

THE LEGISLATIVE OPERATING CLIMATE, WITH PARTICULAR CONSIDERATION TO PETROLEUM PERMIT AND LICENCE ALLOCATION

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Abstract

In determining whether or not to invest in an area, there are various criteria an exploration company needs to consider. One of these is the petroleum regime or operating environment a country has to offer. This includes consideration of how to obtain a permit, rules in respect of ongoing permit compliance, rights to develop a discovery, conditions of permit grant, in particular, the royalty regime, the taxation rules and general matters concerning the investment climate.

This paper outlines where to obtain further information on these matters, particularly concerning petroleum permit and licence allocation and management. It discusses the Minerals Programme for Petroleum which is planned to be issued later in 1994. This document's purpose is to establish the policies, procedures and provisions to be applied in respect of the management of petroleum.

It is presently available in draft form. There will be an opportunity for interested parties to make submissions on it prior to its finalisation.

Introductory Song

"Oh let me tell you now of all the many great advantages;
of coming to New Zealand as Petroleum Explorers;
We know its very difficult to find that useful oily stuff;
It costs a lot of money and there is a lot of risk.
It costs a lot of money and there is a lot of risk.

The most important thing for you to know/is when you find it;

That you can benefit from your investment and discovery;
The Legislative Framework is accordingly important;
And that is what my talk to you today is all about.
And that is what my talk to you today is all about."

(To the tune of Gilbert and Sullivan, the Model of a Modern Major General).

The legislative operating environment, or the petroleum regime, that a country has to offer is one of the key determinants that a company wanting to invest in an area takes into account in formulating its investment decision.

The New Zealand Government recognises this and the importance of getting the regime right in order to provide for continuing investment in petroleum exploration and mining in New Zealand, a stated policy objective of the Government. In recent years, the Government has given considerable attention to developing legislation which provides for investment to take place; for those making the investments to have a stable, fair and open investment environment with government intervention only when considered absolutely necessary because other approaches are not working; and for the people of New Zealand to know that investment must meet acceptable health and safety standards and have acceptable impact on the environment. This includes getting

the framework right for investment in petroleum exploration and mining.

This paper discusses the Crown Minerals Act 1991 and initiatives being taken under this Act to encourage investment in petroleum exploration and development.

Other initiatives which have been taken to directly or indirectly encourage investment in petroleum exploration and development include reform of petroleum exploration and mining taxation, further deregulation of foreign investment rules, the establishment of the Resource Management Act 1991 and the Health and Safety in Employment Act 1992, gas sector deregulation and overall energy sector deregulation.

The Crown Minerals Act 1991

The Crown Minerals Act 1991 provides that all petroleum in a natural state in New Zealand, the Territorial Sea (the 12 mile limit) and the Exclusive Economic Zone (the 200 mile limit) is owned by the Government of New Zealand.

The Crown Minerals Act provides for the ongoing management of petroleum by the Government and is the legislation which provides for companies to obtain a permit to prospect, explore or mine petroleum.

Fundamental to the operation of the Act is the requirement that the Minister of Energy is:

- to prepare minerals programmes
- to carry out and exercise his or her functions in accordance with the relevant minerals programme (notably granting of permits and related matters)
- to monitor the effect and implementation of minerals programmes

What are minerals programmes?

The Crown Minerals Act describes the purpose of minerals programmes:

To establish policies, procedures and provisions to be applied in respect of the management of any Crown-owned mineral that is likely to be the subject of a permit application under the Crown Minerals Act 1991.

The Act details what specific policies, provisions and procedures are required to be included at sections 12 and 15 in particular.

In summary, minerals programmes are about:

- stating what government's policies are in respect of exploring for and mining a particular mineral
- defining the allocation regime, including the royalties to apply, conditions of permit grant, the permit holder's rights and obligations and the circumstances in which the Minister will consider changing the permit and thus the permit holder's rights and obligations

Minerals Programmes are another part of the government's policy direction to make New Zealand supportive and inducive to investment.

The Minerals Programme for Petroleum has the aim to provide certainty to investors as to the conditions under which permits to prospect, explore or mine may be granted. When finalised, it will detail the operating rules and thus the petroleum regime investment parameters.

Discussion of Some Allocation Provisions of the Draft Minerals Programme for Petroleum

A few of the provisions outlined in the Draft Minerals Programme for Petroleum which are fundamental to people considering petroleum exploration investment will now be discussed. It is emphasised that these are proposals and are presently under consideration as part of the Maori and public consultation on the Draft Minerals Programme for Petroleum (refer sections 4 and 16 of the Crown Minerals Act 1991).

Types of permit

There are three types of permit that may be obtained.

Petroleum Prospecting Permits allow a company to undertake reconnaissance and general investigative studies over large areas. More than one permit may be issued over the same area. Permits are generally granted for a period of one year.

Petroleum Exploration Permits are granted for the purpose of undertaking work to identify petroleum deposits and evaluating the feasibility of mining any discoveries made. Exploration activities include geological, geochemical and geophysical surveying, exploration and appraisal drilling and testing of petroleum discoveries. These are issued for a five-year period. There is a five-year renewal option, at which stage, however, 50 per cent of the original permit area must be surrendered. Petroleum exploration permit holders have exclusive exploration rights and the right to the award of a subsequent mining permit if a petroleum discovery is made.

Petroleum Mining Permits are granted to enable the development of a petroleum field with the purpose of extracting and producing petroleum. The term granted depends on the size and production schedule for the field. An extension of term is permissible. There is a maximum term of 40 years.

How to obtain a permit

Prospecting permits, it is proposed, may be applied for at any time. Applications are made by companies wanting to undertake preliminary investigations of the petroleum potential of an area. This may be preliminary to considering obtaining an exploration permit over an area; or may be a research company seeking to obtain data to on-sell. Prospecting permits will not be granted over land which, at the time of application, is held under a petroleum privilege (unless the existing privilege holder gives permission to do so) and there may be restrictions on granting a prospecting permit over land which is planned to be advertised in a petroleum exploration permit block offer. Where a non-exclusive petroleum exploration permit is held, the data obtained is confidential to the party obtaining it for five years (even though the permit will have expired or been surrendered before this time).

Exploration permits, it is proposed, may be allocated in accordance with either

A Petroleum Exploration Permit Block Offer or

An Acceptable Frontier Offer Application

Most petroleum permit applications are for exploration permits.

Petroleum Exploration Permit Block Offers are proposed to be held regularly. Blocks may be advertised as being available for application either by staged work programme bidding or cash bonus bidding. Staged work programme bidding is the predominant allocation method. Cash bonus bidding may be used for areas which are considered to be highly prospective, where there is known competitive interest and over which there exists a good petroleum exploration information database. Generally, a period of six months is allowed for companies to formulate and submit a bid.

A Rolling Two-Yearly Indicative Petroleum Exploration Permit Blocks Offer Schedule is proposed to be published, quarterly in the magazine "Petroleum Exploration in New Zealand News" and would advise the areas where it is planned to hold Petroleum Exploration Permit Block Offers.

A "Notification of Interest" may be lodged by companies interested in exploring a particular area and, if this is accepted, the area will be included in the Indicative Petroleum Exploration Permit Blocks Offer Schedule.

For Staged Work Programme Bidding where there are competitive bids, generally speaking, the applicant proposing the best staged work programme shall be the successful bidder. Committed exploration work most likely to result in information on the petroleum potential of an area is generally favoured ahead of contingent work.

For Cash Bonus Bidding, the exploration permit is awarded to the applicant who has made the highest cash bid, always provided that the applicant is considered satisfactory taking into account such matters as technical and financial capability. Where an exploration permit is awarded by cash bonus bidding, the permit holder is required to drill at least one exploration well within three years of the commencement date of the permit.

Acceptable Frontier Offer applications may be made at any time over permit sized blocks, except onshore New Zealand and over land under consideration or advertised for a Petroleum Exploration Permit Block Offer. There are also restrictions on the receipt of Acceptable Frontier Offer

applications over an area within a reasonable distance of a new discovery; and the Minister may advise from time to time that an area is unavailable for Acceptable Frontier Offer applications.

Acceptable Frontier Offer allocation provides the opportunity for explorers to initiate immediate intensive exploration effort without the need to have a permit application considered as part of a block offer. There are minimum exploration requirements which must be satisfied in order to be granted a permit by this allocation method. In brief, depending on whether or not there has been recent geophysical or well drilling activity in an area, a well commitment must be given and drilling undertaken within either two years or three years of the commencement date of the exploration permit.

Mining Permits are primarily granted as a result of an explorer having made a discovery under a petroleum exploration permit (or a petroleum prospecting licence granted under the Petroleum Act 1937. This Act was superseded by the Crown Minerals Act on 1 October 1991 but the latter provided for existing petroleum rights to continue). Exploration permits (and petroleum prospecting licences) are granted such that the permit holder has a subsequent right to obtain a mining permit in respect of any discovery made, always provided there is an acceptable development work programme.

Conditions of grant of permit

The Minister of Energy grants permits subject to the permit holder complying with a number of conditions. These include the permit holder:

- Making all reasonable efforts to diligently prospect or explore or mine (as appropriate) the permit in accordance with good oilfield practice.
- Undertaking a defined programme of work. The work programme in most instances would have been provided with the permit application and approved by the Minister in making the decision as to permit grant.
- Payment of a royalty on any petroleum produced and sold or used in the production process as fuel or for other purposes, at the rate and in accordance with the provisions outlined in the permit.

The royalty regime

A new royalty regime will commence with the inception of the Minerals Programme for Petroleum. It is proposed that this will provide for the payment either of a 5% ad valorem royalty or a 20% accounting profits royalty, whichever is the greater in any given year.

The accounting profits royalty is payable on the net accumulated accounting profit of production from a petroleum field for that year. Assessments are based on the costs associated with extraction, processing and selling of products and takes into account the price received from products.

This royalty regime will apply to new permits. The previous regime provided for an ad valorem royalty of 12.5% to be paid on the selling value of all petroleum produced from a permit (with defined allowable deductions). The New Zealand Government also maintained an 11% Carry Contributory Interest (CCI). All petroleum prospecting licences granted under the Petroleum Act 1937 have this regime and also permits granted in 1992 and 1993 under the Crown Minerals Act.

The new royalty regime has been designed to be internationally competitive and to encourage exploration and mining in New Zealand.

Readers should refer to the *Draft Minerals Programme for Petroleum* for a fuller discussion of the proposals. The Executive Summary gives an overview of the proposals which are set out in some detail in the body of the text. In particular, there is a very detailed outline of the proposed royalty provisions.

The *Draft Minerals Programme for Petroleum* will be under discussion until mid June 1994. It is tentatively scheduled to have the finalised programme in place by October 1994 (this date is dependent upon the passage off the consultation process and whether major changes are considered necessary to the Draft proposals).

When in place, the Minerals Programme for Petroleum will provide detailed investment parameters for petroleum exploration and mining companies interested in New Zealand. It will provide a good basis for aggressively attracting exploration investment to New Zealand.

For further advice and information, readers are advised to contact the Authorisations Unit, Crown Minerals Operations Group, Energy and Resources Division, Ministry of Commerce, PO Box 1473, Wellington, Telephone (04) 473 0030, Facsimile (04) 499 0968.

Permit Holders Rights and Obligations

- A permit holder has the right to any petroleum discovered within the framework of the permit.
- Exploration and mining permits confer exclusive rights to the permit holder. (The Minister may provide for non-exclusive exploration permits but this is expected to occur rarely).
- An exploration permit holder has the right to appraise any discovery made, subject to there being a satisfactory appraisal programme. A special extension of duration of an exploration permit can be granted for this purpose.
- The permit holder is obligated to comply with the conditions of the permit, relevant Acts and Regulations.
- Compliance includes forwarding reports to the New Zealand Government relating to the progress of all prospecting, exploration and mining activities. Copies of all reports are required to be forwarded in accordance with the Crown Minerals (Petroleum) Regulations.
- Compliance also includes payment of annual fees as specified in the Crown Minerals (Petroleum Fees) Regulations 1993.
- The granting of a permit does not confer a right of access to any land.
- A permit holder must comply with the requirements of other Acts and Regulations, in particular, the Resource Management Act 1991 and the Health and Safety in Employment Act 1992 (discussed further below).

Permit Transfers and Amendments

- Once a permit is granted, interests may be freely transferred by farm-out arrangements. Interest transfers must be registered with the New Zealand Government within three months of the transaction taking place.
- A permit holder may apply in writing to amend the conditions of a permit, to extend the land or minerals to which the permit relates, or to change the duration of the permit.

General Operating Environment

The New Zealand Government is supportive of petroleum exploration. Both domestic and overseas exploration investors are welcome, with no special privileges or priorities given to domestic companies.

There are, however, taxation advantages for all New Zealand registered companies. Overseas companies are encouraged to register subsidiaries in New Zealand.

There are various useful guides for potential investors in New Zealand including *An Introduction to Investment in New Zealand* by Russell McVeagh McKenzie Bartleet and Co, PO Box 10-214, Wellington and investment information from the Ministry of Foreign Affairs and Trade, Private Bag, 18-901, Wellington.

The Taxation Regime

New Zealand has a special petroleum exploration and mining taxation regime. It is based on a desire to enhance investor confidence. The objective of the provisions is to achieve broad international comparability in the tax treatment of petroleum exploration and development expenditure. In summary, the regime provides for the following:

- Immediate deduction of exploration expenditure in the year incurred. Appraisal work is included as exploration expenditure.
- Appraisal wells subsequently used for production purposes are subject to a claw-back provision, but not with interest.
- Development expenditure is tax deductible over seven years.
- For offshore developments, expenditure may be expensed from the year incurred.
- For onshore developments, expenditure may be expensed from the first year of commercial production.
- Farm-out transactions are not taxable. However, the sale of a licence for cash consideration is assessable income for taxation purposes. Future farm-out arrangements will not be subject to tax avoidance deals.
- Normal taxation rules apply in respect of carry forward of losses and offsetting of loss by a company in a group or groups of companies.

The general company taxation rate is 33 cents in the dollar for New Zealand registered companies and 38 cents in the dollar for overseas companies who do not register in New Zealand. New Zealand has double taxation agreements with various countries. Full details on taxation can be obtained from the Inland Revenue Department.

Land Access

- As noted, the granting of a permit does not confer a right of access to any land.
- Land access agreements need to be negotiated between the permit holder and each owner and occupier of the land as necessary (with exceptions for minimum impact activities).

Author

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- Where there are difficulties with land access, an arbitrator may be appointed by the Secretary of Commerce.
- December 1993 brought the launch and introduction of a voluntary Land Access Code for entry on to farm land by petroleum exploration and development companies. The code provides a framework within which individual access contracts can be negotiated. It was developed jointly by the Petroleum Exploration Association of New Zealand (PEANZ) and the New Zealand Federated Farmers.

Resource Management Act

The Resource Management Act 1991 is concerned with the management of New Zealand's natural and physical resources. It sets out the rights and responsibilities of individuals, territorial and regional councils and central government.

Where proposed exploration or mining activities may affect the environment, a formal consent must be obtained under the Resource Management Act 1991. There is one standard process for applying for consents, with section 88 of the Act outlining the information required from all consent applicants.

Resource consents are obtained from the relevant Regional Council or District Council.

Health and Safety in Employment Legislation

The Health and Safety in Employment Act 1992 requires employers to take steps to:

- provide and maintain facilities for the safety and health of employees at work
- ensure that machinery and equipment in the place of work are designed, made, set up and maintained to be safe for employees
- ensure that employees are not exposed to hazards in the course of their work
- develop procedures for dealing with emergencies that may arise while employees are at work

For petroleum exploration and mining, the Act is administered by the Chief Petroleum Inspector on behalf of the Occupational Safety and Health Service of the Department of Labour.

Further Advice and Information

This paper has given a very summarised overview of the New Zealand petroleum regime and investment environment:

Intending explorers are advised to contact the Authorisations Unit, Crown Minerals Operations Group, Energy and Resources Division, Ministry of Commerce, PO Box 1473, Wellington, Phone: (04) 472 0030, Fax: (04) 499 0968, to discuss their exploration intentions and to obtain any detailed information.