

# Fracking the Northern Territory

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## Executive Summary

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In 2016 the Northern Territory government placed a moratorium on fracking and appointed scientific inquiry to investigate the impacts. The inquiry defied its terms of reference to arrive at a palatable solution for industry, concluding serious climate change risks could be managed, but it was up to government to determine how that would be done.

All the while a Chinese government-owned gas pipeline is set for a windfall if the moratorium is lifted. The company freely admits to discussions with the NT government on the issue. As proof of its influence, the company's latest financial reports reveal it successfully gets around new, stricter rules for its NT monopoly pipeline after 'working' with the NT government. At the same time the company is being investigated by the ATO for a tax dodging scheme that could see taxpayers miss out on \$500 million.

On 17 April 2018 the NT government lifted the moratorium on fracking.

This report is designed to assist the Australian public and decision makers become aware of the influence that foreign state owned enterprises are having on extractive industry regulation in Australia and what this could mean for climate change. It provides analysis of financial reports that might spur further discussion.

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 failures of the NT fracking inquiry

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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'.<sup>1</sup> The scientists determined that risks classified as 'medium' and 'high' would be unacceptable for the moratorium on fracking to be lifted.<sup>2</sup>

However, the inquiry said those risks would be acceptable if emissions were offset. It concluded that the risks were manageable.<sup>3</sup>

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).<sup>4</sup>

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.<sup>5</sup> 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.<sup>6</sup>

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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](#)



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 used 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.<sup>7</sup>

The NT government has now 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 future under fracking

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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'.<sup>8</sup>

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' for people. It is also dangerous for a range of other living creatures and eco-systems. One need only look to Queensland and the Great Barrier Reef.

On the cusp of fracking in the NT, winners are lining up to externalise the costs back onto the Australian public.

One such company is Jemena. It is a company registered in Australia ultimately owned by the Chinese (60%) and Singapore (40%) governments. It is building the Northern Gas Pipeline that will transport conventional gas 623 km from Tennant Creek to Mt Isa in Queensland. The Chinese interest is a State Owned Enterprise called the State Grid Corporation of China.

The NT government granted Jemena a monopoly pipeline in exchange for strict contractual requirements in the form of a performance guarantee to build the pipeline and have it up and running by the end of 2018.

A May 2016 [report](#) by the Institute for Energy Economics and Financial Analysis (IEEFA) concluded that the pipeline would be a white elephant without further NT gas supply from fracking and ongoing subsidies. In contrast, the proponent [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.<sup>9</sup> Jemena is a key player. In higher production scenarios, the 'wind' and 'gale' scenarios, the Northern Gas Pipeline will be duplicated<sup>10</sup> 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.

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<sup>7</sup> NT Fracking Inquiry Final [Report](#), p 237

<sup>8</sup> NT Fracking Inquiry Final [Report](#), p 211

<sup>9</sup> NT Fracking Inquiry Final [Report](#), p 355

<sup>10</sup> NT Fracking Inquiry Final [Report](#), p 356, 357



*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.*

## What is Jemena's influence on NT officials?

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It is difficult to quantify the impact a company owned by the Chinese and Singapore governments 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:<sup>11</sup>

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

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

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<sup>11</sup> SPSG (Australia) Assets Pty Ltd, 2017 Financial Report, p 36.

## The Australian Taxation Office investigates Jemena

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But Jemena's actions to ensure healthy profit margins aren't just restricted to successful lobbying. 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.<sup>12</sup>

Instead of paying market interest rates, which could be below 5%, the guaranteed high return would artificially reduce Jemena's yearly taxable income in Australia and, depending on the application of transfer 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:<sup>13</sup>

*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 our request in 2016 was where the \$800 million came from. One way transfer pricing can be implemented is by a round robin arrangement. This is an aggressive and egregious scheme that operates by first sending Australian company money to an entity offshore, only for it to return to Australia to be charged at a higher rate of interest, thus shifting money from Australia to an offshore entity to decrease the Australian company's taxable income.

## What is a 'round robin' arrangement?

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The ATO announced it was investigating a cross-border 'round robin' arrangement for an unidentified company in a [2016 Taxpayer Alert](#) issued three months after EJA's letter.

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.<sup>14</sup>

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.<sup>15</sup>

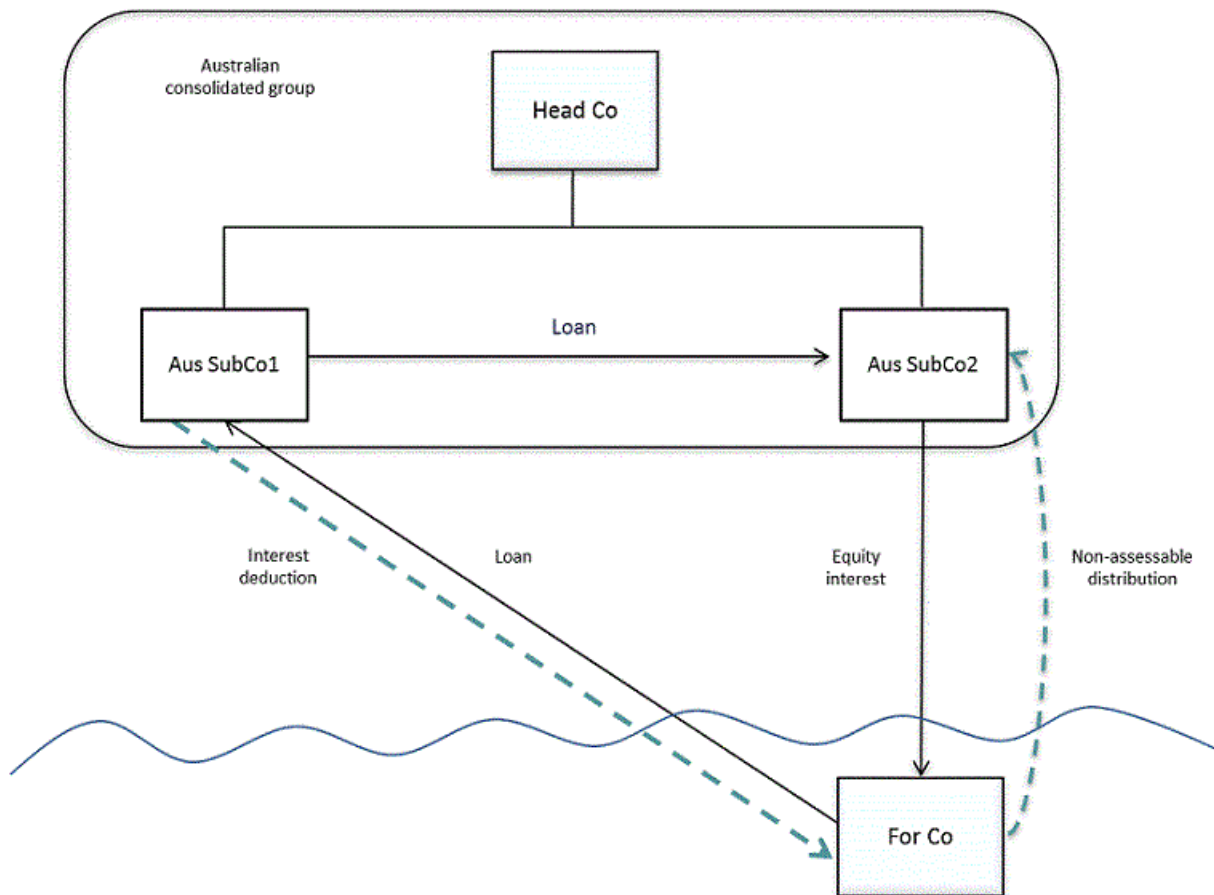
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<sup>12</sup> SPSP (Australia) Assets Pty Ltd, 2015 Financial Report, p 53

<sup>13</sup> SGSP (Australia) Assets Pty Ltd 2017 Financial Report, p 54

<sup>14</sup> ATO Taxpayer Alert TA 2016/10: <http://law.ato.gov.au/atolaw/view.htm?docid=%22TPA%2FTA201610%2FNAT%2FATO%2F00001%22>

<sup>15</sup> As above



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

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

We don't know. But Jemena's financial reports disclose some interesting information.

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.<sup>16</sup> The group repaid \$200 million a year<sup>17</sup> at a rate of 4.7% per year. The trust loan was swapped with \$3.2 billion in equity in the 2015 restructure.<sup>18</sup> This transaction could have been done on paper, with no money changing hands.

If the final \$200 million trust loan payment directly funded the \$800 million convertible note issue (in a paper transaction), \$600 million would be needed. In 2015, Jemena's unsecured bank loans increased by \$602 million, almost double the loaned amount, to \$1.185 billion.<sup>19</sup>

A year later in 2016 Jemena paid the bankers about \$900 million:<sup>20</sup> if that included \$600 million for the hybrid instruments that money would need to be found elsewhere.

<sup>16</sup> SPSPG (Australia) Assets Pty Ltd, 2015 Financial Report, p 72

<sup>17</sup> SPSPG (Australia) Assets Pty Ltd, 2015 Financial Report, p 66, 74

<sup>18</sup> SPSPG (Australia) Assets Pty Ltd, 2015 Financial Report, p 56

<sup>19</sup> SPSPG (Australia) Assets Pty Ltd, 2015 Financial Report, p 64

<sup>20</sup> SPSPG (Australia) Assets Pty Ltd, 2016 Financial Report, p 50

The net amount of Jemena's debt securities increased by \$640 million in 2016.<sup>21</sup> 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.<sup>22</sup>

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.<sup>23</sup>

## Conclusion

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

Jemena should also provide information on its discussions with the NT government and the extent of the exclusions granted by the government from 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.

Depending on the information provided by Jemena, if any, we encourage the Northern Territory's new Independent Commission Against Corruption, which is expected to be functional by the middle of this year, to investigate Jemena's influence.<sup>24</sup>



21 SPSP (Australia) Assets Pty Ltd, 2016 Financial Report, p 60

22 SPSP (Australia) Assets Pty Ltd, 2016 Financial Report, p 61

23 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

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



# About Environmental Justice Australia

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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.

Donate at: [www.envirojustice.org.au/donate](http://www.envirojustice.org.au/donate)

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