

INDEPENDENT PRICING AND REGULATORY TRIBUNIAL

Landholder benchmark compensation rates: Gas exploration and production in NSW

Santos submission | June 2015



Santos Submission: Landholder benchmark compensation rates: Gas exploration and production in NSW

EXECUTIVE SUMMARY

Santos Ltd has provided this submission to the Independent Pricing and Regulatory Tribunal (IPART) issues paper *Landholder benchmark compensation rates: Gas exploration and production in NSW*. The submission provides an overview of Santos' operations and interaction with landholders across the country, the Narrabri Gas Project, and a detailed discussion of the Santos NSW compensation scheme. The submission then responds to each of the questions set out by IPART in the *Issues Paper*.

When considering the *Issues Paper* a balance must be struck between changes which would impose additional costs and encouraging investment in resource development. Imposing additional costs could have two adverse impacts. First, increasing the costs to consumers (families and NSW businesses) of the natural gas produced. Second, potentially preventing any investment due to the costs of making the project uneconomic.

Our submission is based upon our sixty years of experience in working with landholders and state governments to strike the right balance.

In essence, NSW natural gas resources are owned by the citizens of the State. Companies such as Santos pay a royalty of 10% to the Government for the right to commercially develop that resource. Ultimately it is up to the Government to decide how it a portions the money generated from the 10% royalty payment. That is, how much general revenue, or to regional communities that host the activity or indeed landholders who co-exist with gas production or exploration.

With this in mind, our response to the *Issues Paper* is focuses on a number of key points:

- The Narrabri Gas Project land access arrangements already in place with various different classes of landholders are working. We do not believe that NSW needs to regulate or legislate commercial arrangements;
- Land access and compensation arrangements should be a commercial arrangement negotiated between the project proponent and the landholder;
- The principle that in Australia landholders do not own the mineral rights for their properties must not be legislatively compromised. The proposal to legislate the payment of benefits muddles this principle by confusing surface impacts with mineral rights;
- Payments to neighbours are already sufficiently covered by common law protections, and any issues are best avoided by environmental permit conditions;
- The proposal for upfront payments misunderstands the length of time access is required for and the need for long term relationships, possibly with successive future owners of the property;
- As stated above, if the Government wishes to appropriate a greater share of the 10% royalty payment to landholder that is a matter for it, but seeking to effectively increase the royalty take would have significant commercial consequences; and
- Several of the proposals potentially lead to conflict between landholders and their neighbours as well as add unnecessary complexity and potentially create further delays to the development of natural gas in NSW.

Santos believes it has in place highly attractive compensation arrangements for NSW landholders. During the exploration phase a private-landholder will receive in excess of \$30,000 per annum upfront. During the production phase a landholder will share in the benefits of the project by way of a compensation pool based on the royalties paid. We estimate a famer with 4 wells on his or her property would receive \$100,000 per annum (or over \$1 million over ten years).

Finally, Santos is willing to provide evidence at any proposed public hearings later this year if required.

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INTRODUCTION

The NSW Government has requested that the Independent Pricing and Regulatory Tribunal (IPART) collect information on land access agreements in order to provide the NSW Government advice on benchmark compensation rates for landholders as part of the *NSW Gas Plan*.

Santos Ltd welcomes the opportunity to assist IPART to better understand land access arrangements and compensation for landholders in both NSW and other jurisdictions.

Santos Ltd has a proud history of working with local landholders in regional areas across the country for over 50 years. We are proud of the lasting partnerships we have formed along the way. In NSW our focus is on the Narrabri Gas Project (NGP) where we have been very clear about our commitment to drill wells only when the landholder agrees to host our activities and there is a land access agreement in place.

At our Queensland operations, we have about 850 voluntary land access agreements in place with approximately 300 landholders, demonstrating agriculture activities and natural gas development can and do co-exist side by side. A recent independent survey found 9 in 10 landholders in Queensland would welcome us back. In NSW a private survey conducted by Santos of landholders in the project area found 85 per cent of landholders support us.

Our NSW compensation framework provides a valuable income stream for landholders who host our exploration and drilling activities. The framework features a land-value based payment to compensate for the amount of land utilised by Santos' surface facilities and a fee for service to the landholder. In exchange for the fee for service, the landholder signs a Services Agreement and agrees to assist with general monitoring and upkeep of the sites located on their land. A land access agreement is also negotiated.

We work closely with landholders involved in all stages of our activities to ensure they are comfortable with how we work on their land in consideration of their lifestyle and business interests.

Key Facts – Santos CSG Operations in NSW

- Surface footprint of CSG extraction is small and not permanent in nature.
- Santos surface well facilities will be generally spaced at one every 200 to 300 ha.
- During the construction phase, each well normally requires one hectare for approximately one year, decreasing to approximately 25m x 25m (or 0.07Ha) during production which lasts about 20-30 years, after which all well sites are fully rehabilitated and available for agricultural use.
- It is estimated that the surface impact over the life cycle of a project is only around one percent of the total area in which the CSG fields operate.

Narrabri Gas Project

The Narrabri Gas Project (NGP) area includes both State-owned land and private land mostly in and around the Pilliga scrub. These are the landholders we will be seeking to work with as we further develop our NSW operations.

From activities located on about 1000ha the NGP has the potential to supply up to 200 terajoules of natural gas per day, or about half of NSW natural gas needs.

The Project area covers approximately 98,000 hectares; however field operations will only be located on about one percent of that area. The gas will be supplied to the NSW market by up to 850 production wells across the life of the project, the majority of which will be drilled on State land. Santos has committed to drill wells on private land only with voluntary landholder agreements. We are also working towards an agreement with the Gomeroi Native Title claimants who have a registered claim over the Project area.

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The Project will bring substantial economic benefits to Narrabri and the region including 1,200 jobs during construction, 200 ongoing positions and \$160 million Regional Community Benefit Fund to support local and regional programs and initiatives. The Project is also expected to deliver around \$1.6 billion in royalties to the State.

Santos NSW Compensation Scheme

Exploration and appraisal is carried out to gather information on geology and natural gas composition. It involves the drilling of core holes and pilot wells.

An essential part of extracting natural gas is working with landholders. The nature of Santos' work means, at times, our facilities are located on private or government land.

Santos has always made it clear that we will only drill wells on private land where the landholder is happy to host our work.

If a landholder is not willing to sign an agreement for us to drill wells on their land, we will not go there. In 2014 we signed the *Agreed Principles of Land Access* with AGL, NSW Farmers, the NSW Irrigators Council, and Cotton Australia to reiterate this commitment to landholders.

When a landholder agrees to host our activities, we work with them to ensure they are comfortable with every aspect of our work on their land. We negotiate a land access agreement and a farm management plan which includes details of the location and timing of activities and takes into consideration the landholder's lifestyle and business interests.

As part of our commitment to minimising the impact of our work, we monitor water bores to give the landholder confidence our work is not affecting their water and progressively rehabilitate land as we work. We also ensure landholders who choose to work with us receive significant financial compensation and benefits.

Our NSW based compensation framework was developed in consultation with farming groups and landholders. Our compensation framework exceeds current statutory requirements in NSW.

Landholders receive a land-value based payment to compensate for the amount of land utilised by Santos' surface facilities as well as a \$30,000 annual service fee. In the longer term, landholders with production wells on their land will receive a share of a royalties based compensation pool, proportionate to the amount of their land Santos is utilising.

This framework provides a generous income stream for those landholders who host our exploration and drilling activities.

Compensation agreements in other states, such as Queensland, are negotiated in different ways taking into account different specific circumstances, land uses and legislative requirements.

NSW Exploration and appraisal compensation

In these examples, calculations are based on land valued at \$1,000 per hectare, with facilities over one hectare of land (an average well site).

Year One

- Santos pays 120% of the land value of the area used for our facilities
- The land value is based on the landholder's rates notice
- \$30,000 fee for service per landholder per annum, paid in a lump sum

Compensation:

\$1,200 for land utilised + \$30,000 fee for service = **\$31,200** for Year One

Year Two onwards

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- Santos pays 60% of the land value of the area used for our facilities
- The land value is based on the landholder's rates notice
- \$30,000 fee for service (paid at \$2,500 per month)

Compensation:

\$600 for land utilised + \$30,000 fee for service = **\$30,600** for Year Two and each year following for as long as activities remain on the land

Production – benefit payments

The production stage follows exploration and appraisal. During this stage production and transmission of gas occurs. A different form of agreement will be entered into with the landholder to cover a typical production well has a life span of 20–30 years.

Production compensation

Calculations are again based on land valued at \$1,000 per hectare, with facilities over one hectare of land (an average well site).

Year One

- Santos pays 120% of the land value of the area used for our facilities
- The land value is based on the landholder's rates notice
- \$30,000 fee for service per landholder per annum, paid in a lump sum

Compensation:

\$1,200 for land utilised + \$30,000 fee for service = **\$31,200** for Year One

Year Two onwards

Rather than receiving a land value based payment, landholders involved in the longer term production phase will share in a Landholders Incentive Fund.

- The Fund will be equivalent to 5% of Santos' statutory annual royalty payment
- Landholders will receive a share of the Fund proportionate to the amount of their land being utilised by Santos
- A landholder with 2–3 production wells on their property would receive approximately \$50,000 per year (inclusive of the \$30,000 annual fee for service)

KEY ISSUES IPART IS SEEKING COMMENT

Approach to review

1. *Do you agree with our proposed principles of transparency, adaptability and practicability to guide our recommendations for this review? Are there other principles that we should apply in making our recommendations?*

The *NSW Gas Plan* states emphatically “we (the NSW Government) also recognise the need to secure our future gas supply needs in NSW” and “to put downward pressure on energy prices and secure supply, we need the growth of viable gas projects.”

Any approach to landholder compensation being considered by IPART must balance two Government policies, first the need for the compensation to be “at least as good as that received by landholders anywhere in Australia” with the second, ensuring the development of natural gas fields in NSW to secure gas for businesses and home is not inhibited by unnecessary or excessive costs and regulation.

Santos therefore submits that the overarching principles should include:

- **Simplicity:** the arrangements should be simple and address the real issues to the directly involved stakeholders;
 - **Predictability:** both landholders and project proponents should be able to predict with confidence how the arrangements will work including over the long time frames of the industry; and
 - **Commercially realistic:** if the arrangements or the expectations that they give rise to are not commercially realistic they could become a veto to the industry, effectively stopping the development of a domestic gas industry for NSW.
2. *Do you agree with the four key steps in our proposed approach for this review (identify impacts, estimate compensation for these impacts, estimate benefit payments and make recommendations)? If not, what are your concerns?*

Santos agrees with the first two key steps but believes that the second two key steps could be more confusing than helpful for landholders given the often site specific factors at work in any compensation payment and land access agreement, and the different classes of landowners.

Further as discussed below Santos has serious concerns about “benefit payments” (Step 3) as discussed in the *Issues Paper*.

Finally Santos suggests that recommendations for legislative reform are unnecessary.

What impacts should landholders be compensated for?

3. *Do you agree with our preliminary view on the relevant heads of compensation for hosting CSG exploration and production (value of land occupied and loss due to severance, injurious affection and disturbance)? Are there other temporary impacts of CSG exploration and production on landholders that we should consider?*

The current legislation is broadly consistent with that in other states, where successful co-existence between landholders and the industry has been achieved. Further as the *Issues Paper* notes:

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*“Our preliminary view broadly **aligns with the impacts considered under the gas industry’s current CSG compensation arrangements**. However, it covers a broader range than provided for under NSW legislation”¹ (emphasis added)*

This doesn’t signal legislative or a market failure. IPART’s own words suggest that mutually beneficial commercial arrangements between landholders and proponents are the rule rather than the exception in NSW. This is certainly Santos experience in north western NSW.

Further, impacts on landholders (including neighbours) are also regulated by the planning conditions and approvals and environment licence conditions.

- 4. Should we consider any ‘special value’ of land and ‘loss of opportunity’ to make planned improvements on the land’ in recommending compensation for CSG exploration and production?*

These items are covered during the commercial negotiation. Any special value can be acknowledged and managed in the mutually agreed land access agreement given the flexibility to locate infrastructure, wells, access routes etc. available to the natural gas proponents.

- 5. Are there any permanent impacts on the market value of land arising from hosting gas exploration and production that we should consider?*

There is no evidence regarding negative impacts on property values in NSW, Queensland or anywhere else in Australia. This is supported by recent reports by both the Queensland Valuer General latest report on property market movements and the Valuer General of NSW 2014 property value report. In Queensland, it was reported residential land values in Western Downs have continued to increase. In NSW, the Valuer General found CSG development had “no impacts” on several recent real estate transactions.

- 6. Do you agree with our preliminary view that NSW legislative provisions for landholder compensation for gas exploration and production should be broadened? If so, how? If not, why?*

Santos supports clarity in the natural gas and resources regulatory framework. Legislative clarity around landholder compensation would bring clarity to the process, but the *Issues Paper* discusses proposals that in our view could inadvertently lead to greater confusion, and remove certainty by inappropriately introducing new players into the negotiation of land access arrangements.

We are of the view that further legislative reform is unnecessary and rather than adding certainty would in fact create further uncertainty for investors and stakeholders. This would serve to decrease investment attractiveness due to uncertainty.

The principle that land holders are compensated is well established for any and all projects, not just natural gas. It would be unhelpful to establish the precedent that other parties have an interest that must be directly compensated outside of arrangements for the broader community. Other parties are protected by the Common Law and environmental and development consents.

- 7. Do you agree with our preliminary view that our recommendations on compensation should be limited to landholders who host CSG activities and their neighbours who are directly affected? If not, why?*

Santos does not support widening compensation beyond landholders who host directly gas exploration or production activities. In our experience, compensation to neighbours is hard to identify,

¹ IPART [Landholder benchmark compensation rates](#) p.18

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quantify and to manage. The proposal does not indicate how compensation will be calculated for issues such as dust, traffic noise or how wide the net will be cast for local residents. The existing regional community benefit fund should be sufficient to adequately compensate the broader community including neighbours.

The preliminary view of IPART is that compensation should be paid to neighbours for noise or other impacts. Noise and other environmental impacts will be subject to environmental conditions in permits issued by the government. These conditions will typically over-off a range of impacts on neighbours such as:

- Noise limits on sensitive receptors
- Overland flow paths
- Dust nuisance
- Lighting for night works
- Erosion and sediment control

Were a project to breach conditions, the project proponent would be liable under the relevant environmental legislation and damages would be awarded accordingly by a court. It would be “duplicated legislation” to specify that compensation is given for impacts that are governed by other legislation. Furthermore, the environmental compliance framework ensures that effects are avoided, which is a much better outcome than compensating for effects.

Notwithstanding the provisions of other legislation, there is a common law right for parties to claim for damage caused by a project. It is therefore not necessary for further protection in law for neighbouring properties affected by the project. An example of this is where a project vehicle strikes an animal not owned by a landholder with which there is a land access agreement. Despite not being covered by a compensation agreement, Santos compensates the owner for their loss under common law obligations. Additional obligations are unnecessary.

The *Issues Paper* fails to make the case for why neighbouring landholders should be treated differently and separately from the surrounding community. We strongly support measures to ensure the community shares in the benefits. It is for the government to address the wide socio-economic impacts of its decision to allow a certain industry to develop in a particular location.

Both proponents and the NSW Government have agreed to establish a Community Benefits Fund to provide a share of the income from developing natural gas with the local community including addressing any inconveniences which may arise.

Furthermore, the opening up of compensation to parties other than landholders gives rise to a greater potential for frivolous and potentially vexatious claims. For the industry to advance in NSW, the avenues for politicised, vexatious claims must not be opened up.

Estimating compensation payments

8. Are gross margin and market rental approaches appropriate for estimating compensation for the value of land occupied? Are there other approaches that we should consider?

Santos pays compensation based on land value, which is in turn based on the landholder’s rates notice. The rates notice is based upon a widely acceptable independent valuation by the NSW Valuer General.

The Valuer General supplies land values to councils to use in setting rates. The majority of councils receive new land values for rating every three years. The regular issue of land values ensures changes in the local property market are reflected in the councils’ rates model, helping to ensure fairness and equity for ratepayers, and anyone who chooses to use the rates notice to agree land values.

It should be noted that this arrangement has been effectively endorsed by the landholders who have agreed to be part of the Narrabri Gas Project.

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9. *Do you agree with our preliminary view that because severance is site specific and highly variable, providing benchmark compensation would be of limited use to landholders? If not, how should we estimate and structure compensation for severance?*

Agree severance is site specific. Further this illustrates the overall principle that each access agreement and compensation package is commercially specific to the circumstances of both the proponent and the landholder.

10. *Do you agree with non-market valuation and relocation cost approaches for estimating compensation for injurious affection? Are there other approaches that we should consider?*

These matters should be negotiated between the landholder and proponent considering the specifics of the site and proposed works. This further illustrates the overall principle that each access agreement and compensation package is commercially specific to the circumstances of both parties.

11. *Do you agree with our proposed approaches for estimating compensation, or passing through costs, for disturbance? Are there other approaches that we should consider?*

Timing of payments

The review suggests in regard to the timing of payments that *'an upfront compensation payment would be set equal to the present value of all expected future payments'* (Section 5.6 and also section 6.3.2).

Santos does not support the proposal for several reasons including bringing forward compensation can have significant tax implications for the landholder, and compellingly, is likely to create equity issues with future owners of the property and may impede access in the future as only small remainder payments are given for ongoing operations.

The timing of compensation payments needs to be commercial decision for resource companies to make rather than a concept mandated by law. The concept can be attractive for resource companies looking to buy access, but does not create the enduring relationship required for long term projects. The review states that receiving compensation upfront rather than as ongoing annual payments would be reflected in the property price, which is optimistic regarding the transparency and sophistication of the real estate market.

The review's proposals will lead to lengthy negotiations with landholders over duration of activities, discount rates, CPI benchmarks and payment timing. It will also lead to access issues over time as landholdings change hands and ongoing annuals do not compensate owners for operations. This proposal is not facilitating access, but inviting complex commercial negotiations and thereby increasing the transaction cost of an access agreement.

Landholder Time

The review suggests that landholder time should be paid for on the basis of the average number of hours spent multiplied by an 'appropriate rate' (Section 5.5.1).

The SKM review of Queensland landholder compensation in 2010 found companies in Queensland often compensated for time to facilitate negotiations on a case-by-case basis. It also found that setting generic rates would be problematic. Payment for landholder time should not be opened up to generic rates.

The Narrabri Gas Project currently publishes generic rates on its website including a 'fee for service'. This arrangement was a commercial decision by Santos and 'fee for service' applies to negotiations with NSW landholders only.

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Estimating benefit payments

12. *Do you agree with our preliminary view that benefit payments should apply during the production phase for those landholders hosting gas development on their land? If not, why?*

Santos believes it is unnecessary to legislate benefit payments during the production phase to those landholders hosting gas development on their land.

Rather the payment or non-payment of benefits should be a commercial decision negotiated by the project proponent and the landholder. It should be noted that Energy NSW, the Santos entity developing the proposed Narrabri Gas Project has agreed to share the benefits of production with its landholders (see Attachment).

Legislating the payment of benefits (being both a payment by the State from its royalty stream and the project proponent as proposed by IPART) to landholders' risks compromising the legal principle that the Crown owns mineral resources on behalf of all citizens. The justification given in the *Issues Paper* confuses access and ownership, benefit and compensation stating:

"For this reason, we consider the nexus for the benefit payment should be the landholder who is facilitating access to the resource."²

To reiterate, the mineral resource (in this case natural gas) is owned by the State, and the proponent pays a royalty to the Crown for that resource. The proponent pays compensation to the landholder for access and any inconvenience on the surface of the land.

Further the example provided by IPART in the *Issues Paper* would result in an effective royalty rate of 11% at the well head, higher than in any other state and reducing the competitiveness and attractiveness of NSW as an investment destination. For this reason Santos strongly opposes this proposal.

Of course if the Government decides to allocate some part or even all of its royalty payment to landholders that is their decision, but this must be a separate process unrelated to the commercial agreement between proponent and the landholder.

13. *Do you agree that the costs of benefit payments should be shared between the gas company and the NSW Government? If so how? If not, why?*

Santos does not support the costs of benefit payments being shared between the gas company and the NSW Government as discussed above. We believe the compensation should be paid by the proponent as a commercial agreement with the landholder, and is not a matter for the government. However government has a role via Community Benefit Funds, royalties for the regions scheme and such like, which aim to share the benefits of natural gas exploration and production with the communities in which it occurs.

14. *Should funds for benefit payments be pooled and divided among a group of landholders that have signed access agreements? If so, how?*

Santos in NSW provides the landholders involved in the longer term production phase of the Narrabri Gas Project a share in a *Landholders Incentive Fund*. The Fund replaces the land value based payment used during exploration and will be equivalent to 5% of Santos' statutory annual royalty payment. Landholders will receive a share of the Fund proportionate to the amount of their land being utilised by Santos. A landholder with 2–3 production wells on their property would receive approximately \$50,000 per year (inclusive of the \$30,000 annual fee for service).

It should be noted that is a commercial arrangement specific to NSW with no Government payment.

² IPART [Landholder benchmark compensation rates](#) p.35

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The example in 6.3 of the *Issues Paper* of one percent of the value of the gas at the wellhead paid by both the Government and the producer would equate to 20% of Santos' annual royalty payment. This is not commercially viable in the long term. Additionally, the proposed benefits fund would be in addition to land compensation payments which under our scheme do not continue under the Landholder Incentive Scheme. Finally, agreeing the method of distributing these benefits among landholders would lead to complex and lengthy negotiations. All these factors would deter investment in NSW.

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Attachment One: The Narrabri Gas Project: Working with landholders