



COVERSHEET

Minister	Hon Dr Megan Woods	Portfolio	Energy and Resources
Title of Cabinet paper	Clarifying Energy Resources Levy Obligations for Fossil Gas Production Energy Resources Levy Amendment Bill: Approval for Introduction Energy Resources Levy Amendment Bill: Amendments to Policy Decisions and Approval for Introduction by Delegated Ministers	Date to be published	26 June 2023

List of documents that have been proactively released		
Date	Title	Author
8 March 2023	Clarifying Energy Resources Levy Obligations for Fossil Gas Production	Office of the Minister of Energy and Resources
13 March 2023	Clarifying Energy Resources Levy Obligations for Fossil Gas Production DEV-23-MIN-0018 Minute	Cabinet Office
4 May 2023	Energy Resources Levy Amendment Bill: Approval for Introduction	Office of the Minister of Energy and Resources
8 May 2023	Energy Resources Levy Amendment Bill: Approval for Introduction – Minute of Decision CAB-23-MIN-0162.01 Minute	Cabinet Office
15 May 2023	Additional Item: Energy Resources Levy Amendment Bill CAB-23-MIN-0179 Minute	Cabinet Office
17 May 2023	Energy Resources Levy Amendment Bill: Amendments to Policy Decisions and Approval for Introduction by Delegated Ministers	Office of the Minister of Energy and Resources
17 May 2023	Energy Resources Levy Amendment Bill: Amendments to Policy Decisions and Approval for Introduction by Delegated Ministers DEV-23-MIN-0089 Minute	Cabinet Office

Information redacted**YES / NO**

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Some information has been withheld for the reasons of confidentiality, commercial information, free and frank opinion, and legal professional privilege.

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In Confidence

Office of the Minister of Energy and Resources
Cabinet Economic Development Committee

Clarifying Energy Resource Levy obligations for fossil gas production

Proposal

- 1 This paper seeks agreement to amend the Energy Resources Levy Act 1976 in order to clarify levy payment obligations on fossil gas¹ produced from pre-1986 petroleum licences with low royalty rates.
- 2 In order to give effect to this proposal, this paper also seeks agreement to issue drafting instructions to the Parliamentary Counsel Office.

Relation to government priorities

- 3 This policy proposal relates to the Government's wider work programme under the 10-year Resource Strategy *'Responsibly Delivering Value – A Minerals and Petroleum Resource Strategy for Aotearoa New Zealand: 2019–2029'*. The policy proposal is most relevant to Principle 8: The Crown receives a fair financial return for its minerals and petroleum in the strategy.

Executive Summary

- 4 New Zealand petroleum legislation, including the Petroleum Act 1937 and the Crown Minerals Act 1991 which superseded it, grant the rights to mine Crown owned minerals in exchange for a fair financial return – applied through royalty regimes.
- 5 There are inconsistent approaches to achieving a fair return on the Crown's fossil gas resources through petroleum royalty rates, depending on when gas discoveries and resulting licences and permits were granted. This is not uncommon and reflects practice at the time those licences were granted.² The table below summarises the different royalty structures.

¹ The Climate Change Commission (CCC) has adopted the term 'fossil gas' over natural gas. The term fossil gas is used in this Cabinet paper to be consistent with the CCC, however the term natural gas is used when quoting excerpts directly from the Energy Resources Levy Act 1976.

² Licence royalty rates steadily rose from five to 10 to 12.5 per cent from the 1970s through to the 1980s.

Licence/permit category	Example licence/permit	Royalty rate	Energy Resources Levy
Pre-1986 licence	Māui licence, discovered 1969, granted 1973	5%	45 cents per gigajoule fossil gas
	McKee licence, discovered 1980, granted 1983	10%	45 cents per gigajoule fossil gas
Post-1986 licence	Kupe licence, discovered 1986, granted 1992	12.5%	Exempt
Modern permit 1995+	Pohokura permit, discovered 2000, granted 2004	20% (or 5% ad valorem, whichever is higher)	Exempt

6 In 1976 a levy was added to royalty rates through the Energy Resources Levy Act 1976 (**the ERL Act**). The energy resources levy (**levy**) does not apply to gas produced from discoveries made after 1 January 1986 (**post-1986**), as they are already subject to higher royalty rates. It achieves this through a clause exempting discoveries made post-1986 from the levy (**exemption clause**).

7 Commercial Information

8 Commercial Information

9 Legal professional privilege

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11 Free and frank opinions

- 12 This paper proposes amending the ERL Act to clarify that the levy applies to all gas produced from a licence granted prior to 1 January 1986. This amendment would help to mitigate operational complexity related to the exemption clause and assist in minimising foregone Crown revenue.
- 13 The ERL Act includes a power that allows NZPAM to make formal assessments on non-payment of the levy going back four years from the day on which the return was made. I propose that the amendment to the ERL Act makes clear that this clarification applies throughout that period of four years prior to the amendment coming into force.

Background

Petroleum legislation in New Zealand seeks a fair financial return to the Crown for minerals allocated within licence or permit areas

- 14 New Zealand petroleum legislation, including the Petroleum Act 1937 and the Crown Minerals Act 1991 (**CMA**) which superseded it, grants the rights to mine Crown owned minerals in exchange for a fair financial return – applied through royalty regimes.
- 15 The rights to mine fossil gas in certain areas are granted through Petroleum Act licences and Crown Minerals Act permits. These are issued following the discovery of a deposit, and the subsequent determination of a licence or permit area deemed large enough to contain the reservoir or field intended to be mined.

The Energy Resources Levy Act 1976 seeks a fair return to the Crown on fossil gas from early petroleum licences

- 16 The ERL Act was initially introduced to increase the prices of domestically produced gas and coal relative to imported oil to prevent the wasteful use of energy resources, in light of the significant price rises associated with the 1970's oil shocks. It provides for this as follows (summarised):

4(1) ...a levy on all natural gas and coal produced in New Zealand at any time on or after 1 January 1977.

(2) ... the rate of levy shall be—
(a) on natural gas, 45 cents per gigajoule.

- 17 The ERL Act is administered by MBIE and all revenues received are paid into the Crown's Consolidated Fund.
- 18 Since 1993, the ERL Act has been used as a royalty relativity mechanism, enabling the Crown to offset or balance revenue from fossil gas production on pre-1986 licences compared to later licences and permits.
- 19 Pre-1986 fossil gas producing licences attract royalty rates of five or ten per cent (revenue less deductions). This compares to the post-1986 licence royalty regime which rose to 12.5 per cent; and to the CMA's permit regime,

applied since 1995, of a 20 per cent accounting profit royalty or a five per cent ad valorem royalty³ (whatever is higher in any year).

20 To achieve royalty relativity the ERL Act was amended to exempt post-1986 fossil gas discoveries as those discoveries had higher royalty rates imposed on them.⁴ The purpose of the ERL Act as a royalty relativity mechanism has been implicit and has never been publicly articulated by government.

21 There has been a level of inconsistency in the past about the interpretation of the term “discovery” in the exemption clause. The text of a 2005 Cabinet paper states as follows “[i]t must also be noted that as the ERL Act is not levied on new discoveries it does not discourage new exploration within those licences”. However, this paper is also internally inconsistent and there are statements that suggest the levy should be payable on new discoveries.⁵

22 Legal professional privilege

The arrangement of a five per cent royalty in conjunction with the levy already advantages pre-1986 licence holders

23 The low royalty rate of five per cent set under pre-1986 licenses are a function of age and reflect practice at the time granted. Even when combined with the levy, these licence holders are at an advantage compared to producers on other royalty regimes.

24 For indicative purposes, the table below provides a comparison of total annual Crown revenue from a hypothetical licence/permit production against royalty regimes described earlier (see paragraph 19).

Royalty Regime	Annual production volume of fossil gas (PJ)	Royalty payable (\$ million)	ERL payable (\$ million)	Total annual Crown revenue (\$ million)
Pre-1986 licence agreement with 5% royalty rate and ERL of 45 cents per gigajoule	25	\$10	\$11	\$21
Pre-1986 licence agreement with 10% royalty rate and ERL of 45 cents per gigajoule	25	\$19	\$11	\$30
Post-1986 licence agreement with 12.5% royalty rate	25	\$24	N/A	\$24
Modern permit with 20% royalty rate or 5% ad valorem royalty (whatever is higher in any year)	25	\$38	N/A	\$38

³ An output-based royalty that is levied as a percentage of the value of production of a mining project.

⁴ Energy Resources Levy Amendment Act 1993 (1993 No 145).


⁵ The Future of the Energy Resources Levy on Coal, 1 June 2005. EDC Min (05) 15/8.

- 25 This example assumes the same, nominal, accounting profit of \$192 million. The accounting profits are based on a mixed gas and oil field (where LPG and fossil gas contribute 64 per cent of net sales revenue) which is common in New Zealand. The 25 petajoule amount used represents the average annual production across the five major gas fields reported on in the period 25 November 2021–24 November 2022.⁶
- 26 In addition to lower royalty rates, licence royalty regimes are based on revenue less deductions and do not have the "whatever is higher" arrangement that permits do (see paragraph 19). This means that when licences incur a loss in a royalty period no payment is due, apart from the energy resources levy.

Legal professional privilege

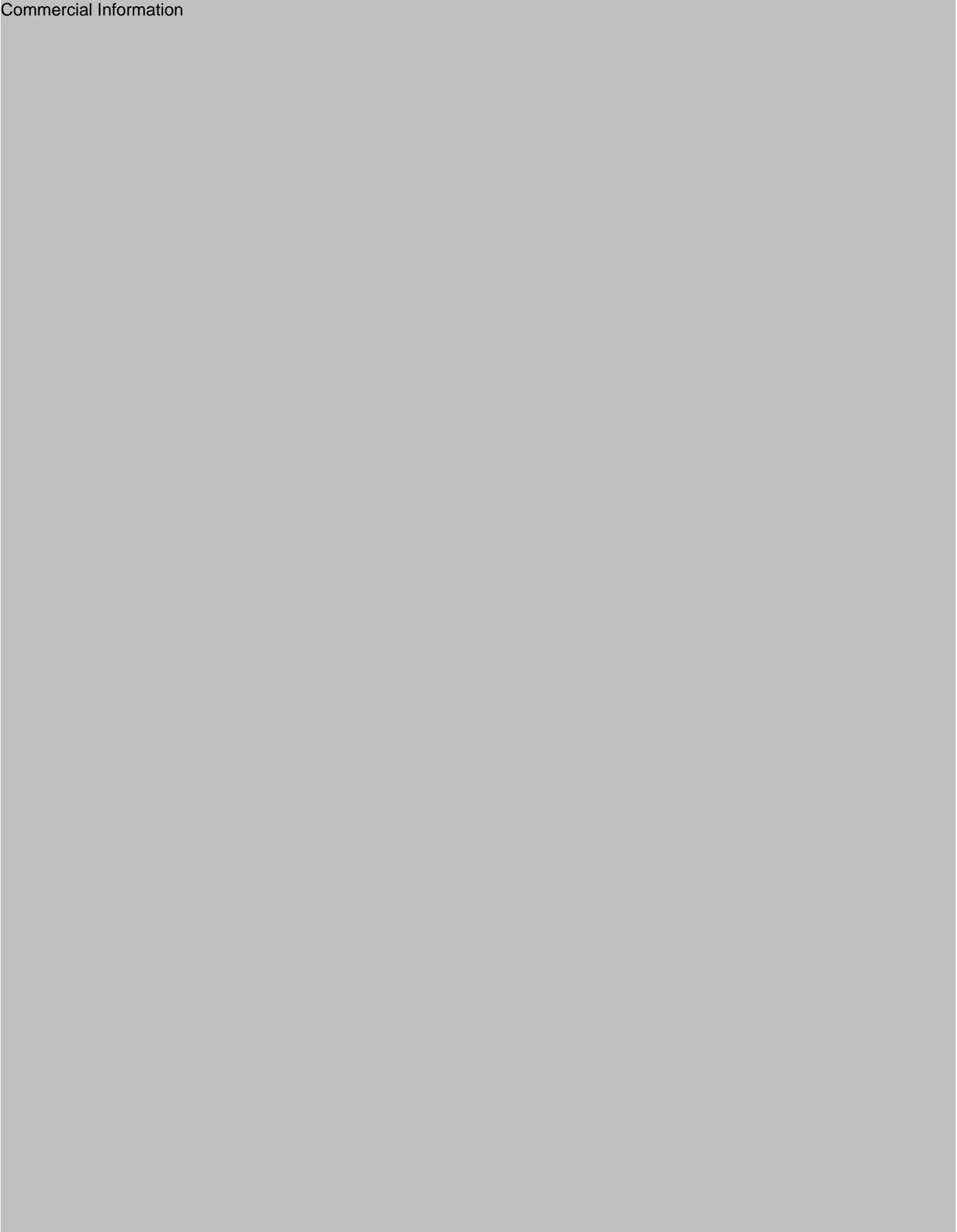


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⁶ <https://www.gasindustry.co.nz/data/gas-production-and-consumption/>

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I propose to amend the Energy Resources Levy Act 1976 to clarify that the levy applies to any gas produced from a pre-1986 licence

A clarification would ensure that all gas produced as a result of a pre-1986 licence is required to pay the levy

- 35 The proposed Energy Resources Levy Act Amendment Bill (**the Bill**) would clarify existing obligations such that the levy applies to all gas produced under a licence that was granted in relation to a deposit discovered prior to 1 January 1986.
- 36 The purpose of the amendment is to remove any doubt as to whether or not the levy is payable on gas claimed as having been produced from new deposits or accumulations of gas identified within the area of pre-1986 licences, and to ensure comparable returns to the Crown across classes of licences and permits.
- 37 A legislative amendment is necessary as relying on enforcement action through a formal assessment will likely involve a drawn-out process through the courts, for which the outcome is ultimately uncertain. Free and frank opinions

The impact of this clarification is constrained

- 38 There are only two pre-1986 licences that continue to produce fossil gas: Māui and McKee.
- 39 The 1973 Māui licence is located offshore of Taranaki, operated by OMV, produced around 30 petajoules of fossil gas in 2021. This represents around 18 per cent of national gas production.⁷ Commercial Information
- 40 The impact of the clarification to OMV would be constrained. OMV produces gas from a number of wells across the Māui A and B lobes. This clarification would only apply to gas from areas that are claimed as new “discoveries”.
- 41 The 1983 McKee licence is also in Taranaki, operated by Todd Energy, and predominantly produces oil. It only produced 3.33 PJ of fossil gas in 2021, around 2 per cent of national production. Free and frank opinions

- 42 Commercial Information

^{7 7} <https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-statistics-and-modelling/energy-statistics/gas-statistics/>

⁸

Retrospectivity

- 43 Section 12 of the ERL Act allows NZPAM to make formal assessments into non-payments of the levy. Section 13 places a four year long stop on exercising this power, from the day on which the return was made.
- 44 I propose that the amendment to the ERL Act makes clear that this clarification applies throughout that period of four years prior to the amendment coming into force. This is seen as an application of existing practice.

The clarification could be made as part of Budget night legislation

- 45 I am working with the Leader of the House and Minister of Finance to progress this amendment as part of Budget night legislation as it seems appropriate to use this vehicle and for timing reasons.

Financial Implications

- 46 There are no financial implications to the Crown in undertaking this policy proposal. However, choosing not to progress this proposal may significantly reduce Crown return from the petroleum estate over time, Commercial
[REDACTED]

Legislative Implications

- 47 Cabinet has agreed that the Bill should have a category of 3 on the Government's Legislation Programme – to be passed if possible before the 2023 general election.
- 48 The principal Act is already binding on the Crown. This is not proposed to change.

Impact Analysis

Regulatory Impact Statement

- 49 The Treasury's Regulatory Impact Analysis team has determined that the proposed amendment to clarify obligations relating to the fossil gas levy exemption in the ERL Act is exempt from the requirement to provide a Regulatory Impact Statement on the grounds that it has no or only minor impacts on businesses, individuals, and not-for-profit entities.

Climate Implications of Policy Assessment

- 50 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met. While this proposal will clarify existing obligations on levy payments for specific petroleum licences,

this is not expected to have an impact on fossil gas production or greenhouse gas emissions.

Population Implications

51 There are no population implications arising from this policy proposal.

Human Rights

52 This policy proposal is consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

53 The following agencies were consulted on this paper: The Treasury, Inland Revenue Department, and the Ministry for the Environment. The Department of Prime Minister and Cabinet was informed.

Communications

54 An appropriate communications approach to this legislation will be developed as the process progresses.

Proactive Release

55 Should the Bill be passed, I intend to release this paper, subject to redaction as appropriate and consistent with the Official Information Act 1982.

Recommendations

The Minister of Energy and Resources recommends that the Committee:

- 1 **note** that all petroleum legislation in New Zealand seeks a fair financial return to the Crown for minerals allocated through Petroleum Act 1937 licences or Crown Minerals Act 1991 permits;
- 2 **note** that since 1 January 1986, the Energy Resources Levy Act 1976 (**the ERL Act**) has been used as a royalty relativity mechanism to offset or balance revenue from fossil gas production on pre-1986 licences with low royalty rates compared to later licences and permits with higher royalty rates;
- 3 **note** that the ERL Act contains an exemption clause so that the levy is not applied to new “discoveries” after 1986 with higher royalty rates;
- 4 **note** the interpretation of the word “discovery” in the ERL Act’s exemption clause could undermine the broader intent of petroleum legislation to achieve a fair return to the Crown;

5 Commercial Information

I N C O N F I D E N C E

- 6 **agree** to amend the ERL Act to clarify levy payment obligations for all natural gas produced from pre-1986 licences;
- 7 **agree** that the amendment makes clear that this clarification applies throughout the period of four years prior to the amendment coming into force;
- 8 **note** the proposal in recommendation 6 currently holds a category [3] priority on the 2023 Legislation Programme (to be passed before the 2023 general election);
- 9 **invite** the Minister of Energy and Resources to issue drafting instructions to the Parliamentary Counsel Office to give effect to the recommendations above; and
- 10 **authorise** the Minister of Energy and Resources to make changes consistent with the policy intent and on any minor or technical matters that may arise during the legislative drafting process.

Authorised for lodgement

Hon Dr Megan Woods

Minister for Energy and Resources