

THE APPLICATION OF THE PETROLEUM ACT 1937 WITH REFERENCE TO THE WAIHAPA NGAERE CASE: THE INDUSTRY PERSPECTIVE

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Abstract

The decision of the Judicial Committee of the Privy Council in the Waihapa/Ngaere case is an important decision because it had a great impact upon the contractual relations between the private sector and government in the development of New Zealand's petroleum resources.

The oil industry, with its commitment of capital and long lead times from exploration to production, requires a fiscal and regulatory environment that is both stable and consistent in its application.

The Privy Council decision, whilst vesting title to Ngaere in the Minister of Energy, unfortunately created for the industry an environment of uncertainty in respect of the application of the Petroleum Act and construction of the joint venture operating agreements which combine both private and governmental participation.

In particular these concerns are:

Reconciling the Crown's commercial and regulatory roles;

The Ministers overriding discretion in the national interest;

Strata Titles.

The industry and government must work together to resolve these matters if New Zealand is going to see the level of exploration activity that is required to address its declining indigenous hydrocarbon resources. It is hoped that through the development of the Minerals Programme, industry and government will be able to address these concerns.

Introduction

The decision of the Judicial Committee of the Privy Council in the Waihapa Ngaere case was an extremely important decision for the petroleum exploration industry in New Zealand.

It was important because it had a great impact upon the contractual relationships between the private sector and government in the development of New Zealand's petroleum resources. These relationships are the cornerstones of the current petroleum regime here in New Zealand.

The oil industry, with its commitment of capital and long lead times from exploration to production, requires a fiscal and regulatory environment that is both stable and consistent in its application.

The Privy Council decision, whilst vesting clear title of Ngaere in the Minister of Energy, and certainly providing in respect of that particular situation, unfortunately created for the industry an environment of uncertainty in respect of both the application of the Petroleum Act and the construction of the joint venture operating agreements which combine both private and governmental participation.

From an industry perspective the Ngaere case was the first in which the Minister of Energy, in exercising his discretionary powers under the Petroleum Act 1937, had

been challenged through the legal system to the highest court in the land - the Privy Council. As such it set an important benchmark against which the Petroleum Act could be interpreted. It also gave an insight into the various factors that the Minister could consider when exercising his discretionary powers under the Act. "The rules seem to have changed".

The government, whilst conscious of the industry's concerns, held the view that the Ngaere decision had not set any new parameters within which the Crown could act. Rather it had reinforced those parameters which were already there and which the industry had worked with over the past decade.

It was also stated that "Ngaere" was a unique situation in itself and could not be viewed as setting any new precedents.

Background

I will not dwell on the background of the case as that has been more than aptly covered by the previous speaker. Nor will I dwell on the legal aspects of the case as there are more qualified people than I who can cover that. Rather I will attempt to look at the Privy Council decision through the eyes of a petroleum explorer who is charged with the decision of where to invest the exploration dollar.

As all of you at this conference know, the exploration dollar is international, extremely mobile, and will seek out the best return available. In making the investment decision, the petroleum explorer will consider not only prospectivity, but also the regulatory and fiscal regime of the host country. Does it offer a fair return to both the owner of the resource (in New Zealand, the Crown) and the petroleum explorer? And is it clear, consistent and stable?

It is also important to note that since the Ngaere decision the petroleum fiscal and regulatory environment has changed or is in the process of change.

For example:

- (i) As from 1 October 1991 the Petroleum Act 1937 is superseded by the Crown Minerals Act.
- (ii) The Crown Minerals Act requires the Minister to establish a "minerals programme". The purpose of such a programme is to "establish policies, procedures and provisions to be applied in respect of management of any Crown owned mineral".
- (iii) The Minister in the 1991 Budget announced that he would be entering into negotiations with his Waihapa co-venturers to sell to them the Crown's interests in Tariki, Ahuroa, Waihapa and Ngaere.

It is against this background that I will attempt to outline some of the concerns of the industry, in respect of the Ngaere decision. In addition, I will indicate where appropriate, steps that have subsequently been taken by some of PEANZ members in an attempt to mitigate these concerns.

Government Participation in Petroleum Joint Ventures

Since 1975, Crown participation through active involvement, at both the exploration and development stages, has been an integral part of the role which the government fashioned for itself under the Petroleum Act and the published policy regime.

Crown participation is currently set at an 11 % non-contributory interest during the exploration stage of a licence, converting to a full contributory interest upon the issue of a mining licence. At that time the Crown has the right to increase its contributory interest by a further 15 %.

The joint venture operating agreement has been the accepted vehicle for recording and administering such participation.

The standard joint venture operating agreement handled this by acknowledging the Crown as a full participant, being able to vote in its full interest from day one even if that interest was non-contributory.

It was the view of the industry, that the Privy Council's decision seriously undermined the enforceability of joint venture operating agreements where the Crown was a participant.

This was due to the perceived potential for conflict between the Minister's statutory powers, both regulatory and commercial. In particular:

- (i) The application of provisions regarding the use of confidential geological information.
- (ii) Area of mutual interest clauses.
- (iii) Preferential rights of assignment.

As we all know these provisions and covenants in a joint venture operating agreement go right to the full scope of the joint venture relationship.

Accordingly some licensees have considered it appropriate to modify the documentary basis of the relationship between the Crown and private mining companies.

One such approach has involved the adoption of the concept of "no pay, no say". That is the Crown has no vote in respect of operating committee decisions until its interest becomes contributory, normally when a mining licence is issued. Under this approach the Crown, as an observer/contributor, attends all technical committee meetings, but attends the operating committee meetings at the discretion of the joint venture partners.

Another approach is the use of two separate agreements.

The first, the joint venture operating agreement, is made among the mining companies. The second is a participation agreement between the joint venture and the Minister of Energy, acting on behalf of the Crown. Under this approach, the mutual obligations of the mining companies in the first agreement are not rendered totally illusory by being unenforceable with respect to all parties.

Government participation is dealt with in the second contract on the principles of statutory purposes, so as not to confuse them with commercial duties.

Requirement for Separate Agreements

It is also inferred from the Ngaere judgement that joint venture agreements take their entire meaning and effect from the petroleum licences to which they refer. Therefore, the ability of the participants to conduct activities and impose obligations on one another beyond the limits of existing licences, is questionable.

Accordingly, it would be prudent for any oil explorer to ensure that there are separate agreements for processing, transporting and marketing where these activities are to be conducted outside the geographical boundaries of the licence.

Licence Boundaries

According to the Privy Council, the clearest way to avoid the misfortune of the Waihapa Joint Venture, whose discovery extended into unlicensed lands, is to conduct prospecting work while the discovery is still within the limits of the Petroleum Prospecting Licence (PPL). Obviously this observation comes with the benefit of hindsight.

However, this does mean that petroleum mining companies must be careful to advance their testing and exploration programmes to potentially productive formations, so that results can be interpreted prior to the expiration of the PPL and the surrender of lands required under Section 11 procedures.

This presents a particular dilemma for planning and approval of authority for expenditure particularly where, as in Waihapa, the productive horizon is not the initial target of the work programme. Another alternative would be to ensure that the area of the mining licence application covers all potentially prospective zones, prior to the relinquishment of the prospecting licence.

Section 20: Extension Applications

The Ngaere decision cast a great deal of uncertainty over a Section 20 application for extension of existing licence areas. The decision confirmed that:

- (i) The Minister would, before awarding an extension have to take into account national interest considerations.
- (ii) Economic gain for the Crown is one of the national interest considerations.
- (iii) The Minister's view as to what is in the national interest is a matter for him alone, and cannot be challenged by the courts.

When considering the above, the industry could be excused for viewing the Minister as a potential rival to an extension of an existing mining licence, where the discovery in that licence is found to naturally extend into unlicensed lands.

Records do show, however, that numerous Section 20 applications have been granted over the years, including extensions of mining licences. Some have been granted since the decision to award the Ngaere licence.

Of concern to the industry was this question: what was so different in respect of the Section 20 application for Ngaere, to make the Minister exercise his national interest discretion by awarding the Ngaere licence to himself.

The new Crown Minerals Act which will supersede the Petroleum Act from 1 October has attempted to address some of these concerns. I would strongly urge petroleum explorers to become very familiar with that Act. In particular, to pay special attention to the terms and conditions of the prospecting, exploration and mining licences that will be issued under the Act.

These terms and conditions when read in conjunction with the Act, will have a large bearing on your rights to any discovery.

Strata Titles

The High Court in its original judgement found that the Waihapā licensees under the Mining Licence had a right to prospect the whole licence to whatever depth they chose but not the right to a mining licence over any new discovery.

The potential problem of a mining licence holder is this; while the licensee can explore other strata in his or her

licence with impunity, he or she has no automatic right to a mining licence in the event of a discovery.

The Court of Appeal subsequently reversed this finding by ruling that the Waihapā Mining Licence entitled the joint venture to mine for petroleum anywhere within the area of that licence, subject to the Minister's approval of a work programme.

To the industry, the Crown seems to have accepted this aspect of the Court of Appeal judgement by not pursuing the issue with the Privy Council.

This matter, however, is addressed in the new Crown Minerals Act, where Section 30(5) gives the mining permit holder rights to further discoveries made. From my reading of the Act that right, however, is not automatic. It is at the Minister's discretion.

Sections 30 through to 32 also firmly entrench for the first time in New Zealand the concept of "strata titles" at the prospecting, exploration and mining stages.

The industry and Government must work together to resolve the issues raised by Ngaere, if New Zealand is going to be in a position to attract the international exploration dollar so as to meet the level of exploration activity required to address its declining indigenous hydrocarbon resources.

The government has acknowledged our concerns, and meaningful discussions have taken place between industry and officials. Further dialogue is planned.

It is hoped that through the development of the Minerals Programme under the new Crown Minerals Act, which enables open public participation, industry and government will be able to address these concerns.

If a conducive, stable and consistent fiscal and regulatory environment can be established that will secure industry confidence, I am sure that the petroleum exploration industry will respond with the investment and exploration activity that is required to provide some possibility of ensuring continued supplies of indigenous hydrocarbons.

Author

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