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Ministry of Business, Innovation and Employment Energy
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PEPANZ Submission: Crown Minerals (Minerals & Petroleum) Fees Review 2016

Introduction

This document constitutes the Petroleum Exploration and Production Association of New Zealand's (PEPANZ) submission in respect of the discussion document *Crown Minerals (Minerals & Petroleum) Fees Review 2016* ("discussion document"), which was released by the Ministry of Business, Innovation and Employment (MBIE) in July 2016.

PEPANZ represents private sector companies holding petroleum exploration and mining permits, service companies and individuals working in the industry.

PEPANZ welcomes the opportunity to comment on the discussion document. The Crown Minerals Act regime is a key part of the regulatory environment. It often the first point of formal interaction for new entrants and so has a strong influence on initial perceptions of the New Zealand regulatory regime.

Summary

PEPANZ recognises that MBIE requires sufficient funding to do its work properly and process permit applications and changes efficiently. Efficient processing is important to allow commercial decisions to be made and implemented. We also recognise the third party funding of MBIE in this area has in recent years entered into deficit and that changes to fees and/or costs will likely be required to rectify this.

PEPANZ is nonetheless for the following reasons concerned with the proposed fee increases:

- The impact of increasing fees at a time when industry is under pressure due to reduced commodity prices and in the middle of the annual Block Offer process.
- The direct effects of the proposed fee increases under the Crown Minerals Act, particularly on some industry participants, and the cumulative effect of these with other planned new fees (e.g. new annual fees under the health and safety regime for petroleum production assets and for major hazard facilities).
- The proposed increases would move New Zealand's fees out of line with some comparator jurisdictions (e.g. Australia).

We also have concerns with the fee model and the basis for the proposed fee increase:

- The level over-recovery from annual fees and an under-recovery from application fees and change applications, which is a fundamental disconnect and has contributed significantly to the current deficit.
- The calculation of costs was undertaken over a short time period that may or may not be representative of work over an annual period.

Given the current deficit that has arisen in the last two years PEPANZ considers:

- MBIE's service provision needs to be carefully considered to ensure it is efficient as possible.
- A more fundamental review is required by 2019 to determine whether MBIE cost structure is appropriate and whether the structure of fee settings is still appropriate and sensible cost-recovery is occurring.
- If a fee increase is to occur, consideration should be given to:
 - phasing the introduction of fee increases to recognise that some companies budgets for the period through to mid to late 2017 will have already been set;
 - re-calibrating the fees to some extent to reduce the level of over-recovery from annual fees and an under-recovery from application fees and change applications; and
 - ensuring that the any changes remain in line with policy direction (e.g. not unduly discouraging the taking of large frontier permits).

PEPANZ also considers that MBIE could engage more with industry on improving the efficiency of administering the regime. MBIE notes that processing time is often consumed (and cost therefore incurred) in engaging with applicants on incomplete or insufficiently detailed applications etc. Direct industry engagement (workshops etc.) and/or increased guidance from MBIE would be ways of clarifying expectations and bridging this gap and thereby making the administration of the regime more certain and efficient for both government and industry.

Proposed fee increases

In considering the discussion document PEPANZ recognises it is important NZP&M has sufficient funding to do its work properly and process permit applications and changes efficiently. Under the *Crown Minerals Act 1991* MBIE is required to approve various commercial transactions. To enable commercial decisions to be made and implemented it is important this occurs swiftly. Otherwise the regulatory environment can start to become a barrier to investment and appropriate commercial activity.

Current memorandum account deficit

We are aware the third party funding of MBIE's administration of the Crown minerals permitting regime has entered into deficit over the last two years as outlined in the following table.

Crown Minerals Estate Memorandum Account	Financial Year ending (figures in 000s)					
	30/06/2011	30/06/2012	30/06/2013	30/06/2014	30/06/2015	30/06/2016
Opening Balance	291	265	453	490	511	-624
Add: Third Party Revenue	6,834	6,285	7,077	6,995	5,367	4,641
Minus: Third Party Expenses	-6,860	-6,097	-7,040	-6,974	-6,502	-5,503
Closing Balance	265	453	490	511	-624	-1,486

We understand this has been primarily due to a substantial decrease in fee revenue in the 2014/15 and 2015/16 financial years (largely a result of increased permit surrenders), an increase in expenses due to organisational and regulatory changes, and reductions in fees for certain categories under the 2014 Partial Fees Review. The discussion document proposes that fees need to increase by \$2.5 million per annum but does not outline in detail the basis for forward projections although there is a sensitivity analysis in the Deloitte Report.¹

Whilst we recognise the business environment changed abruptly in late 2014 it is a concern that such a sizeable deficit has been allowed to occur. We would expect systems and processes to be in place to adjust to the downturn in the resources sector. It is recognised however that should the current cost/fee settings persist an increase in fees and/or reduction in MBIE's costs in this area is required to allow the revenue and expenses to be balanced.

Cost structure

The discussion document does not consider the underlying cost structures of managing the Crown Mineral Estate. These appear to be taken as a given and this in turn provides little opportunity for the industry to understand and comment on whether those underlying cost structures are appropriate. While cost related information is included in the discussion document this is limited and difficult to analyse. The focus of the discussion document is to increase revenue to return the Memorandum Account to zero, rather than providing analysis or evidence to support the cost structure.

The Deloitte Report identifies that the Ministry's calculations for costs for managing the permitting regime include a "forecast to spend \$474,000 on contract staff and \$786,000 on consulting and professional services" and "assumes filling nine new permanent staff positions that are currently vacant." As suggested by Deloitte the necessity of these resources should be carefully reviewed to reduce the impact on costs and the resulting deterioration of the Memorandum account.

Proposed fee increases

Whilst understanding the current situation and revenue gap we are concerned with the proposed level of fee increases at this time given the reductions in commodity prices in recent years, the

¹ Energy & Resources Markets Branch: High Level Review of the Crown Minerals Fees Review Model, Deloitte, 7 July 2016.

potential cumulative effects of these fee increases, other recent changes to the regulatory environment and the introduction of other new regulatory fees. We are also mindful of the fee review coming in the middle of the annual Block Offer process creating some uncertainty for bidders and with relative increases versus comparator countries such as Australia.

An increase in fees at this time does not recognise the challenges resulting from the more than halving of in oil prices since the 2010-2014 period. Whilst we recognise the costs incurred by MBIE, proposing to materially increase fees in relation to the administration of the Crown minerals regime puts additional pressure on company budgets, which have been reduced substantially in recent years in response to lower oil prices.

It is also important to remember that the increases will also not be spread evenly amongst industry participants. While a number of companies may experience an increase broadly in line with the overall fee increase of ~35% (under option 1 for petroleum permit holders) others could be subject to increases of more than 350% under option 1 and over 400% under Option 2. This is largely a result of introducing minimum fees for exploration and mining permits.

We are mindful that combined with upcoming new fees under Health and Safety regulations² applying to the upstream sector the proposed fee increase will represent a material increase in costs for industry participants. Direct costs imposed by regulators have increased substantially in recent years through for instance the creation of new regimes (e.g. EEZ Act) and fees for new regulatory actions (e.g. safety case approvals cost between \$70,000 and \$103,000 per facility).

An outline of the current and proposed fees and comparison with Australian (offshore) fees in common fee areas is outlined in the following table. Comments are provided on the proposed changes and where relevant to the comparable Australian fees.

Type of Fee	NZ Fees current	NZ Fees Option 1	NZ Fees Option 2	Fees Australia (in AUD)	Comments
Permit applications					
Prospecting (non-exclusive) and Exploration permits	\$5,333	\$7,250	\$8,333	\$7,500	Fees in this area are currently lower in NZ.
Annual fees					
Prospecting permits (non-exclusive)	\$43,478	\$43,478	\$43,478	Zero	This is an area where fees in NZ are much higher than those for the similar "petroleum special prospecting authority", which last for six months and so don't have annual fees.
Exploration permits	\$9.33 per km ²	\$9,000 minimum	\$10,345 minimum	\$10,000	For smaller permits the fees under Option 1 would be massively higher

² The *Health and Safety at Work (Major Hazard Facilities) Regulations 2016* and the *Health and Safety at Work (Petroleum Exploration and Extraction) Regulations 2016*.

		& \$10.55 per km ²	& \$12.13 per km ²		<p>than present, for example increased from well under \$1,000 to \$9,000, due to the introduction of the \$9,000 minimum. For larger permits the increase would be 13% under Option 1 and 30% under Option 2.</p> <p>By comparison to Australia fees, for smaller offshore permits (e.g. 1000 km²) the fees are broadly similar but for larger offshore permits in NZ (e.g. greater than 5,000km²) the fees are 5 or more times higher due to the area based calculation applied. The largest exploration permit would have annual fees under Option 2 of over \$200,000 and a number of others would be around \$100,000.</p>
Mining permits	\$88.89 per km ²	\$15,000 minimum & \$121.00 per km ²	\$17,242 minimum & \$139.09 per km ²	\$20,000 per production licence + \$25,000 per infrastructure licence	<p>For mining permits the increases would range from over 6000% for small mining permits due to the introduction of minimum fees to 35% to 57% for those subject to the per km² calculation.</p> <p>The largely fixed Australian fees (e.g. \$45,000) are similar to those for a mid-size offshore field in NZ, with NZ fees comparably lower or higher outside this due to the per km² based calculation.</p>
Change applications/transactions					
Changes of permit conditions	\$2,222	\$3,500	\$4,023	A\$7,500	Whilst they are proposed to be increased, fees in NZ remain lower than in Australia.
Approvals for dealing etc.	\$888	\$3,000	\$3,448	A\$7,500	Whilst they are proposed to be increased, fees in NZ remain lower than in Australia, although the scope of required approvals for dealings in NZ is wider and therefore there is a greater regulatory involvement.

Overall the proposed fees increases would be felt most severely in proportional terms by the holders of smaller sized permits. Comparison with Australia illuminates some areas where the fee differences are large (e.g. greater than 500%) including annual fees for large exploration permits and for non-exclusive prospecting permits. This could potentially deter the continued tenure or the

uptake of large frontier permits in current and future Block Offer rounds. We note that in contrast change/transaction related fees are lower in New Zealand.

It is proposed that fees for change applications are increased substantially, particularly approvals for dealings. This is appropriate as even with the increases proposed, large cross-subsidies will remain between annual fees and transaction based fees. We question whether the balance should be shifted further at this time, noting that the higher fees in Australia associated with transactions appear to be closer to the actual costs incurred by MBIE.

Other potential means for improving efficiency and reducing costs for industry and MBIE

There have long been calls from industry to more carefully target the approvals required under sections 41-41D of the *Crown Minerals Act 1991*. Refining these to only those matters that clearly require regulatory oversight would reduce the level of administrative activity for MBIE and associated fees and indirect costs for industry. It would also enable commercial transactions and investments to be more swiftly concluded.

The application of fees at all to “dealings”³ solely on the basis that the “term of the agreement is for 12 months or longer” warrants particular consideration (refer section 41B(4)(b) of the Act). The necessity for inclusion of this type of dealing was challenged by PEPANZ during the 2012/13 review of the Crown Minerals Act. We understand the rationale for its continued inclusion was based on the desirability of the government to continue to receive market information on gas contract prices. Whilst there may be value for MBIE’s other energy policy work there is no private good value here as there is no anti market price judgement for the Minister to consider in terms of the Crown Minerals Act and there could be other ways for government to acquire this information.

More generally PEPANZ considers there would be value in MBIE engaging more with industry on improving the efficiency of administering the Crown minerals regime. MBIE notes that processing time is often consumed (and cost therefore incurred) in engaging with applicants on incomplete or insufficiently detailed applications. Direct industry engagement (workshops etc.) and/or increased guidance from MBIE in relation to petroleum applications/transactions (noting there is greater minerals related guidance) would be a way of bridging this gap and making the administration of the regime more efficient and certain for both government and industry.

Funding model and the basis for the proposed fee increases

The current funding model has been in place since 2007. Until the 2014/15 year it provided a level of revenue that met or exceeded MBIE’s (and prior to this the Ministry of Economic Development’s) costs in administering the Crown minerals regime. Notwithstanding this as outlined in the discussion document this balance was achieved with a substantial level of internal cross-subsidisation through an over-recovery from annual fees and an under recovery from application fees and change applications.

The arguments made in the discussion document to support this level of ongoing cross-subsidisation “are to minimize disruption to industry and fiscal risks to MBIE”. It is important to consider that the

³ A “dealing” is any agreement (other than a transfer of interest in a permit or a mortgage or other charge) that imposes on any participant in a permit any obligation relating to the sale or proceeds of production.

cross subsidisation is in favour of those parties looking to change conditions. One of the clear problems of this cross-subsidisations is that MBIE is not positioned to scale up its resources in line with increasing transaction related work levels as the fee revenue generated for each additional transaction is less than the costs incurred. This is a fundamental flaw in the fee structure.

We welcome the detailed information provided in the discussion document and the subsequent provision of the peer review by Deloitte of the "Crown Minerals Fees Review Model". Whilst a structured approach has been taken to the costing analysis we are concerned that:

- Time allocation survey was run over a period of just five weeks and this was at the time of petroleum Block Offer bids being considered. While an important period of the year this is unlikely to be representative of annual averages.
- The costings were based on a level of staffing beyond that currently in place (e.g. nine currently unfilled staff positions), which amongst other things makes it difficult to forecast the balance of work.
- There is a lack of analysis on the efficiency of service provision by MBIE.

We support the proposed fundamental review of fees in this area being undertaken by 2019 to determine whether MBIE cost structure is appropriate and whether the structure of fee settings is appropriate and sensible cost-recovery is occurring. Given the time taken in undertaking this current review we question why this more fundamental review is being delayed for up to three years, particularly given the knowledge of the level of cross-subsidisation going on at present. MBIE should put in place the internal resource allocation tools necessary to support this review. Consideration of whether MBIE's service provision is as efficient as possible should also be undertaken in parallel. This would logically include some form of independent peer review and/or benchmarking.

The discussion document notes charges in the petroleum and minerals sectors will have risen by approximately 36 percent between 2006 and 2019. The relevance of this to reviewing MBIE fees for permitting services for matters such as new petroleum mining permit applications is too indirect to be of any apparent use.

Conclusion and recommendations

Given the current position and the deficit in the Memorandum Account that has opened up in the last two years it is necessary to take steps to stabilise the Memorandum Account. However, given the unfortunate timing of the proposed increases in terms of the commodity prices and the scale of proportional increase to some industry participants, PEPANZ considers that at most fee increases should look to stabilise the memorandum account (i.e. Option 1).

Given the substantial cross-subsidies in place and the resulting disconnect between costs and revenue for MBIE we support a more fundamental review being undertaken by 2019 to determine whether MBIE's cost structure is appropriate and whether the structure of fee setting provides for sensible cost-recovery is occurring. The review outlined in the discussion document suggests that greater change would be required to achieve this than is proposed at this time.

We accordingly recommend the following:

- A more fundamental review is required by 2019 to determine whether MBIE cost structure is appropriate and whether the structure of fee settings is appropriate and sensible cost-recovery is occurring. MBIE should put in place the internal resource allocation tools necessary to make cost information transparent and well understood and so the “Best Practice Recommendations” outlined on page 21 of the Deloitte Report should be implemented.
- Consideration of whether MBIE’s service provision is as efficient as possible should also be undertaken.
- MBIE engages more with industry on improving the efficiency of administering the Crown minerals regime.
- If a fee increase is to occur, consideration should be given to:
 - phasing the introduction of fee increases to recognise that some companies budgets for the period through to mid to late 2017 will have already been set (i.e. don’t commence any fee increases until at least mid-2017).
 - re-calibrating the fees to some extent to reduce the level of over-recovery from annual fees and an under-recovery from application fees and change applications.
 - ensuring that any changes remain in line with policy direction (e.g. not unduly discouraging the taking of large frontier permits).

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