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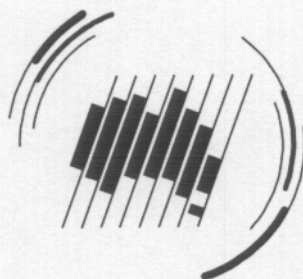
**INVITED SUBMISSION**

to the

**HOUSE OF REPRESENTATIVES  
STANDING COMMITTEE ON  
INDUSTRY & RESOURCES**

**INQUIRY INTO RESOURCE EXPLORATION  
IMPEDIMENTS**

**REGULATION OF PETROLEUM  
EXPLORATION AND DEVELOPMENT IN  
COMMONWEALTH WATERS**



**INDUSTRY  
TOURISM  
RESOURCES**

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12 March 2003

# **REGULATION OF PETROLEUM EXPLORATION AND DEVELOPMENT IN COMMONWEALTH WATERS**

## **INTRODUCTION**

In February 2003, the House of Representatives Standing Committee on Industry and Resources requested the Department of Industry, Tourism and Resources to prepare a submission on the regulation of petroleum exploration and development in Commonwealth waters.

Beyond 3 nautical miles from shore, exploration for, and development of, petroleum resources are primarily governed by the *Petroleum (Submerged Lands) Act 1967*. This legislation sets out the basic framework of rights, entitlements and responsibilities of government and industry.

The current Government's strategy is to release offshore acreage annually with a range of prospectivity for competitive bidding by potential explorers. The legislation underpins all matters relating to application for exploration permits, granting of exploration permits, retention leases and production licences.

## **RELEASE OF ACREAGE**

Preparation of release information packages, the conduct of genuine consultation with stakeholders pre-release, and industry's assessment of areas made available, are all resource intensive activities. Therefore all efforts are made to ensure the release is focussed on areas of genuine interest to small, medium and large exploration companies.

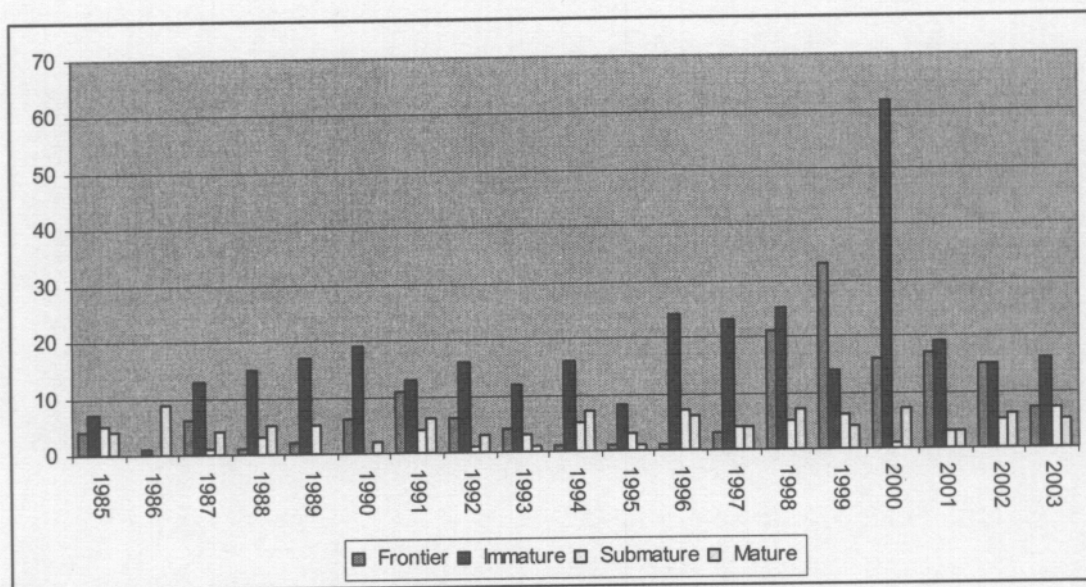
The release includes a selection of mature, sub-mature, immature and frontier areas<sup>1</sup> (Figure 1). Larger areas are offered in frontier and immature areas and smaller ones in more mature areas. The rationale behind this approach is to offer the opportunity for explorers to retain relatively larger permits in lesser-explored regions in return for significant reconnaissance work and drilling information. Some areas for release may

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<sup>1</sup> The offshore regions of Australia have been classified into mature, submature, immature and frontier. Mature regions are where there is a greater than 50% probability that more than 50% of the total petroleum in the region has been discovered. Submature regions are where there is a greater than 50% probability that 20-50% of the total petroleum in the region has been discovered. Immature regions are where there is a greater than 50% probability that less than 20% of the total petroleum in the region has been discovered. Frontier regions are regions where no petroleum has been discovered.

have become available from the relinquishment, surrender or cancellation of former titles. Input on the release program is sought from industry and individual companies, who can nominate areas of interest.

After collecting information on nominations on possible release areas, representatives of the Resources Division of the Commonwealth Department of Industry, Tourism and Resources, Geoscience Australia and the State/Northern Territory mines departments shortlists the release areas (more recently about 40 areas per annum). These areas are then the subject of consultations with Commonwealth, State and Northern Territory government agencies to determine whether proposed permit areas are suitable for release, and how petroleum activity may impact on the environment, native title and other uses such as fishing, defence, shipping, telecommunications and environment protection.



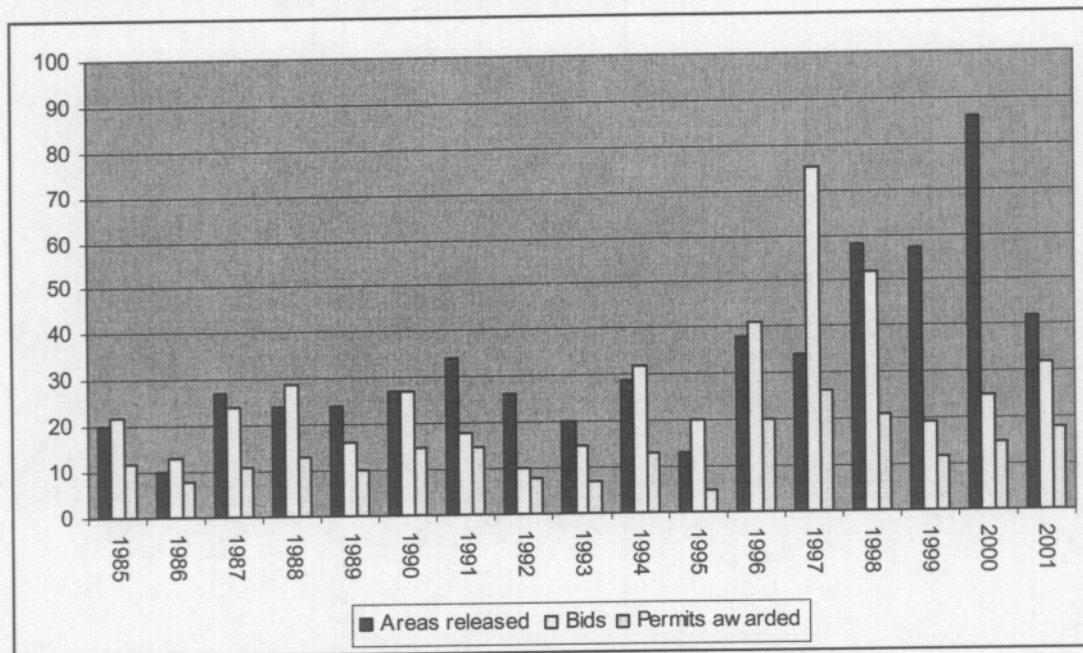
**Figure 1.** The number of areas released by maturity.

The above short listing process occurs approximately 8 months in advance of the release. In keeping with the commitment made in the 1999 Australian Offshore Petroleum Strategy, these preliminary areas are advertised approximately 4 to 5 months in advance of the release date to facilitate planning by industry.

Much of the remaining release process is devoted to negotiating stakeholders' issues and finalising preparations of geoscientific information packages. The annual release is then typically announced by the Minister for Industry, Tourism and Resources to

coincide with the first day of the Australian Petroleum Production & Exploration Association (APPEA) conference (varies March to May, this year it is 24 March). Areas are open for bidding for either 6 or 12 months, depending on the area. Bids are submitted by industry members in the form of work programs, not as cash bids.

The National Competition Policy Review of the *Petroleum (Submerged Lands) Act 1967* conducted in 2000 concluded that the acreage release process does not restrict the supply of exploration acreage in Australia. This is in part evidenced by the fact that not all areas released have been taken up (Figure 2).



**Figure 2.** Number of release areas, bids (including multiple bids for the same area), and permits awarded each year from 1985 to 2001 (does not include re-released data).

### APPLYING FOR EXPLORATION AREAS

Applications for release areas are invited under the work program bidding system in accordance with section 20 of the *Petroleum (Submerged Lands) Act 1967*. The application must contain a technical assessment, an exploration program over six years and particulars of the applicant (including technical and financial resources).

A technical assessment should include an assessment of relevant data, the amount of seismic surveying and the number and conceptual targets of wells to be drilled. The minimum guaranteed program (Years 1, 2 and 3) should state precisely the exploration wells to be drilled, seismic and other surveying activities, data evaluation and other work within the permit area (including indicative minimum expenditure).

The secondary work program (Years 4, 5 and 6) must specify substantial operational activities that will significantly advance exploration of the area (including indicative minimum expenditure). The secondary work program is guaranteed on a year to year basis which provides a greater degree of flexibility for the permittee.

### **Cash vs Work Program Bidding**

The *Petroleum (Submerged Lands) Act 1967* provides for the possibility that the Joint Authority may invite applications for exploration permits by way of cash bidding. This system allows permits to be awarded to the company proposing the highest cash bid for that area. Such permits are issued for either one 6 year term or one 6 year term with an optional 5 year renewal term. The technical and financial resources available to the applicant must be specified in the cash bid. Cash bidding was last used in 1993 and it is current Government policy not to use cash bids to allocate acreage.

The use of cash bidding is generally not supported by industry, but there is a diversity of views as canvassed in the 1999 National Competition Policy Review of the *Petroleum (Submerged Lands) Act 1967*. Cash bidding favours companies with liquidity or fund raising ability. The work program bid system allows the smaller companies to compete more effectively by using technical skills and knowledge and by inviting other participants to extend or complement their capabilities. The work program bidding system encourages exploration and development of exploration areas, by ensuring dollars are not diverted from exploration budgets.

### **ASSESSMENT OF APPLICATIONS**

Work program bids are assessed by the Joint Authority against published selection criteria. The basic objective in awarding any exploration permit is to select the program most likely to achieve the fullest assessment of the petroleum potential within the permit area in the minimum guaranteed period, recognising the essential role of wells in the discovery of petroleum. Work programs proposed in bids must significantly advance the exploration status of the area, and must be undertaken by explorers with adequate financial and technical capacity.

Bids are assessed against the following criteria:

- . the number and timing of exploration wells to be drilled;
- . the amount, type and timing of seismic surveying to be carried out;
- . other new surveying, data acquisition and reprocessing to be carried out;
- . the amount, type and timing of any purchasing or licensing of existing data;
- . significant appraisal work over any previous petroleum discoveries within the area; and
- . the extent to which the applicant's technical assessment supports the amount of seismic surveying and the number and conceptual targets of wells proposed in the application.

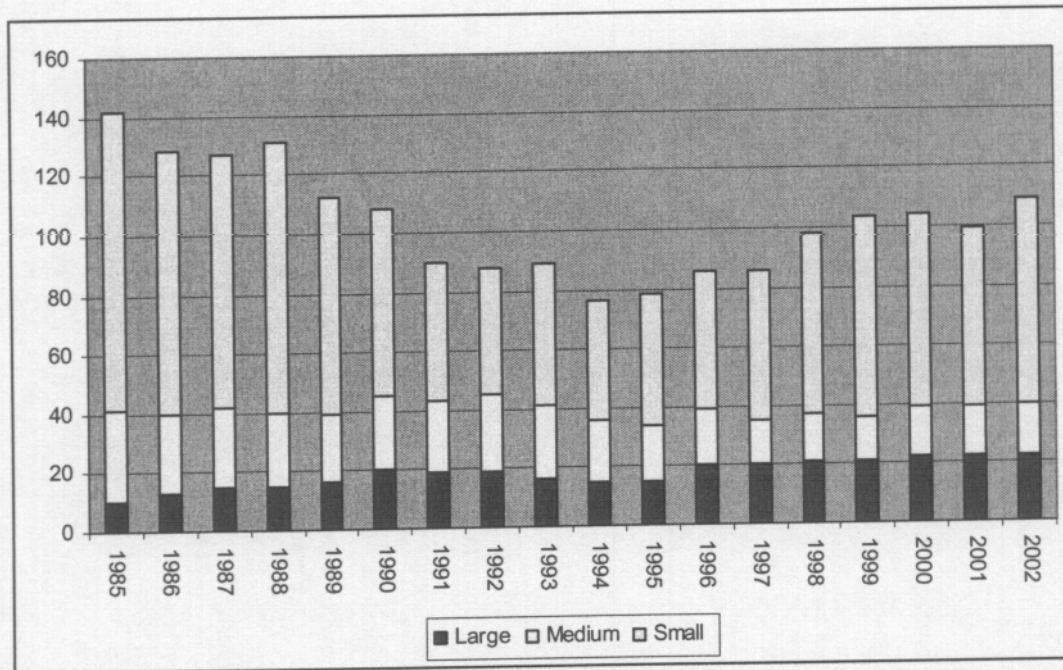
In the event that a winning applicant cannot be chosen on the basis of the minimum guaranteed work program (years 1 to 3), the amount and timing of work proposed under the secondary work program will be assessed against the above criteria.

If a winning applicant cannot be chosen on the basis of the information contained in the written application or provided during an interview, supplementary written information will be requested and assessed. There is no discrimination between large, small, domestic or international companies (Figures 3 & 4).

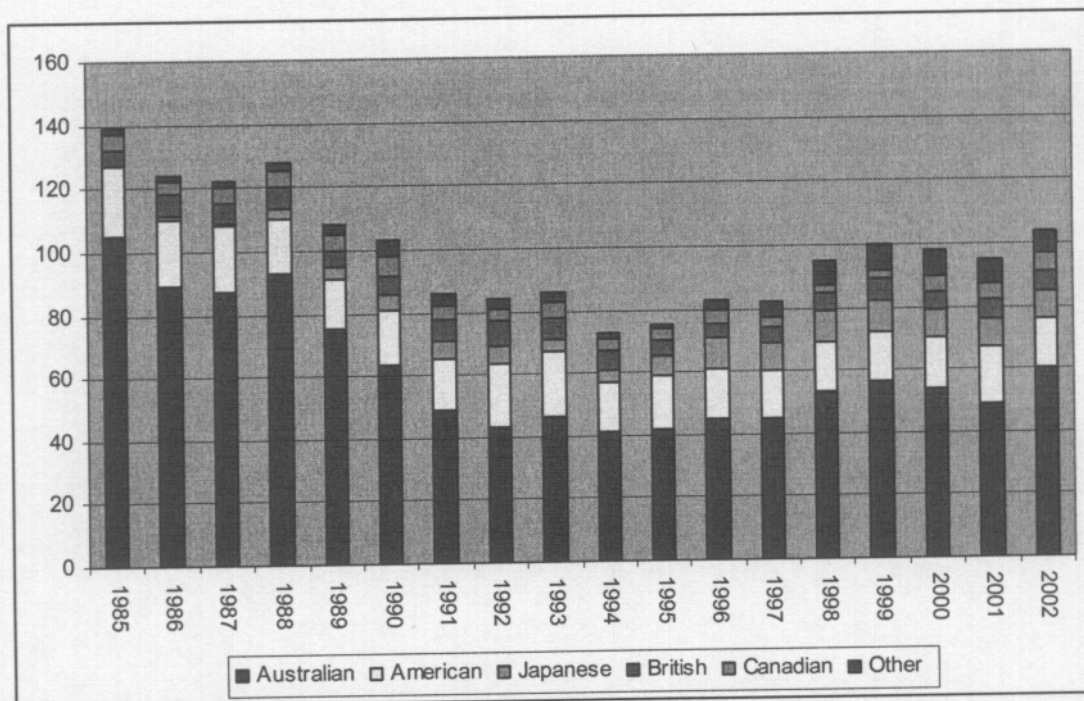
Consideration of an applicant's past performance in other petroleum exploration areas may occur even where the applicant's proposed work program is the highest submitted. Past performance include permits that have been cancelled because of a default in meeting work program commitments and where the good standing<sup>2</sup> arrangement was not utilised. The applicant would be given the opportunity to establish that the earlier failure was irrelevant to the current situation and that default would not occur in the current application.

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<sup>2</sup> A company that has not complied with its work program may be eligible to access arrangements to maintain good standing. The company must satisfy the government that it has made a significant attempt to assess the petroleum potential of the permit area. The defaulting company can maintain their 'good standing' by entering into an agreement with the Joint Authority to undertake work in re-released acreage. The defaulting companies will be required to spend the full amount of the agreed value of any outstanding commitments in the minimum guaranteed period of the new permit or permits obtained from re-released areas.



**Figure 3.** Size of exploration companies which participated in successful bids for exploration permits, offshore Australia, 1985 to 2002.



**Figure 4.** Nationality of exploration companies participating in exploration permits, offshore Australia, 1985 to 2002.

An exploration permit generally will not be offered where:

- . the work program proposed is inferior to that of a competing bid;
- . the work program bid is inadequate to significantly advance the exploration status of the area;
- . the work program bid is not supported by a sound technical assessment;
- . the Joint Authority is not satisfied that the applicant possesses the financial or technical capacity to complete the work program bid; or
- . the Joint Authority is not satisfied that, on the basis of past performance, the applicant will comply with permit conditions.

Exploration permits are issued for an initial term of six years, and may be renewed for further five year periods. At each renewal 50 per cent of the permit area must be relinquished. Amendments to the *Petroleum (Submerged Lands) Act 1967* in 2002 mean that all areas released since the start of this year are restricted to a limit of two renewals (which is an outcome of the National Competition Policy Review). Previously an exploration permit would be renewed many times, subject to the relinquishment requirements. This change expedites the rate at which exploration acreage can be made available ("recycled") to second and subsequent explorers.

There is no time line for assessing applications, but most are assessed within 2 months. Bids involving smaller companies or new entrants to Australia tend to take longer to assess as such bids generally entail more issues that require clarification.

#### **PERMIT CONDITIONS**

There are a number of conditions applying to permits granted under sections 22 (initial term) or 32 (renewal term) of the *Petroleum (Submerged Lands) Act 1967*.

A key condition is that a permit holder must do the exploration work in the permit year specified. Permit holders are expected to maintain permits in good standing. Failure to undertake each component of the minimum guaranteed work program or secondary work program in the designated year or earlier may result in the cancellation of the permit.



The secondary work program (years 4 to 6) is guaranteed by the permit holder on a year by year basis and may be renegotiated on an annual basis by providing substantial and compelling evidence that the work program should be varied on technical grounds. If a mutually acceptable agreement cannot be reached in any of these negotiations, the permit may be surrendered in good standing or continue in force subject to the original secondary work program.

Surrender of a permit in good standing may only be agreed if the work guaranteed for that year or the first 3 years, has been completed. If a permit holder fails to complete a guaranteed year's work program, the permit holder will not have complied with the conditions of the permit.

In general, failure to meet a work commitment will result in permit cancellation. There are limited circumstances under which exemptions may be granted, eg. *force majeure*<sup>3</sup>, which are covered in published guidelines. Cancellation may also lead to a loss of standing, which can be raised when assessing future bids.

### **RETENTION LEASE & PRODUCTION LICENCE**

The retention lease may form an intermediate step between an exploration permit and a production licence. The lease provides security of title for resources that are not currently commercially viable, but have genuine development potential within the next fifteen years. Retention leases are issued for five years, with renewal periods of five years.

To grant a retention lease, the government requires a permit holder to provide a description of all realistic development options as well as technical and economic assumptions used in the evaluation of the resource's commercial viability. The permit holder must provide evidence that the discovery is not currently commercially viable and demonstrate that the discovery is likely to become commercially viable within 15 years.

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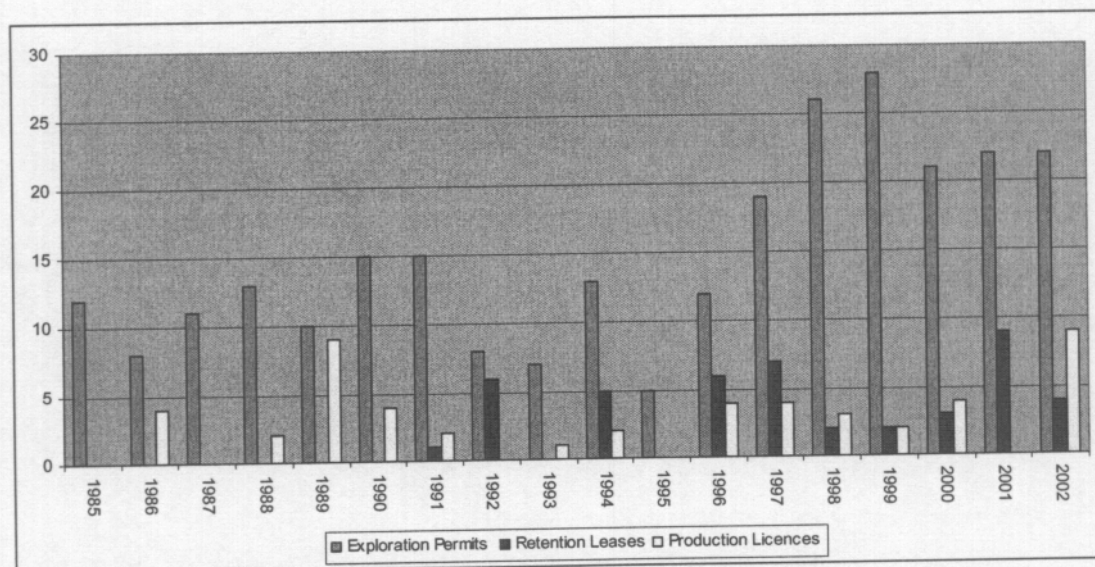
<sup>3</sup> Force majeure refers to an event or effect that cannot be reasonably anticipated or controlled by experience or care, and specifically excludes difficulty in attracting finance and other commercial circumstances such as fluctuations in the price of oil.

At anytime during the five year term of a retention lease the government can request a review of the commercial viability of the petroleum production in the lease area. This ensures that a leaseholder is not able to sit on a lease when it is commercially viable to develop.

The conditions of the retention lease may involve requirements to carry out work such as geophysical, engineering or marketing in the area. The aim of the work program is to ensure the lease holder is endeavouring to enhance the commerciality of the discovery.

Production licences are granted to the holder of an exploration permit or retention lease, for the recovery of petroleum following a commercial discovery. The permit or lease holder must provide evidence that the petroleum exists and details of development proposals for the area. Production licences are issued for the duration of production plus a period of five years. The conditions of the production licence may involve matters such as resource management issues.

The number of retention leases and production licences granted or renewed in each year from 1985 to 2002 is presented in Figure 5.



**Figure 5.** The number of exploration permits, retention leases and production licences granted or renewed each year.

## CONCLUDING COMMENTS

The Australian Government is committed to encouraging new investment in offshore exploration. Accordingly, the regulatory regime is subject to regular consultations with industry to ensure it is competitive and conducive to new investment. Anecdotal feedback from exploration companies suggest Australia's regulatory regime is generally well respected, as is the access to a high quality geoscientific data base, the profit-related tax system, the closeness to markets in Asia and the Pacific, and our open and competitive economy. That said, the single most important factor in attracting new investment is likely to be the perceived prospectivity of offshore basins.

By focussing on the regular release of acreage accompanied by significant packages of geoscientific information, and emphasising on exploration work as a way of allocating permits, the Australian regime helps investors address some of the risk associated with bidding for our underexplored offshore areas. From 1985 to 2001, this system of releases and competitive bidding has been used to advertise 3.37million sq km of acreage, resulting in work program bids with an indicative value of close to \$6 billion, and the allocation of 229 exploration permits.

The Government has reviewed and modified the system a number of times, but considers the basic framework still has widespread support from industry. Nevertheless, the Department of Industry, Tourism and Resources welcomes the fact that this House of Representative inquiry may lead to further suggestions for improvements to this regulatory regime.