

# CESG High Level Policy Paper

## Proposed Coal Exploration Licence Allocation Framework

The Coal Exploration Steering Group (CESG) was established by the NSW Government in response to the Independent Commission against Corruption's (ICAC's) recommendations to reduce opportunities and incentives for corruption in the state's management of coal resources.

The Government asked the CESG to make recommendations to help improve the quality and transparency of the processes used to allocate coal exploration licences. Under its Terms of Reference, the CESG is to submit its recommendations to the Cabinet Standing Committee on Resources and Land Use for consideration and approval, prior to the Minister for Resources and Energy making a final determination. The Cabinet Standing Committee will review the effectiveness of the CESG process after 12 months of operation.

This paper sets out the framework recommended by the CESG for allocating future coal exploration licences and provides brief explanations about how these recommendations were arrived at. A flow diagram describing the allocation steps is provided at Appendix A.

In developing its recommendations, the CESG considered stakeholder submissions to the 'Interim Guidelines for the Allocation of Coal Resources', a discussion paper on the CESG's key areas of work, and input from two information sessions for key stakeholders.

### Identify an area for potential future strategic release

The CESG recommends that the Division of Resources and Energy (DRE) complete an initial identification of an area for potential future strategic release that is based on an overarching NSW identification of coal resources. The identification of a specific area will be informed by factors such as the level of industry interest in an area.

### Resource Assessment

The CESG recommends that DRE undertake an assessment of the resource in the area selected. The assessment will look at the area in terms of:

- resource body characteristics
- ease of access to resource and markets
- market characteristics
- other strategic matters.

The CESG considers that as much detail as possible should be publicly released about the criteria of this assessment.

The CESG's approach is informed by stakeholder feedback including in relation to the name of this assessment (that it be changed from 'prospective commercial viability assessment' to 'resource assessment' given that it is only with further exploration work that an area's commercial viability can be determined).

Stakeholders raised questions in relation to whether the resource assessment should come before or after a strategic preliminary regional issues assessment, and whether there should be industry input to identification and prioritisation of resource areas.

In relation to the timing of assessments, the initial step should be to identify areas where there is resource potential warranting careful identification of economic, environmental and social key issues or constraints relating to areas identified for potential release for exploration. Some assessment tasks would be undertaken concurrently to ensure the process is efficient.

The CESG considers that industry input will be critical for informing strategic releases and understanding the level of likely competition for a release area.

This resource assessment process implements ICAC's view that DRE should bring its technical geological expertise to the interagency process of decision making in relation to potential exploration licence release areas.

#### Strategic Preliminary Regional Issues Assessment ("Issues Assessment")

The CESG recommends that the Department of Planning and Environment (DPE) identify known risks and constraints relating to exploration in the identified priority area. This should take into account social, economic and environmental factors.

Stakeholders expressed strong views in relation to the proposed strategic preliminary regional issues assessment, particularly the need for community consultation.

Stakeholders also wished to see the criteria for the Strategic Preliminary Regional Issues Assessment released publicly, and ensure that specific issues such as water availability are taken into account. The CESG agrees that the community should be given the chance to provide input at the issues assessment stage and agrees and notes that the assessment will include the current understanding of available water resources. Detail about the assessment is provided in DPE's attached practice paper, *Strategic Preliminary Regional Issues Assessment* (Appendix B).

This assessment implements ICAC's recommendations 5 (that DPE provide a preliminary strategic assessment of areas considered for release) and 8 (that an assessment is undertaken of the environmental, social and economic factors of allocating an exploration licence).

The CESG notes that while ICAC used the terminology of "triple bottom line" assessments, that this describes a specific type of accounting framework, and that there is no agreed definition of this accounting framework. The CESG supports analysis of environmental, social and economic factors and agrees that this nomenclature is preferred.

#### CESG makes recommendations on an area for competitive release to Minister

The CESG should consider the resource assessment and issues assessment reports, and make a recommendation to the Minister about whether an area should be competitively released for coal exploration.

#### Minister determines area to be released for exploration following Cabinet approval

Once endorsed by Government, the CESG's terms of reference (part 2d) require that its recommendations be made public, consistent with ICAC's recommendation 6 (that the steering group's recommendations are made publicly available). It is proposed that the CESG's rationale for its recommendations also be made public to ensure the process is transparent.

#### Level of competition for area assessed

It is recommended that an assessment of the following factors should be undertaken:

- unsolicited expressions of interest in the area;

- level of likely interest from known industry players;
- potentially some form of market testing e.g. advertisements or seeking expert advice; and
- the potential economic viability of the area (e.g. whether the area concerned is geographically constrained).

The assessment should inform decisions about how an allocation area should be offered to market (including the nature of the auction process and relative weighting of cash, financial and technical evaluation).

It should also inform decisions about the how the area will be divided into exploration licenses (e.g. one or a number or at discretion of bidders).

#### Selection of approach for assessing applications

Practice Guidelines should set out the range of assessment models that may be chosen. These Guidelines should be made publicly available and should specify, for any given circumstance, the appropriate:

- auction type (will range from sealed bids where there will be limited bidders to an open ascending bid format); and
- assessment weighting that will be placed on: the value of the bid; capability (e.g. track record); and commitment to exploration (e.g. expenditure and timeframes).

This approach recognises that, as identified by the Productivity Commission, “no single method of allocating exploration permits is likely to be most appropriate in all situations in Australia”. Stakeholders also called for the allocation framework to take into account differences between, for example, underexplored and well explored areas.

#### Setting a Reserve Price

The CESG recommends that the Government set a reserve price that reflects the minimum value that it is willing to accept for an exploration licence. Practice Guidelines should set out the methodology that will be used to set this price.

Stakeholders did not raise any concerns with the proposal to set a reserve price. Some suggestions were made in relation to the possible methodology to set the reserve price, which will be worked through in the development of a detailed methodology.

The CESG’s work was informed by advice received from the Centre for Market Design at the University of Melbourne. In light of stakeholder views and this advice, the CESG considers that maximising the potential revenue from an exploration licence requires that a reserve price be set as a take-it-or-leave-it offer.

Setting a reserve price will be critical when the expected number of bidders is low, because it is more likely in that circumstance that a final price would be equal to the reserve price. However, the optimal reserve price should not depend on the number of bidders. Reserve price setting could take into account issues such as: potential size of the resource, costs of prospective mining operations, future possible market conditions.

The CESG considers that a reserve price should be set based on an objective formula based approach, rather than solely on economic value, which risks setting a reserve price that will be either too high or too low.

The CESG also considers that there may be circumstances in which the reserve price could be a nominal amount or zero, for example, when very little is known about a potential resource.

#### Applicants pre-qualify for competitive process

The CESG recommends that for each Exploration Licence offering, a short list of companies who meet the minimum requirements for being awarded an exploration licence be established.

Pre-qualification for this shortlist should include that bidders meet minimum: financial and technical capabilities; work program commitments; probity and integrity standards; regulatory compliance benchmarks and other issues such as regulatory compliance history.

The CESG considers that this prequalification process will implement ICAC's recommendations 16 (that the assessment panel conducts technical analysis of preferred companies to determine if each company has the technical expertise to undertake the exploration activities) and 17 (that the assessment panel conducts financial analyses of preferred companies to determine if each company has the capacity to fund exploration work).

#### Competitive process and the assessment of applications

The CESG recommends that Practice Guidelines set out how bids will be assessed (based on a model chosen as described above). Winning bids should be selected on the basis of:

- value of bid (this could be money to government or expenditure on work program);
- commitment to exploration (e.g. expenditure, timeframes, extent of work program); and
- capability (e.g. track record, access to funding, access to technical capability).

The scope of this assessment is important in providing a means for applicants to be assessed against their ability to deliver on the Government's strategic objectives, such as those outlined in the Strategic Statement on NSW Coal.

It also recognises that there may be allocations in areas where there is little or no competition, in which instance the value of the bid may be the reserve price (which may be nominal), so the assessment will be more heavily weighted towards other aspects of the applicant's bid.

#### Requests for an Exploration Licence for possible extension to an existing mine

The CESG recommends that an area threshold be set for existing mines seeking exploration licences for the purpose of a possible extension, or exploration projects seeking licences in order improve a mine development proposal.

For an area under the threshold, an application would be examined against defined criteria and market interest in that allocation would be tested. Even in circumstances of an extension to an existing mine, a competitive test will always be applied, and there will be no direct allocations. Above the threshold, the request may be subjected to the process described in the preceding steps above.

The CESG considers that the use of a threshold is required to support the Government's regional economic objectives, and streamline the process if an allocation is required to extend the life of an existing mine or extend an exploration area where this would support a better mine design proposal.

In this context, the allocation would be provided where it is adjacent to an existing mining lease or exploration licence. Prior to the allocation, a form of competitive testing should take place commensurate with the expected level of competition. The threshold should be set recognising that this type of allocation is for a specific purpose.

The CESG considers that this approach is consistent with ICAC's recommendation 15 that addresses the issue of an application from an existing mine being too large (that the transfer of an application for direct allocation of an exploration licence be referred to the assessment panel in circumstances where an application meets a specified threshold determined by the steering group).

#### Allocation of an exploration licence

The Exploration Licence will be allocated to the winning (in some cases the single) bidder.

Some stakeholders suggested that all landholders affected by a coal exploration licence application should be personally notified in advance. The CESG supports public notification of exploration licence applications, and recommends that a cost efficient and effective mechanism to ensure that affected landholders are notified of applications is developed.

