Singapore Power International Pte Ltd. That entity in turn is ultimately owned by the Singapore government.

8 NT Fracking Inquiry Final Report, p 211

Jemena is building the Northern Gas Pipeline that will transport conventional gas 623 km from Tennant Creek to Mt Isa in Queensland. It is expected to be operational by the end of 2018.

A report by the Institute for Energy Economics and Financial Analysis (IEEFA) released May 2016 concluded that the pipeline would be a white elephant without further NT gas supply from fracking and ongoing subsidies. In contrast, Jemena says the pipeline is commercial without extra assistance or supply.

Jemena's Northern Gas Pipeline is the only pipeline that exports gas from the NT. It is expected to reap substantial profits from the NT government lifting the moratorium. One outcome has Jemena building or accessing pipelines from Mount Isa to the Queensland coast to supply the Australian export or domestic market.

The inquiry recognised the Northern Gas Pipeline will benefit from all three economic scenarios modelled on lifting the moratorium. In the 'breeze' scenario the Northern Gas Pipeline will operate at increased capacity. According to the inquiry, the impact to the economy will largely be from profits generated by the industry.[9] Jemena is a key player. In higher production scenarios, the 'wind' and 'gale' scenarios, the Northern Gas Pipeline will be duplicated[10] providing additional profit accruing infrastructure to Jemena.

It is no surprise then that Jemena representatives have been meeting regularly with the NT government on the issue before its decision to lift the moratorium.

What is Jemena's influence on NT officials?

It is difficult to quantify the impact a company ultimately owned by a Chinese State owned enterprise can have on Northern Territory officials. However, Jemena is already getting around rules in the Territory following discussions with the NT government.

In August 2017, new national gas rules were gazetted. They increase the transparency for gas pipeline arrangements in Australia. The rules place new obligations on businesses in relation to information disclosure, contract negotiations and dispute resolution. The rules also regulate access to pipelines, and therefore effective monopolies like Jemena's Northern Gas Pipeline.

However, Jemena's 2017 financial report reveals it successfully worked with the NT to ensure some or all of the rules wouldn't apply to the Northern Gas Pipeline. The company stated:[11]

> *Management successfully worked with the Northern Territory Government to secure a derogation from the new Rules for the Northern Gas Pipeline.*

In fact, the Northern Territory government requested the derogation from the new National Gas Rules for Jemena's Northern Gas Pipeline.[12]

This new information poses serious questions about the influence Jemena and its Chinese and Singaporean owners have over government officials.

The result of Jemena's influence

The derogation from the new, national gas rules provide Jemena with an unregulated monopoly over exporting pipeline gas from the NT. In effect, it is free to set the price of access to its pipeline without the interference of the Australian Energy Regulator. The tariffs it charges will not be guided by the National Gas Rules.

9 NT Fracking Inquiry Final Report, p 355

10 NT Fracking Inquiry Final Report, p 356, 357

11 SPSG (Australia) Assets Pty Ltd, 2017 Financial Report, p 36.

12 http://gmrg.coagenergycouncil.gov.au/sites/prod.gmrg/files/publications/documents/Final%20Explanatory%20Note%20-%202%20August.pdf p47

The current National Gas Rules are contained in volume 38. Schedule 4 Part 2 contains the relevant exemption for the Northern Gas Pipeline. The exemption triggers section 216C(2)(a) of the National Gas Law. That section says Chapter 6A of the Law does not apply to pipelines excluded by the Rules. Chapter 6A of the National Gas Law covers access disputes. It sets out how access to pipelines is negotiated and if there is a dispute, how it is referred to arbitration; a process overseen by the Australian Energy Regulator (s 216A).[13]

The Northern Gas Pipeline exemption in Schedule 4 Part 2 of the National Gas Rules says that the 'access principles' agreed between the NGP service provider and the NT government apply (s 3(1)(a)).

Jemena's access principles reveal the company can change the principles at any time.[14] The principles include tariffs (Annexure 1).

Unlike all other gas pipelines subject to the rules, Jemena's dispute procedure for accessing the pipeline (Annexure 2) is not overseen by the Australian Energy Regulator. In addition, if an arbitrator makes a ruling on Jemena's disputed tariffs, that ruling is not informed by the National Gas Rules. Further, there is scope for the dispute not to be resolved, meaning Jemena can effectively shut out whoever it likes in an attempt to secure the right price.

On first glance, Jemena's access principles appear to apply only to situations where the 'Access Seeker' is subject to a Nitrogen Removal Services Agreement (s 1(c)). However, it is compulsory for the Access Seeker to enter into such an agreement. Section 20 of Jemena's access principles states 'the Access Seeker is required to enter into the Nitrogen Removal Services Agreement irrespective of whether in fact Nitrogen Removal Services are required to be performed'.

If Jemena wishes to change tariffs under the access principles there is merely a notification requirement to the NT government (s 24).

There is an important question on whether Jemena's exclusion from access rules applies to any new parallel pipeline, which Jemena is actively promoting following the lifting of the moratorium. So long as any new parallel pipeline or extension in the NT is under the current pipeline license PL 34 (not available online) then the exclusion applies.

Jemena's access principles also contemplate this possibility. Under the principles the exclusion applies for any extension or expansion to the project known as the Northern Gas Pipeline[15].

In the past, Jemena has made no secret that it hoped the moratorium would be lifted. The *Australian Financial Review* reported on 30 March 2017 in the article 'Jemena CEO hopeful of relaxation in NT fracking ban':

> *Jemena chief executive Paul Adams has voiced hope that the Northern Territory will at least partially lift a moratorium on fracking later this year in what would be a significant boost for an $800 million pipeline the company is building to take gas from the NT to east coast buyers.*

The Australian Taxation Office investigates Jemena

On the back of IEEFA's analysis referred to above, in June 2016 Environmental Justice Australia wrote to the Australian Taxation Office (ATO) asking it to investigate Jemena's corporate restructure and compliance with transfer pricing laws for $800 million in so-called 'convertible instruments'.

It worked like this: an offshore component of the group effectively loaned the Australian companies $800 million at 10.25% return per year in an agreement that would shift more than $80 million per year from Australia overseas until 2050.[16]

Instead of paying market interest rates for the return on the hybrid instrument, which could be below 5%, the guaranteed return would artificially reduce Jemena's yearly taxable income in Australia and, depending on the application of transfer

13 The 'scheme administrator' oversees the dispute process (ss 216H, 216I, 216J). Ultimately disputes that are unresolved are referred to arbitration (ss 216J, s 216K) and the arbitrator takes into account pricing in the Rules (s 216M). Provisions in the Rules can also guide the decision (s 216L). The 'scheme administrator' is the Australian Energy Regulator (s 216A).

14 Glossary definition of 'Access Principles', http://jemena.com.au/getattachment/industry/pipelines/Northern-Gas-Pipeline/Services/NGP-Access-Principles.pdf.aspx p1.

15 Section 25, Part G and the definitions in the Glossary for 'extension' and 'expansion'.

16 SPSG (Australia) Assets Pty Ltd, 2015 Financial Report, p 53

pricing rules, cost Australian taxpayers around $500 million in unpaid taxes.Recently, on 4 April 2018, more information came to light. Jemena's Australian parent company published its 2017 financial report and said:[17]

> *The Australian Taxation Office is currently conducting a transfer pricing audit in relation to the Company's convertible instruments.*

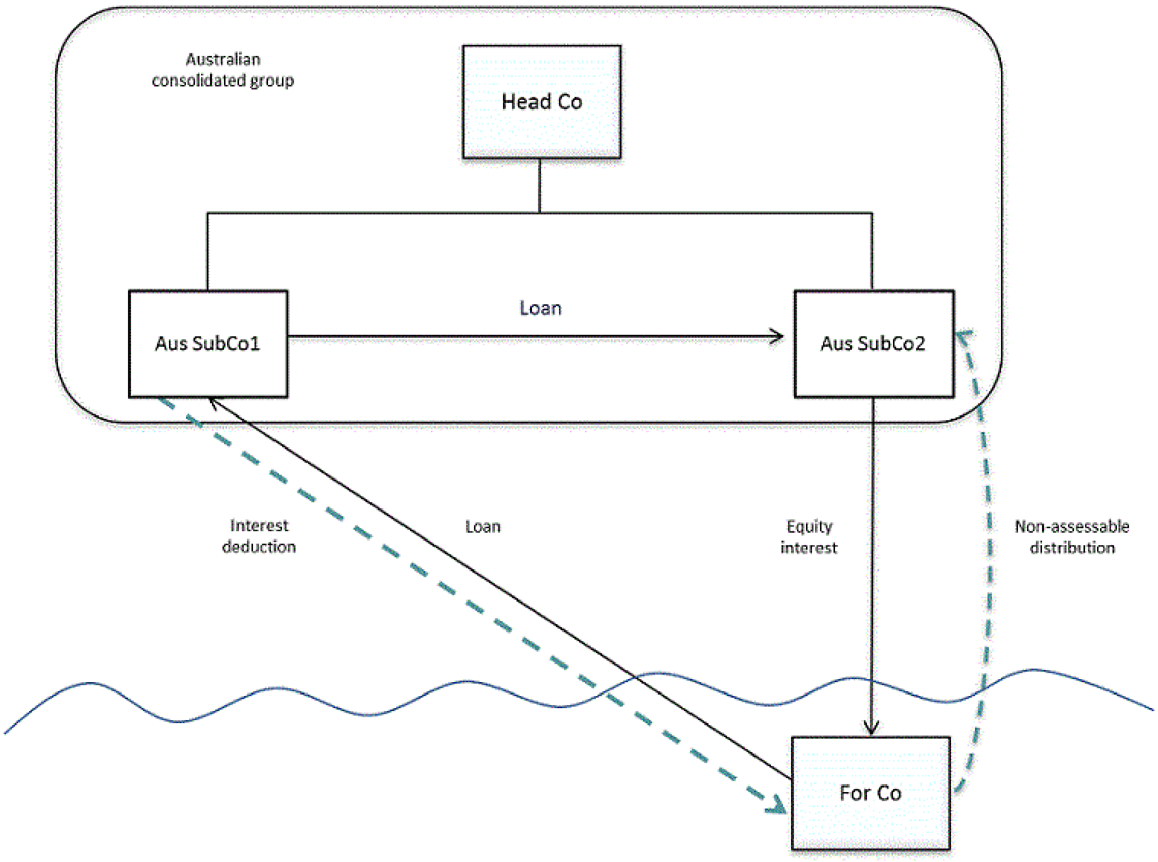
What was unknown at the time of EJA's request in 2016 was where the $800 million came from for the 'convertible instruments'. We still don't know, but one-way transfer pricing can be implemented is by a 'round robin arrangement'.

ATO investigates a 'round robin' arrangement

The ATO announced it was investigating a cross-border 'round robin' arrangement in a 2016 Taxpayer Alert. The ATO did not disclose the identity of the company under investigation.

The ATO describes a cross-border round robin financing arrangement as where a corporate entity within an Australian group funds the acquisition of equity in that same group by an offshore company. The funding to the offshore company will be at a rate much less than the offshore company receives in return for its investment back into the Australian group. The higher return to the offshore company artificially decreases the taxable income of the Australian group, leading to lesser amounts of tax payable in breach of transfer pricing laws.[18]

According to the tax office these arrangements can include paper transactions where no money changes hands. Other features might be an offshore parent domiciled in a low-tax jurisdiction that receives benefits, and the existence of hybrid instruments.[19]



One type of 'round robin' arrangement. Source: ATO

17 SGSP (Australia) Assets Pty Ltd 2017 Financial Report, p 54

18 ATO Taxpayer Alert TA 2016/10: http://law.ato.gov.au/atolaw/view.htm?docid=%22TPA%2FTA201610%2FNAT%2FATO%2F00001%22

19 As above

Has Jemena been involved in a 'round robin' arrangement?

We don't know. But Jemena's financial reports disclose information that suggest it is a possibility.

Jemena's Australian group is ultimately owned by a parent company domiciled in Singapore, a jurisdiction with a company tax rate of 17%, almost half Australia's current corporate tax rate of 30%.

Before Jemena's corporate restructure in 2015, the group benefited from a $4.2 billion trust loan from its Chinese and Singaporean shareholders.[20] The group repaid $200 million a year[21] at a rate of 4.7% per year. The trust loan was swapped with $3.2 billion in equity in the 2015 restructure.[22] This transaction could have been done on paper, with no money changing hands.

If the final $200 million trust loan repayment directly funded the $800 million convertible note issue (in a paper transaction), $600 million more would be needed for the Northern Gas Pipeline. In 2015, Jemena's unsecured bank loans almost doubled. The loans increased by $602 million to $1.185 billion.[23]

During the next year, in 2016, Jemena repaid the bankers about $900 million:[24] If that repayment included $600 million for the hybrid instruments, that $600 million would need to be found elsewhere.

The net amount of Jemena's debt securities increased by $640 million in 2016.[25] Debt securities issued by Jemena in 2016 for over A$1 billion were in AUD, USD and HKD denominations with 7 to 10 year maturity. The fixed yearly returns on the instruments were between 3.25% and 3.75%, well below the fixed 10.25% return on $800 million of convertible instruments.[26]

If the interest rates in those open market transactions were the appropriate arm's-length benchmark for the application of Australia's transfer pricing laws, then Australian taxpayers could miss out on more than $530 million in tax revenue to 2050.[27]

Jemena's public statements

The Australian Financial Review reported in 2016 that a Jemena spokeswoman had said the 'restructuring of the company had been approved by the ATO'. A key aspect of the restructure was the 'convertible instruments'. The current ATO audit raises questions about that statement.

In other publications Jemena has promoted its transparency on tax matters. In its 2016 *Tax Transparency Report* released by Jemena's parent company SGSP Assets (Australia) Pty Ltd (**SGSPAA**) states:

> *SGSPAA's Board has also approved a Tax Risk Management (TRM) Policy which is used to categorise tax risks and mandate the steps SGSPAA needs to take to manage such tax risks. This includes obtaining external professional advice and/or ATO confirmation as appropriate. SGSPAA seeks to adopt tax positions that are of low risk. Where there is uncertainty in application of the tax law, SGSPAA only adopts tax positions that are at least 'reasonably arguable'.*

With respect to international related parties, Jemena says in the same report:

> *All material international related party dealings are based on arm's length principles with supporting documentation.*

20 SPSG (Australia) Assets Pty Ltd, 2015 Financial Report, p 72
21 SPSG (Australia) Assets Pty Ltd, 2015 Financial Report, p 66, 74
22 SPSG (Australia) Assets Pty Ltd, 2015 Financial Report, p 56
23 SPSG (Australia) Assets Pty Ltd, 2015 Financial Report, p 64
24 SPSG (Australia) Assets Pty Ltd, 2016 Financial Report, p 50
25 SPSG (Australia) Assets Pty Ltd, 2016 Financial Report, p 60
26 SPSG (Australia) Assets Pty Ltd, 2016 Financial Report, p 61
27 Calculated on an arm's length interest rate of 3.75% pa and company tax rate of 30% for 34 years between 2016 and 2050

Conclusion

We invite Jemena to disclose to the Australian public further information about its discussions with the Northern Territory government on lifting the moratorium, and its forecast profits under the fracking scenarios.

Jemena should also provide information on its discussions with the NT government regarding derogation from the the National Gas Rules.

Finally, Jemena should provide more information to the public on the ATO transfer pricing audit and precisely why that audit is occurring.

Given Jemena's influence on Northern Territory government officials disclosed in this report we recommend the Northern Territory's new Independent Commission Against Corruption, which is expected to be functional by the middle of 2018, investigate Jemena's relationship with and influence on public officials.[28]

28 http://www.abc.net.au/news/2017-11-23/northern-territory-passes-laws-to-set-up-icac/9184496

About Environmental Justice Australia

Environmental Justice Australia (formerly the Environment Defenders Office, Victoria) is a not-for-profit public interest legal practice. Funded by donations and independent of government and corporate funding, our legal team combines a passion for justice with technical expertise and a practical understanding of the legal system to protect our environment.

Our **Climate and Finance** program brings legal capacity and expertise to climate and finance campaigning in Australia. Climate risks are financial risks. The Paris Climate Agreement means 'business as usual' is no longer an option. Australian regulators have confirmed climate change is a financial risk. Barristers' advice puts directors on notice for not considering the risks. Government officials must act with care and diligence. These are the new realities for investors and financiers.

But climate change risks are not being taken seriously. That's where we step in.

Environmental Justice Australia exposed serious flaws in plans for a government subsidy to support Adani's Carmichael project – a proposal for the world's largest new coal mine. The Northern Australia Infrastructure Facility (NAIF) considered lending $1 billion in taxpayers' money to a coal railway to service Adani's mine. EJA exposed NAIF board members' conflicts of interest, raised serious questions about NAIF's Risk Appetite Statement and its Anti-Money Laundering policy and advised that NAIF's officials would breach their duties if the loan proceeds.

EJA is the only legal practice in the world to file court proceedings against a bank over climate risk disclosure. In July 2017 we lodged the case in the Federal Court of Australia against the largest public company in Australia, the Commonwealth Bank. The case was brought by long-term shareholders alleging the bank failed to adequately disclose climate related risks in its annual report.

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For further information on this briefing paper, please contact:

David Barnden, Principal Lawyer, Environmental Justice Australia
T: 03 8341 3100
E: admin@envirojustice.org.au

Produced & published by Environmental Justice Australia
ABN 74 052 124 375

Telephone:	03 8341 3100 (Melbourne metropolitan area)
	1300 336 842 (Outside Melbourne metropolitan area)
Facsimile:	03 8341 3111
Email:	admin@envirojustice.org.au
Website:	www.envirojustice.org.au
Post:	PO Box 12123, A'Beckett Street VIC 8006
Address:	Level 3, the 60L Green Building, 60 Leicester Street, Carlton

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Environmental Justice Australia
Telephone: 03 8341 3100
Facsimile: 03 8341 3111
Email: admin@envirojustice.org.au
Website: www.envirojustice.org.au
Post: PO Box 12123, A'Beckett Street VIC 8006
Address: Level 3, the 60L Green Building, 60 Leicester Street, Carlton