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Welcome to the General Policy Review Bulletin #1

September 2005

First General Policy Review Bulletin- Future Directions for the *Petroleum (Submerged Lands) Act (1967)*

Welcome to our first General Policy Review Bulletin, prepared for the purpose of consulting interested parties on reviewing policy issues in the offshore petroleum legislation post the rewrite of the Petroleum (Submerged Lands) Act.

As foreshadowed in our Rewrite Bulletin #22 of 20 July 2005, a Pre Conference Discussion on future directions for the rewritten Petroleum (Submerged Lands) Act was held in Sydney on 24 August 2005 in conjunction with the AMPLA Annual Conference. The session was well attended, with presentations by 4 speakers and questions and comments from the audience at the end. Enclosed for your information is a summary record of the discussion.

Also enclosed is a paper entitled: *Production sharing contracts as an alternative to the PSLA: consideration pursuant to the review of the PSL Legislation against National Competition Principles.* This paper is circulated in view of the fact that production sharing contracts were raised as an issue at the end of the discussion.

If any attendee or non-attendee has comments on the material presented at the discussion as summarised in the enclosure, we would be interested to hear them.

At the function, Mr Griffiths undertook to circulate a list of policy issues raised so far. We have such a list, running to some 42 items, but each issue will require a little more commentary to be written about it before the list could be useful for public release. We will be circulating this list, possibly in our next General Policy Review Bulletin. In the meantime, we will regard review of the criminal law aspects of the legislation as our top priority.

Summary Record of AMPLA Discussion

SUMMARY RECORD:
AMPLA PRE-CONFERENCE PANEL DISCUSSION :
THE PETROLEUM (SUBMERGED LANDS) ACT - AFTER THE REWRITE - WHAT NEEDS TO BE DONE TO IMPROVE OUR ACT?
24 AUGUST 2005

Acknowledgments

Mr John Griffiths, General Manager of the Offshore Resources Branch, Department of Industry, Tourism and Resources, introduced himself and others on the panel:

- Professor Michael Crommelin: Zelman Cowen Professor of Law, Dean of Faculty of Law and Head of the Department of Law, University of Melbourne;
- Mr Stuart Barrymore: Partner, Freehills; and
- Mr Greg Munyard: Senior Lawyer, Woodside

Mr Griffiths welcomed and thanked participants for attending and thanked Carol Bartlett of AMPLA for making discussion possible. He then outlined the purpose of the day's panel discussion, ie to start the process of setting priorities for the policy review and determining how the stakeholder consultation process should operate.

Mr Griffiths emphasised the value of all the feedback received from stakeholders during the rewrite process and updated the meeting on progress with the Offshore Petroleum Bill, ie that it was introduced in Parliament on 23 June 2005 and was debated and passed without controversy by the House of Representatives' Main Committee on 18 August. He added that he anticipated the Bill would be debated in the Senate in the week of 5 September 2005.

Focus of the rewrite

Mr Griffiths then recapitulated the history of the rewrite, mentioning that the petroleum industry first raised the Act's lack of user-friendliness many years ago. The Government responded to industry's lobbying in its 1998 election platform, giving an undertaking to rewrite the Act to reduce compliance and administrative costs for industry and government. However, the rewrite could not precede the review of the Act against national competition policy.

Mr Griffiths pointed out that the focus of the rewrite was to:

- restructure the Act;
- delete outdated text;
- rewrite text while minimising the potential for current intent or established interpretations to be altered;
- generally improve readability rather than rewrite in "plain English";
- avoid change to current regulatory arrangements; and
- not to make policy changes.

Nonetheless, some minor policy changes were made in the rewrite, generally to correct obvious drafting errors made in the past or correct identified policy anomalies where the change was deemed uncontroversial. Mr Griffiths noted that the Department steered clear of minor policy changes which would increase the regulatory burden on industry and, in essence, dealt with policy anomalies where the result of the correction would be in industry's favour.

Stockpiled policy issues

Mr Griffiths mentioned that consultation continued throughout the rewrite, the Department and drafters took comments on board where possible and, where not, they were placed in a stockpile of policy issues to be reviewed after the rewrite. In the stockpile, 36 issues posing varying degrees of challenge have been identified.

Mr Griffiths cited, as examples of less complex policy issues, making surrender and cancellation provisions for retention leases the same as for permits and production licences and the need for a provision which prevents the Joint Authority from re-gazetting blocks already subject to an exploration permit. As more complex problems, he mentioned the function and purpose of dealings registration and multiple title holders, whether liability under the Act is joint or several. He also noted that experience with the rewrite process has taught us that there will be some issues where consensus will not be reached.

In terms of departmental priorities for the policy review, Mr Griffiths indicated that, when approval was sought from the Minister for Justice and Customs for the offence, law enforcement and penalty provisions in the rewritten Bills prior to their introduction in Parliament, an undertaking was given to the Attorney-General's Department to review the rewritten Petroleum (Submerged Lands) Act's criminal law regime.

Mr Griffiths pointed out that this does not necessarily mean that penalties under a revised criminal scheme will be increased, and he raised the example of section 96 of the PSLA, which imposes on certain titleholders a maximum 100 unit penalty for failure to commence works or operations within a specified timeframe. After consultation with stakeholders, the penalty was judged inappropriate. Failure to comply with the equivalent clause 300 of the Offshore Petroleum Bill carries no criminal sanction and will be dealt with via administrative remedies such as cancellation.

Review process

In terms of the process for the policy review, Mr Griffiths indicated a revised form of the rewrite bulletin, renamed the General Policy Review Bulletin, could be used for consultations with stakeholders, particularly in dealing with some of the more routine policy changes. He suggested that if attendees at the meeting would like their names added to the policy review bulletin circulation list, they could leave their business cards with one the Department's officers who would be attending for the whole conference.

Mr Griffiths raised questions as to whether stakeholders would prefer face-to-face meetings, seminars or workshops and whether the Department should formulate a discussion paper on all the policy issues raised or just the major issues? He emphasised that this will not necessarily be a quick process, especially if amendments to the Offshore Petroleum Bill are necessary. He gave an undertaking that, through the General Policy Review Bulletin, the Department of Industry, Tourism and Resources would circulate the outcomes of the day's discussion and outline the next steps to be taken.

Mr Griffiths then called on the other speakers, who presented as follows.

Professor Michael Crommelin

Professor Crommelin referred to his longstanding interest in the Petroleum (Submerged Lands) Act and said he would be sad to record its demise. However, transitional provisions in the Offshore Petroleum Bill mean that the Petroleum (Submerged Lands) Act will exert an impact for some time yet and, in any case, the Act has left an indelible mark.

The fundamental conflict

Professor Crommelin observed that the Offshore Petroleum Bill suffers from schizophrenia, as it is at times seen to be administrative and at other times proprietary in character. This fundamental conflict needs to be tackled. A lot hangs on it and there will be many consequences whatever choice is made.

Rule of capture

Professor Crommelin then went on to discuss rights conferred by a production licence in the context of the rule of capture. Do the rights extend to any petroleum that finds its way into the licence area during the term of a licence? He pointed out that clauses 137 and 248 of the Bill would leave the matter in no doubt were it not for the fact that both provisions are "subject to the Act". This circularity is a problem which is not difficult to resolve but it could be contentious.

Power to direct recovery of petroleum

Professor Crommelin next drew attention to petroleum field development. The Act is light on detail in regard to issues to do with production. Nevertheless, there is a very wide, open-ended discretionary power in clauses 161 and 162 of the Offshore Petroleum Bill to direct recovery of petroleum and the rate of recovery. This could create a situation where the licensee of a current production facility might be forced to expend more funds on investment.

Unit development

Professor Crommelin also raised unit development, noting that the provisions in the Act are quite narrow, with application to adjoining licence areas but not where there is a licence area and an adjoining permit or lease area. The provisions are aimed to achieve a more effective development of the common pool, but what about the equity/distributional aspects?

Common carrier provision

Professor Crommelin mentioned the provision whereby a pipeline licensee could be directed to be a common carrier of petroleum, saying it is hard to elaborate the scope and meaning of this provision. The concept is derived from an old area of law that is

practically impossible to properly translate into a provision covering activities such as pipeline conveyance of petroleum.

Other issues
In concluding, Professor Crommelin raised without further comment whether this legislative regime should additionally make provision for petroleum storage in natural reservoirs and for carbon dioxide capture and storage?

Mr Stuart Barrymore

Nature of the legislation
Mr Barrymore noted that the Petroleum (Submerged Lands) Act was a Commonwealth-State compromise enactment which, in 1967, went through Parliament very quickly. A Senate Select Committee later produced a voluminous report on it. The Act has been amended many times but most of the changes have been superficial. Exceptions have been the introduction of retention leases and infrastructure licences and the 1985 changes to dealings registration provisions.

Nevertheless, Mr Barrymore felt the Petroleum (Submerged Lands) Act had been quite a successful piece of legislation that had served its purpose. However, from an energy perspective the world has changed substantially since 1967 and oil is no longer the primary focus. In particular, Australia's offshore energy industry is now predominantly linked to gas and it is appropriate that the offshore petroleum legislation be tested for "gas" as against "oil" issues and to ensure competitiveness against competing regimes. It is to be noted that the most immediate reform to facilitate to encourage gas exploration was made in the area of PRRT.

Dealings registration
Mr Barrymore then drew attention to the dealings and registration provisions. He said that all countries have a legitimate interest controlling ownership of their petroleum resources and ensuring both at the time of award and in the future that the holders and operators are fit and proper persons. Society also requires that government regulate ownership but also that the operations are conducted in a safe and otherwise appropriate manner.

Nonetheless, the registration of dealings amounts to an unusual form of control, as failure to register with the government authority renders the dealing of "no force".

Mr Barrymore summarised the different types of dealings that feature in the Act and observed that issues are often raised about whether a particular document is a dealing and, as such, registrable. The breadth of the provisions reflects concerns emanating from the Painters' and Dockers' Royal Commission in the 1980s, which may not be issues for concern today, particularly offshore.

From a policy perspective, having regard to the "no force" outcome, which is a real practical issue for title holders, does Australia need to have such a regime in place for dealings that do not go to the core issues that concern the extraction of petroleum – principally title related? In his view a case can be made out that number of dealings can be minimised without detracting from an appropriate policy position. He also raised the application and approval process and the time that it took for the relevant

government departments to process applications and contrasted it with the similar provisions that apply under the mining laws in the State of Western Australia, where approvals can be secured in a few days. It is to be noted that approvals can take a number of months and such time period is inconsistent with commercial practice and what the industry expects.

Mr Barrymore then highlighted some issues of a drafting nature that are of concern.

First, when is a dealing effective? Is it only at the date that it is registered under the PSLA, or is there a relation back effect, so that upon a dealing being approved and registered, the instrument and those dealings operate in accordance with their terms, establishing rights and obligations at an earlier point in time? For example, from the date of signature of the instrument evidencing the dealings or from an effective date stipulated in the instrument. The point being, that if government is concerned about any "relation back" effect, it is a matter that they should take into account in deciding whether or not to approve the dealing. Industry regulates itself on a relation back basis, as it provides certainty, although the legal position is not completely clear.

The PSLA contemplates that a dealing may relate to a number of titles and requires separate applications to be made. It does not, however, recognise that an instrument may evidence a number of dealings in relation to a title. The concern exists as to whether or not a dealing which is not mentioned in the application is in fact approved or deemed to be approved as part of the process of approval and registration.

Registration fees
As far as the Registration Fees Act is concerned, he noted the valuation process that applies in that legislation and that once initiated, the process inevitably led to a long delays. During this period, the commercial transaction had to be put on hold (it is still of "no force") whilst government determined the appropriate tax to be levied.

Mr Barrymore also noted that the Fees Act was a taxing piece of legislation but that it did not contain the usual checks and balances that were found in modern legislation, such as the Income Tax Assessment Act, in terms of process, appeals and so forth.

Direction power
Mr Barrymore commended the audience to the recent paper published in the Australian Resources and Energy Law Journal by Jessica Davies on section 101 of the PSLA and the conclusion there that the directory power was at odds with standard regulatory practice of governments and appeared to have outlived its usefulness. Mr Barrymore indicated that as part of the policy review, the directory power ought to be revisited.

<u>Mr Greg Munyard</u>

Resourcing
Mr Munyard opened his presentation by drawing attention to the fact that State and Northern Territory Mines Departments have lost people to the National Offshore Petroleum Safety Authority and they have not necessarily been replaced, plus the Department of Industry, Tourism and Resources has been run on a lean resourcing

plan. He drew attention to the importance of the oil and gas industry to Australia, and said that the Departments should be resourced accordingly.

Locations
Mr Munyard then described a scenario in which the location process could create an alarming situation. He referred to the Designated Authority's power to nominate a location if the permittee over a discovery block does not do so. The declaration of a location sets the clock ticking for the permittee to apply for a production licence. A disturbing consequence would arise if the matter were overlooked by the company because of a clerical omission. It could lead to the loss of the discovery block.

Production licence conditions

Mr Munyard then identified a second risk that arises if the permittee makes a production licence application. There is no formal provision about consultation between the applicant and the Designated Authority on the conditions that the Joint Authority may include in the offer document.

The Joint Authority might require conditions that are not acceptable to the permittee. The conditions could cost the company in the tens of millions of dollars or more. Worse, this could occur when a location has been forced by the Designated Authority and the applicant has no choice than to apply for a production licence or lose the discovery block(s). The Joint Authority makes an offer and the applicant has 3 months in which to accept it, as is. Again, the acreage is potentially at risk because if the applicant does not accept the offer within those 3 months, the offer lapses, which means the permittee loses the discovery block(s). Mr Munyard said it was difficult to imagine a more severe consequence. The situation is ameliorated only by the way the Department administers the provision.

Circumstances have changed
Mr Munyard said he could understand the rationale for the application period and the condition setting provisions referred to above in the early days of the Petroleum (Submerged Lands) Act because, in practice, permits might otherwise have been held almost indefinitely (when there was discretion to continue to renew permits for up to 16 blocks) and because production licences were awarded for terms of 21 years at a time, even if production was likely to cease sooner. In other words, there was greater justification for powers to "move things along". Both provisions have now changed, meaning that the abovementioned provisions should now be subjected to review.

Possible solutions
Mr Munyard suggested that perhaps locations should be replaced by incremental consents under a single title and, for production licences, express recognition should be given to an applicant's administrative law rights. In relation to requirements requiring an act to be done within a defined period, he suggested that perhaps there should be a general provision allowing application to be made (possibly to a Court) for an extension of time where justice dictated e.g. where a title would otherwise be lost because of a mere oversight.

Concluding comments

Dr Mark Snell asked about the consultation process for the policy review, noting it would take some time. Mr Griffiths indicated that General Policy Review Bulletins would be distributed, including a summary of the Department's own stockpile. Industry-members will be asked to also raise other issues, with a view to giving the Department of Industry, Tourism and Resources guidance on what is to be placed at the head of the queue. The Department would focus first and foremost on the matters that the stakeholders see as most important.

Mr Peter Reid recounted how the China Offshore Oil Corporation had been in the process of investing in an Australian oil venture and had seen the Petroleum (Submerged Lands) (Registration Fees) Act as its biggest problem. The valuation that determines the level of registration fee payable could have both an upstream and a downstream component. That one issue threatened to derail the whole transaction. Mr Reid saw this as a major policy issue, with possibly a serious impact.

Mr John Grace drew attention to the fact that contract systems are more common in the world than a regulatory system like the Petroleum (Submerged Lands) Act, and that we do have a contractual system in the Joint Petroleum Development Area. Mr Griffiths responded that the review of the Act against competition policy principles had recommended that Australia not go down the contract route. Mr Grace then observed that sovereign risk in Australia is higher than in many other places.

The session concluded with Mr Griffiths undertaking to circulate a list of issues raised so far and thanking people for their help in the rewrite and attendance at this event.

Compiled by:

Legislation & Review/Timor Section
Resources Division
Department of Industry, Tourism and Resources
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Production sharing contracts as an alternative to the PSLA: consideration pursuant to the review of the PSL Legislation against National Competition Principles

Consideration pursuant to the review of the PSL Legislation against National Competition Principles.

Commencing in November 1999, under the auspices of the Australian & New Zealand Minerals and Energy Council (ANZMEC), the Commonwealth, the States and the NT undertook a review of the Petroleum (Submerged Lands) legislation against competition policy principles. Among the issues suggested for consideration by the review was whether there were alternative, including non-legislative, means for achieving the same objectives determined for the legislation.

An issues paper drafted by the review secretariat sought comments on a range of possible alternatives to the legislative regime including:

- "contractual arrangements between government(s) and private companies"

The issues paper asked stakeholders whether they favoured the use of any alternative system "in place of part, or all, of the current legislative regime".

STAKEHOLDER RESPONSES/COMMENT

Submissions to the review and comments provided on the exposure draft of the report were mute on the issue of production sharing contracts. None raised the issue let alone discussed its merits. In its submission to the review, the Australian Petroleum Production & Exploration Association (APPEA) stated, in regard to a suggestion of wider government management of petroleum mining operations that it "did not see a need for direct government participation in exploration or production activities and notes that successive Commonwealth and State governments have moved away from this concept."

ESSO Australia stated that "We believe that the Act has generally served both the industry and government well over the past 30 years by assisting to provide a stable framework for the offshore petroleum industry to conduct its business."

In its report of April 2000 to the Review Committee, ACIL Consulting considered (pp.78-79) alternatives to the legislation including:

- "contractual arrangements between government(s) and private companies (e.g. the production sharing contract approach adopted in many countries)."

In regard to this contractual approach ACIL stated that "effective tailoring of conditions requires vast information resources to be available to the regulator, resulting inevitably in the regulator adopting uniform conditions. In circumstances where the conditions are effectively uniform, the outcomes would be expected to be no different to the application of PSLA legislation with uniform provisions."

ACIL concluded that:

"the alternatives to PSLA style legislation are either not practical or that, in all likelihood, would result in outcomes that are no different. In particular, PSLA legislation (with a PRRT or royalty) that aims to optimise the value of the resource while ensuring safety and protecting the environment is a valid approach to the problems that need to be addressed."
and:
"On balance, ACIL concludes the PSLA type of legislation ought to exist." (p.vii)

In its final report the Review Committee concurred "with ACIL's conclusion that the PSL legislation takes a valid approach to the issues it seeks to address, and that there are no alternatives to the legislative approach which commend themselves." (p.9)

ANZMEC Ministers endorsed the Review Committee's final report. The report was also forwarded to the Chair of CoAG's Committee on Regulatory Reform for information.

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