

Why do business in New Zealand?

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Abstract

There is more exploration acreage available today than ever before in the history of the international petroleum industry, and there is intense competition among host governments for the finite amount of risk capital which the international oil companies (“IOCs”) have for E&P investments. New Zealand is remarkably attractive to foreign investor IOCs for the following reasons:

1. increasing number of explorations successes;
2. some of the most attractive fiscal terms in the world (including both “profit split” and “effective royalty rate”);
3. gas infrastructure;
4. “area-wide leasing” policy permits “direct negotiations” for available acreage at the discretion of the IOC; and
5. licensing policy permits expedited contracting process which eliminates transactional time, expense and risk associated with the negotiation of a PSC or other “host government contract”.

Intense competition among host Governments for IOC risk capital

We see more competition today among host governments for foreign investor international oil company (“IOC” or “Company”) risk capital for E&P than ever before in the history of our international petroleum industry. This competition is the result of the following factors:

1. nationalization of national oil companies (“NOCs”);
2. the low price “scare” of 1998 and early 1999, which resulted in:
 - (a) “merger-mania” among IOCs – resulting in fewer IOCs; and
 - (b) IOCs using lower price assumptions upon which to run economics in order to assess E&P opportunities, thereby requiring generally greater financial concessions on the part of host governments in order to attract foreign investment;
3. the fact that there is more exploration acreage available today than ever before in the history of the international petroleum industry (including more countries as well as more areas - such as deep water environments).

Relative attractiveness of New Zealand - general

New Zealand is very competitive in the worldwide marketplace of host government petroleum regimes for the following reasons:

1. some of the most attractive fiscal terms in the world;
2. geological prospectivity and exploration successes;
3. stability;
4. gas infrastructure; and
5. permitting policy - “area-wide” policy allows “direct negotiations” for available acreage at the discretion of the IOC, as well as an expedited contracting process (similar to the UK North Sea) which eliminates transactional time, expense and risk associated with the negotiation of a PSC or other host government contract (“HGC”: inclusive of the full range of production sharing agreements, tax and royalty contracts and service contracts).

These features make New Zealand attractive to IOC foreign investment.

Attractive fiscal terms

When we compare the fiscal/economic regimes of host governments in the worldwide marketplace the two most important elements are:

1. Company's "Access to Gross Revenue" (for purposes of IOC recovery of investment); and
2. "Company Take" of profit.

Basically, what we want to know, assuming that the IOC makes a commercial discovery, is: (a) what percentage of the revenue in any given accounting period is available to the IOC for purposes of recovery of costs; and (b) what percentage of profit goes to the IOC.

From an IOC foreign investor point of view, New Zealand ranks very high, in both of these categories, in the worldwide marketplace of HGCs.

In New Zealand, the Company's "Access to Gross Revenue" is 95%. In other words, up to 95% of revenue goes to the IOC until the IOC has recovered its costs. This means that the IOC's recapture of expenditures is greatly accelerated, compared to terms offered by most competing host governments.

The complement of the Company's "Access to Gross Revenue", from the host government's point of view, is what Daniel Johnston refers to as the "Effective Royalty Rate". The "Effective Royalty Rate" is the *minimum* percentage of revenue which the host government will receive in any given accounting period (assuming, for this purpose, infinite expenditures in the context of tax deductions and/or cost recovery). In New Zealand, the "Effective Royalty Rate" is only 5%. Again, this is one of the lowest in the world.

By way of contrast, in Syria (1994 Model) Company's "Access to Gross Revenue" is only 41% (and the "Effective Royalty Rate" is a comparatively large 59%). In Egypt and Vietnam "Company's Access to Gross Revenue" is only about 53% (and the "Effective Royalty Rate" is a comparatively large 47%).

In fact, in the worldwide marketplace of petroleum regimes only a handful give the IOC a greater "Access to Gross Revenue" (and a commensurately lower "Effective Royalty Rate"), and they include countries such as Ireland, the UK, and the U.S. Gulf of Mexico – all of which offer 100% of the revenue to the IOC for this purpose (see the "Comparison of Fiscal Terms For Oil" by the Daniel Johnston & Co. Inc, on the following pages).

The Daniel Johnston Company Inc. calculates New Zealand "Company Take" of profit (the IOC share of profit after all royalties, taxes and government participation) in New Zealand is about 53% (and the complement, "State Take", is about 47%). Again, this is one of the most attractive in the world (see the "Comparison of Fiscal Terms For Oil", and the "Country Comparison", both by the Daniel Johnston & Co. Inc., on the following pages – both showing "State Take", the complement of "Company Take").

The current fiscal system has been in place since 1995. It provides for no production sharing or government participation. Instead, there is only a royalty payment calculated as a 5% of revenue (ad valorem royalty or "AVR") or 20% of profit ("Accounting Profits Royalty or "APR") whichever is higher. The Accounting Profits Royalty allows the deduction of all costs, inclusive of exploration costs, an abandonment allowance and an allowance for overhead of 2.5% for the onshore and 1.5% for the offshore. Excess deductions may be carried forward. Exploration costs are expensed, and development costs are depreciated over seven years on a straight-line basis. Interest is recoverable. The Accounting Profits Royalty is not applicable when net sales revenue is less than the equivalent of USD700,000 per year, when only the AVR would be applicable.

The result, as indicated above, is about a 50/50 split between New Zealand and the IOC. Very generous by world standards.

As we all know, not all international barrels are created equal. The extremely attractive New Zealand fiscal system means many more dollars per barrel to the IOC foreign investor than what is available under the petroleum regimes of most host governments.

A Daniel Johnston Company Inc. study, using a 100 million barrel case with a 10% discount rate, yielded an estimated NPV in New of Zealand of USD322, compared to a NPV of USD 56 in Indonesia for the same number of barrels (see the "Country Comparison" by the Daniel Johnston & Co. Inc., on the following pages). The same study yielded an "Effective Monetary Value" ("EMV" – assuming a 15% possibility of success and an 85% possibility of failure) on the same number of barrels of USD48 for New Zealand and USD8 for Indonesia.

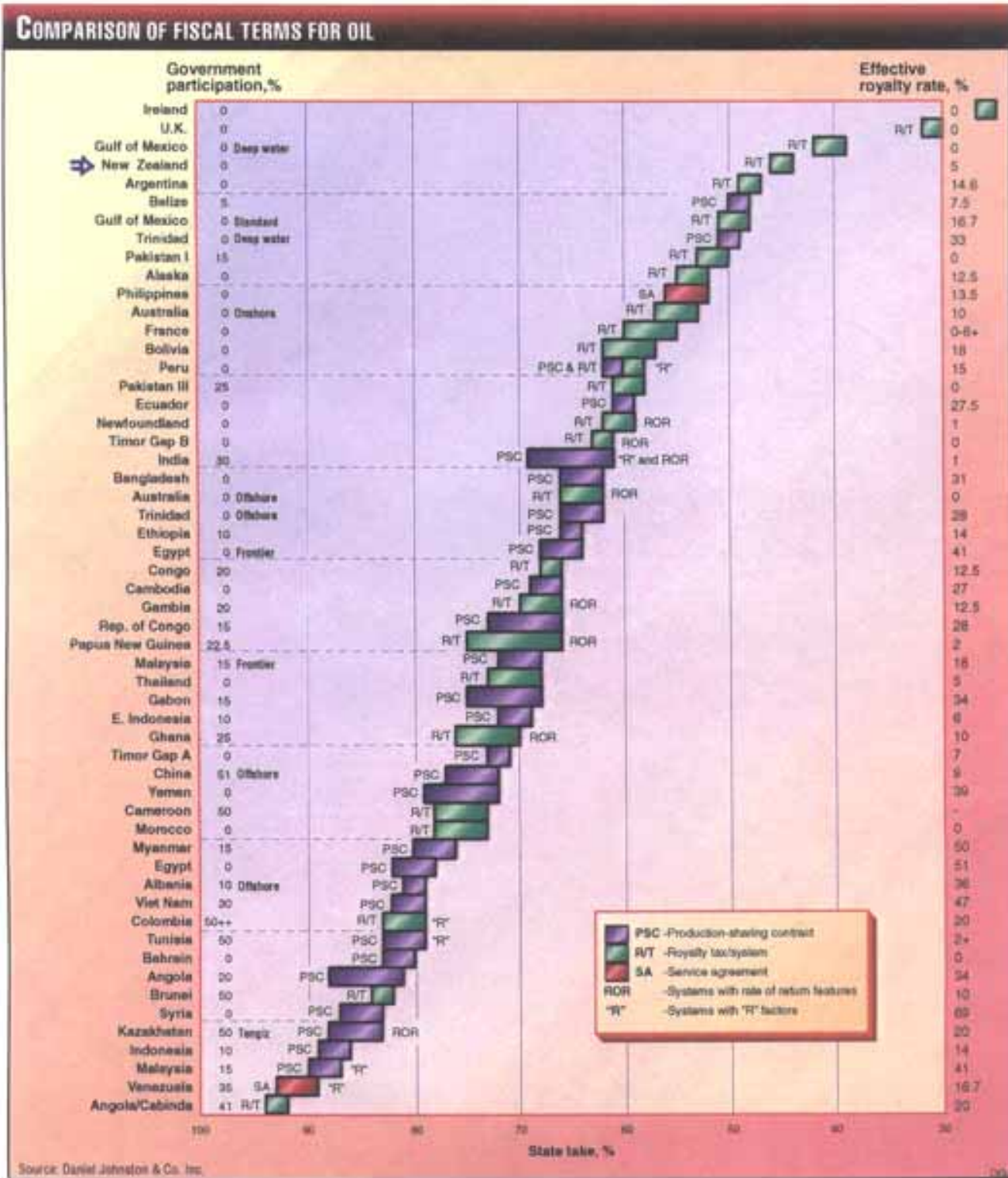
Geological prospectivity and exploration successes

Other presentations/papers at this conference will best address the long history of the oil and gas industry of New Zealand, which dates back to the first oil strike in 1866 when oil was discovered in the Taranaki Basin, includes the 1959 Kapuni gas-condensate field discovery in 1959, the Maui gas-condensate field in offshore Taranaki in 1969, and continues today with the recent oil/gas discovery by Swift Energy Company in the onshore Taranaki Basin (Rimu-A1).

Stability

Especially when compared to many of the places where I have worked during my 23 year career, New Zealand is particularly stable, in terms of political risk, with none of the problems with wars, insurrection and terrorism which we note as an unfortunate fact of life in many areas of the world where the international petroleum industry is active.

In terms of fiscal term stability, the corporate income tax (currently 33%) is subject to change. However, IOCs face the same prospect in other areas of the world which enjoy heavy industry activity, such as the North Sea (United Kingdom) and the Gulf Coast (United States).



Gas infrastructure

Unlike many countries in the world, there is an established gas market in New Zealand. Although limited in size, the New Zealand gas market boasts an infrastructure on the North Island, along with a deregulated gas transmission market.

Permitting policy

New Zealand's terms and conditions for IOC E&P activity are some of the most attractive in the world.

New Zealand's current permitting system, which they call the "Acceptable Frontier Offers", amounts to "area-wide" permitting which permits the IOC access to almost any area in New Zealand not already under permit.

IOC's can initiate the dialogue with the government in regard to any such area and do not have to wait for a "bid round" (although it is rumored that New Zealand may in the near future emphasise more of a "bid round" approach).

IOCs are also afforded great flexibility in regard to the delimitation of the exploration permit – as the work program can be tailored to permit size.

COUNTRY COMPARISON
On-Line Summary

Net Present Value Rank

COUNTRY		Bonus \$MM	Gvt. Part.	Royalty %	C/R Limit	Ring- fence	ERR	State Take %	NPV \$MM	RMV \$MM
52	UK			0		No	0.0	31	433	65
22	Gulf of Mexico - Deepwater	1.0		H		No	0.0	37	400	59
16	Falkland Islands			9			9.0	41	373	56
1	Argentina			14.6		No	14.6	46	329	49
5	Belize		5	7.5	100	No	7.5	48	324	49
→37	New Zealand			5			5.0	47	322	48
23	Gulf of Mexico - Standard	3.0		16.7		No	16.7	50	299	42
49	Trinidad & T - Deepwater			0	35		32.5	53	293	44
38	Newfoundland			2.5		No	2.0	54	290	44
51	Turkey			12.5		No	12.5	51	290	44
15	Ethiopia		10	5	50	No	10.0	57	275	41
45	Philippines			0	70		13.5	54	274	41
18	Gabon - Deepwater	1.0	5	6	77		12.8	53	273	41
6	Bolivia - 1996			18			18.0	55	267	40
44	Peru - Peru			24			24.0	65	263	40
42	Pakistan - Zone 2		20	12.5		No	12.5	56	260	39
13	Ecuador - Triton	2.0		27	100		25.0	58	246	37
2	Australia - Offshore			0		No	0.0	62	241	36
17	France			7		No	2.0	58	236	35
35	Namibia			12.5			12.5	61	231	35
50	Trinidad & T - Offshore			0	55		28.0	65	217	33
47	Thailand Gulf			9			9.0	63	215	33
36	Nepal - 1995 Model			12.5	100		12.5	65	210	32
20	Gambia		20	12.5		No	12.5	67	201	30
31	Malaysia - Deepwater		15	10.5	75		14.6	67	200	30
12	Congo Z		20	12.5		No	12.5	67	195	29
29	Laos - 1991			0	33		43.6	68	193	29
8	Cambodia	.5		12.5	70		21.0	67	190	28
24	India		40	0	90		0.9	71	180	27
11	Congo Br - Standard	1.0	15	12	65		20.0	70	170	25
19	Gabon - Standard	1.0	10	7	65		21.0	68	170	25
33	Morocco - 1989		35	8		No	8.0	74	162	24
43	Papua New Guinea		22.5	2			2.0	72	160	24
25	Indonesia - Frontier	1.0	10	0	85		14.6	74	159	23
30	Libya - 1990 Model		65	0	35		17.0	82	152	23
9	China Offshore	1.0	51	7	60	No	9.0	76	145	21
48	Timor Gap - ZOCA			0	85		5.0	74	145	21
3	Azerbaijan - AIOC		10	0	65	No	23.8	76	144	22
34	Myanmar - 1994 Model	1.0	15	10	40		39.0	77	128	18
10	Colombia		51+	20		No	20.0	82	120	18
39	Nigeria - Deepwater	30.0		2.0	100	No	2.0	78	115	(8)
55	Yemen 1995	2.0		3	50		38.5	78	110	17
14	Egypt - Standard			0	35		47.0	79	108	15
7	Brunei		50	10		No	10.0	82	107	16
21	Ghana		25	10		No	10.0	77	107	16
54	Vietnam PSC	2.5	30	0	35		46.8	81	106	14
41	Oman - 1992	0.2		0	45		44.0	82	94	14
4	Bahrain - 1990			0	70		22.0	85	76	11
40	Norway		30	0		No	0.0	83	68	10
46	Syria - 1994 Model			13	29		59.0	83	66	10
28	Kazakhstan		50	6	100		9.0	85	64	11
26	Indonesia - Standard	1.0	10	0	80		5.0	89	56	8
32	Malaysia - Standard		15	10.8	50		35.0	86	52	8
53	Venezuela 3rd Round	10.0	35	16.7			16.7	93	34	(3)
27	Iraq	10.0	28	0	40		54.2	93	11	2

An IOC has 30 months in which to undertake exploration activities preliminary to drilling. At the end of such 30 month period the IOC must either “drill or drop”. If the IOC chooses to drill the IOC must commit to spud a well within 6 months.

If one well is drilled the IOC may hold the permit for an additional 24 months (a total of 5 years). A permit may be renewed for an additional 5 years upon surrender of one half of the permit area.

All data is held confidential for 5 years or upon surrender of the permit, whichever occurs first.

If the IOC makes a discovery it has a right to a mining permit for up to 40 years, longer if necessary to deplete the field.

Conclusion

New Zealand offers a rare combination of:

1. some of the most attractive fiscal terms in the world;
2. geological prospectivity and exploration successes;
3. stability;
4. gas infrastructure; and
5. an expedited licensing policy implemented in a fashion which is extremely flexible for the IOC.

The sum of these elements is a very competitive petroleum regime in terms of the worldwide marketplace.

Authors

FRANK C. ALEXANDER, JR. JD, LL.M., is a Houston-based consultant who assists international petroleum company and host government clients with international petroleum contract matters. He specializes in host government petroleum regimes, including model Host Government Contracts (including PSAs) and petroleum legislation, and also the analysis of the international marketplace of legal-contractual terms and conditions of international petroleum contracts, including JOAs, transfers of interest and other international energy contracts. An attorney, Mr. Alexander began his career in 1977 with the Law Department of ARAMCO in Saudi Arabia, held several management positions within the international petroleum industry, and has been an independent advisor since 1993. He is the sole author of the AIPN's *Host Government Contract Handbook (For The International Petroleum Industry) – Volume No. 1*, is the Chief Editor and contributing author of *Volume No. 2* (scheduled for publication in 2000), is one of the contributing authors of the AAPG book: *International Oil and Gas Ventures: A Business Perspective* (scheduled to be published in 2000) and has authored 29 papers on international energy contracts and related matters. Mr. Alexander was also Chair of the AIPN Model Form Provisions Committee, an international committee populated by both international petroleum company and host country representatives which worked for two years on the development of model provisions for Host Government Contracts. In addition to his international energy contract work for IOC and host government clients, he lectures on international energy contracts at universities, seminars and conferences around the world, gives in-house courses and also serves as an arbitrator, or expert witness, in connection with international arbitration and court proceedings regarding international petroleum contract matters.

DANIEL JOHNSTON is a petroleum consultant with 19 years experience in the international sector of the petroleum industry. He has worked in 38 countries conducting oil and gas reserve certifications, field development feasibility studies, evaluating exploration potential of licenses and concessions, and providing expert testimony. He has worked directly for numerous Governments and/or Government owned National Oil companies. He has published numerous articles and gives lectures worldwide on subjects of: Economics and Risk Analysis; Petroleum Fiscal Systems; and Financial Analysis. Daniel is the author of *Production Sharing Agreements* published by the University of Dundee-Scotland and three PennWell books: *Oil Company Financial Analysis in Nontechnical Language* (1992); *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994); and *Oil Company Financial Management in Nontechnical Language* (1998). He was also the guest editor for the special international issue (Summer 1994) of the *Petroleum Accounting and Financial Management Journal* published by the Institute of Petroleum Accounting. In March 1999, Daniel was asked by the Institute of Petroleum Accounting, University of North Texas, to become column editor for the *Petroleum Accounting And Financial Management Journal*. He is also a member of the editorial advisory board of the *Oil & Gas Law and Taxation* review magazine in Oxford, England, and the *Global Energy Outlook* published by Gordon Moody.