

MEETING OLD CHALLENGES WITH NEW PERSPECTIVES

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Minister of Energy

Introduction

Welcome to the 1991 New Zealand Oil Exploration Conference. It is with great pleasure that I open this fourth major New Zealand Oil Exploration Conference which is being hosted by the Ministry of Energy with sponsorship from the Petroleum Exploration Association of New Zealand (PEANZ).

I am especially pleased to see the number of overseas representatives attending. This reflects the international nature of the New Zealand oil exploration industry. It also shows the increasing interest explorers have shown in New Zealand over recent years and, of course, the promising results that have been obtained.

The theme of this conference is "Meeting Old Challenges with New Perspectives." This implies revitalised petroleum exploration efforts—a goal which can be achieved through enhanced co-operation between industry and government, and the need to take opportunities, and to create positive events rather than waiting for them to happen.

New Zealand, whilst having a long history of petroleum exploration, dating back to 1866, is still essentially unexplored. Tremendous possibilities exist for new discoveries, with consequent rewards for those prepared to take the calculated risks for which your industry is renowned.

Some Recent Events and Developments

One of the most significant events during 1990-91 was the conclusion to the Ngaere mining licence issue. In March 1991, the Privy Council found in favour of the Government in the dispute over the rights to develop the Ngaere sector of the Waihapa/Ngaere oil field. It determined that the Government had acted correctly within the terms of the act and within the terms of the Waihapa joint venture contract.

I see that the Solicitor-General (John McGrath) and the Chairman of PEANZ (Trevor Taylor) will be addressing this issue in their respective papers at this conference. The Ngaere case has received significant publicity worldwide, much of which has been downright wrong and of no benefit to either the petroleum industry or the New Zealand Government.

I refer in particular to an article in the May 1991 issue of *Petroleum Economist* which states that "The (Privy Council) ruling effectively declares that the Government may hijack an unlicensed area merely on the strength of a claim to be acting in the national interest." This statement is simply wrong and I am certain the 1991 Proceedings will be of great interest and will hopefully clarify any misconceptions about the case. With regard to this case I would like to make two points. Firstly, issues of conflict of interest, contractual obligations and misuse of data arose throughout this case.

The court found that the Government of the day acted lawfully and did not act contrary to any of its obligations to the non-Crown joint venturers. The Crown, as a party to any joint venture is well aware of its obligations to its co-joint venturers and will always continue to act in accordance with these obligations. Secondly, the circumstances of the case were quite unique and in no way should be looked upon as precedent-setting. This particular case should now be put in perspective and be assigned to the pages of history, while we all get on with our common objective of exploring for and winning New Zealand's petroleum resources.

On 30 July 1991, the Government announced the proposed sale of its interests in the Waihapa, Ngaere, Ahuroa and Tariki petroleum mining licences. Initial negotiations are with the Government's co-joint venturers in the Waihapa, Ahuroa and Tariki licences. However, I am aware of other parties desiring to purchase the licence interests from the Crown and the option of selling the Government's interests by competitive tender remains a possibility.

A number of petroleum companies thought that the 30 July announcement was a change in government policy on its involvement in petroleum joint ventures. This is not the case. The Government has elected to sell its interests in these particular licences in order to minimise its risk exposure in the commercial sector and to use the proceeds to retire public debt. In coming to our decision my cabinet colleagues and I were also mindful of the importance to facilitate the early and orderly development of the Waihapa/Ngaere field. In the event that these interests are sold to parties other than the co-joint venturers then the unitisation order for the two licences will provide for the orderly development of the field.

Oil Exploration and Production Plays an Important Role in the Economy

The New Zealand oil exploration and mining industry is very small on a world scale, but increasingly it is playing a more and more important role within the New Zealand economy. In the last 10 years the industry has had a remarkable growth. In 1979 there were only five prospecting licences. By 1988 this had grown to 54. There are presently 43 prospecting licences. In 1979, there were just 554 kilometres of seismic line shot. This has grown an average of 5068 kilometres per year over the past 10 years.

The last 2 years has seen a marked drop-off in oil well drilling. Total wells drilled dropped from the 18- or 19-per-year level of the previous 4 years to 7 wells in 1989 and 11 in 1990.

In 1979 there were just three mining licences, today there are twelve. Five fields are presently producing while a further seven fields (albeit smaller) are under appraisal.

In 1989 New Zealand fields produced over 1.7 Million tonnes of oil/condensate and over 6000 million cubic metres of gas, a 5 percent increase over 1988.

Indigenous gas supplies about one third of the country's energy needs, while indigenous oil and condensate have supplied about half the country's liquid fuel needs for the past 5 years. This is very beneficial to the New Zealand economy.

It is worthwhile emphasizing here the importance to the country of the Maui gasfield. It has supplied the bulk of the gas that satisfied one third of the country's energy needs. However this field is finite and is due to be exhausted early in the next century. New Zealand needs a replacement for this field.

It is up to government to make the exploration environment (which will shortly be promulgated in the forthcoming petroleum minerals programme) as attractive as possible in order to encourage exploration. I will discuss this point in more detail later.

General Government Approach to the Petroleum Industry

The existing petroleum regime in New Zealand is, in most respects, highly competitive with those of its regional neighbours; the level of government "take" is lower, and the return to companies consequently higher.

The regime is simple in its concept and operation, and has remained unchanged over the past decade. One area in which work is required, is the taxation regime for petroleum exploration and mining, (and I shall return to this subject later).

There is a need to maintain a fair balance between the respective interests of industry and the Government. The Crown's rights to a fair financial return from petroleum should be no less than that of any other resource owner. However, there must be ample opportunity for private interests to explore for and develop our natural resources, and to secure an attractive return on their investment.

New Legislation

In July 1991, two new statutes were enacted which will govern the management of nearly all natural resources in New Zealand from 1 October 1991. These are the Crown Minerals Act and the Resource Management Act, and I would like to touch briefly on some important aspects.

Of particular interest will be the petroleum minerals programme which is currently envisaged as being one of the four minerals programmes to be proposed; one each for petroleum, coal, metallic minerals, and non-metallic minerals.

The petroleum minerals programme has the purposes and objectives of establishing policies, procedures and provisions for the management of New Zealand's petroleum resource. Prime points in the petroleum minerals programme will encompass:

- the efficient allocation of rights (permits) for prospecting, exploring and mining petroleum;
- obtaining for the Crown a fair return for its petroleum resource; and
- promoting and encouraging petroleum prospecting, exploration and mining in New Zealand.

The pricing and allocation for petroleum (and other Crown-owned minerals) has long been the object of study

within various branches of government. Also both local and overseas expert opinions have been elicited by government. These studies and opinions will all be drawn upon in formulating the most favoured pricing and allocation modes and levels.

The pricing and allocation process together with all the other features of the petroleum minerals programme will, as part of the process of minerals programme development, be opened for public submission. The views of industry will especially be canvassed and considered in formulating the minerals programme to be finally submitted for ministerial approval. Please make your views plainly known. We will listen.

Petroleum-Mining Taxation

The Government is concerned that on the basis of New Zealand's existing petroleum reserves, our level of self-sufficiency in energy and liquid fuels will soon reach a peak, and will fall off rapidly thereafter. This decline will accelerate even more dramatically after 2010, with the expected depletion of the Maui gasfield. This scenario has serious future consequences for energy security, economic growth and the balance of payments in New Zealand.

Because of the long lead times required to develop petroleum resources once discovered, increased exploration must take place now to cover the expected shortfall in production.

With many other countries also seeking to reduce their dependence on imports of petroleum and petroleum products, there is intense international competition for the petroleum exploration and development dollar. Any regime which penalises this sector, is likely to cause a sharp reduction in industry investment.

It is for these reasons that the Government undertook in its election manifesto to repeal the petroleum-mining taxation provisions passed by the previous government. These provisions, now in force, go beyond the "level playing field" approach, and actually create disincentives to explore.

The principal changes brought about by the existing regime included:

- delaying the ability of companies to deduct exploration and development expenditures;
- introducing taxation of "Payments in Kind" farm-out transactions; and
- removing the ability to utilise undeducted expenditures at the end of a project.

The provisions relating to farm-in/farm-out agreements are particularly irrational. They treat farm-in expenditures on drilling as taxable licence (i.e. Asset) purchase expenditures, even though there is no identifiable asset, and even though no cash changes hands. In effect, these provisions refuse to recognise that farm-out arrangements play a crucial role in spreading risk, and they maintain the fiction that a farm-in party receives a tangible asset in return for its drilling expenditures.

The current regime is legislatively very complex, resulting in high compliance costs. A further problem is that special national interest concerns such as long term energy security were considered completely irrelevant. Recent events in the Middle East have shown how absurd this notion is.

Government Approach to Taxation

We fully intend to implement our election manifesto promise to create a tax system which is both fair and administratively simple. Specifically, we will:

- cancel the "cost of licence" system for petroleum mining and allow full deductibility for exploration expenses in the year incurred;
- allow development expenses to be written off in a manner consistent with other sectors; and
- review farm-out arrangements to achieve a neutral tax effect.

In so doing, the government's clear objective will be to establish a cost-effective and equitable tax environment which will enable ongoing exploration and development of New Zealand's hydrocarbon resources. Our policy is to bring tax treatment for petroleum exploration and mining into line with both international practice and the tax treatment of other sectors of the economy.

This policy recognises the fact that about 30 percent of New Zealand's current external debt is attributable to petroleum imports over the past 15 years. New Zealand has paid on average of \$1 billion per year for petroleum imports, representing between 60 and 100 percent of the current account deficit, depending on the year and crude oil price.

However, whilst our policy must take cognisance of regimes existing elsewhere in the world, it must also recognise the effects it is likely to have here in New Zealand. Accordingly, the fact that some other governments may offer considerable incentives to attract petroleum exploration and investment, is not in itself an argument for New Zealand trying to compete by providing an ever-increasing level of incentives, either for your industry or any other. Incentives for one sector always create a corresponding cost for someone else in the economy, and our policy must work for all New Zealand.

The Government will consider detailed policy options for a review of the existing petroleum-mining taxation within the next few weeks. Cabinet decisions on these options, once made, will form the basis for a petroleum mining taxation reform to be carried out by my colleague the Minister of Revenue, as part of an omnibus taxation bill to be passed in 1992.

These policy decisions will also influence the selection of pricing options for the petroleum minerals programme to be produced under the Crown Minerals Act. Work on the preparation of this and other minerals programmes is now underway.

Author

The Hon. John Luxton was first elected to Parliament in 1987 and achieved full Cabinet status in his second term. In October 1990 he was given two key portfolios; Housing and Energy. He was also appointed Associate Minister of Education and more recently Associate Minister of Maori Affairs.

Mr Luxton has a Bachelors degree and a post-graduate diploma in Agricultural Science at Massey University.

He is a businessman, farmer and agricultural consultant, and has worked in Africa, Southeast Asia and the Pacific for a considerable part of his working life. Mr Luxton has worked as an agricultural consultant for various multilateral agencies and governments including the FAO World Bank, United Nations Dairy Projects, Asian Development Bank and the New Zealand and West German Governments.