Investing in Australia’s oil & gas sector – an overview
Overview of Investment in the Australian Petroleum Industry

Foreword

Allens presents to you its Investment in Australia’s oil & gas sector – an overview, a short introductory guide that aims to identify some of the legal and regulatory issues that foreign investors will face when considering an investment opportunity in Australia’s petroleum sector.

Australia has been, and will continue to be, an attractive location for foreign investors to find and capitalise on investment opportunities. The Australian Government welcomes foreign investment, and has an open foreign investment policy, making it easy for foreign investors to enter the Australian market. Australia has a flexible market-driven economy that encourages new and expanding enterprises. It also has political, economic, legal and social systems that are robust and transparent, ensuring stability and surety for investors, and has strong ties with the countries in the region.

Allens is a leading law firm with partners, lawyers and corporate services staff across Australia and Asia. Through our integrated alliance with Linklaters, we provide our clients with access to market-leading lawyers through a global network spanning 40 offices and 29 countries. We have been a longstanding player in the Australian oil and gas industry – an industry that has an important role to play, not only as a significant contributor to the Australian and regional economy, but in meeting growing global energy demands.

Our role as key adviser to many of the world’s largest resources companies, and the industry expertise of our team members (many of whom have either been seconded to or worked full-time with oil and gas companies), allows us an in-depth knowledge of the legal issues confronting developers and investors operating in this sector.

This guide aims to make investing in the Australian petroleum sector easier to understand, and discusses the legal and regulatory environment that investors will face. However, this guide is intended only as a summary of the issues, and is not a legal opinion. If you require more information or advice about your particular circumstances, please do not hesitate to call any of the contacts listed.
Overview of exploration and production regime

Introduction to legislative regimes

Ownership of hydrocarbons is vested in the Commonwealth, state or territory governments. The right to conduct petroleum activities, including exploration and production, is acquired through the grant of various licences and approvals from the government authority responsible for administering the applicable legislative regime/s. Once it has been recovered, the titleholder/s own the petroleum and the Government’s interest in such petroleum is limited to an economic interest in the form of a tax or royalty.

In Australia, it is not uncommon for offshore petroleum projects to be regulated by petroleum legislation from all three regimes; for example, where a project involves exploration in the Commonwealth offshore area, a pipeline that passes through the state offshore area and an onshore processing facility.

Commonwealth

Upstream petroleum activities in the Commonwealth offshore area are principally governed by the Offshore Petroleum and Greenhouse Gas Storage Act 2006 (Cth) (the OPGGSA). Project proponents are granted rights to conduct petroleum exploration, appraisal, development and production activities in the Commonwealth offshore area under a statutory licensing regime. The Joint Authority and the National Offshore Petroleum Titles Administrator (NOPTA) have responsibility for the administration of petroleum tenure under such a licencing regime.
State
Each state and territory has its own legislative regime regulating petroleum activities in each of their offshore and onshore areas. The types of petroleum tenure established by each of these regimes broadly mirror those contained in the OPGGSA. The relevant state or territory Minister is responsible for the grant and administration of this tenure.

Petroleum tenure
Although the licencing regimes vary between jurisdictions, they share common features. All regimes establish forms of exploration and production licences. Some regimes have a third form of licence authorising the retention of an area following a petroleum discovery which is not yet commercially viable. The main types of petroleum licences applying to the different stages of petroleum projects are as follows.

Exploration permit
An exploration permit grants the permit holder the right to explore for petroleum within the permit area, and also authorises the recovery of petroleum on an appraisal basis, and any works associated with these purposes.

Retention lease
A retention lease authorises a lessee to retain tenure over a lease area containing petroleum resources that are not currently commercially viable, but are expected to become commercial within 15 years. A lessee is expected to conduct activities to enhance the commercial viability of the resource. A retention lease, similar to an exploration permit, allows the lessee to explore for petroleum in the lease area, recover petroleum on an appraisal basis, and carry on such operations as are necessary for those purposes.

Production licence
A production licence permits a licensee to produce commercial quantities of petroleum from the title area and also to conduct further exploration activity. Production licences may be granted subject to such conditions as the Joint Authority thinks appropriate. Since 1998 production licences are granted for an indefinite term. However, the Joint Authority may terminate a production licence where no petroleum recovery operations have been conducted in the title area for a continuous period of five years.

Pipeline licence and infrastructure licence
Generally, upstream petroleum project participants will also require pipeline licences and infrastructure licences in respect of the pipeline between the production facility and the processing facility and any associated infrastructure, including the processing facility itself.

The licences are usually granted for an indefinite term and subject to a number of standard conditions. Similar to production licences, the relevant administrative body has discretion to terminate the licence if the relevant pipeline or infrastructure has not been operated for a continuous period of five years.

Government take
Unlike in many jurisdictions, the Australian Government does not seek to participate in the production of petroleum directly, but has an economic interest in oil and gas production levied through royalties or the Petroleum Resource Rent Tax (PRRT).
Royalties
In relation to onshore projects, proponents will need to pay state and territory based royalties on their production. Generally, the states and the Northern Territory levy a royalty of between 10 -12.5 per cent on the wellhead value of petroleum produced within their jurisdiction.

PRRT
The PRRT is a tax levied by the Commonwealth on the taxable profits of petroleum projects. It is the primary method by which the Commonwealth gains revenue from Australian petroleum operations. Proponents of petroleum projects will be liable to pay the PRRT where they have an interest in a petroleum project and are entitled to receive receipts from the sale of petroleum, or of marketable petroleum commodities produced from the petroleum. The tax is determined based on the receipts of a project, less certain prescribed deductible expenses, such as eligible exploration expenditure. The PRRT is then levied at a rate of 40 per cent of such profits.

Since 2012 the PRRT applies to all onshore and offshore projects, including those on the North West Shelf and unconventional gas projects.
Obtaining an interest in a petroleum title

Release of acreage for exploration

Commonwealth offshore area
The Commonwealth Government releases a number of prospective areas in the Commonwealth offshore area on an annual basis. Acreage is released on the basis of graticular blocks which form an ‘area’. Petroleum exploration companies are invited to place bids for exploration permits, whereby they nominate the particular blocks within a released area in respect of which they propose to obtain the exploration permit.

State offshore and onshore areas
Acreage falling within the state offshore areas or onshore is generally released in a similar manner as Commonwealth offshore acreage. For example, the Western Australian Department of Mines and Petroleum administers the release of graticular blocks within its area of jurisdiction on an annual basis.

Assessment of bids
Generally, the grant of petroleum exploration acreage is competitive process assessed on the basis of a work program bidding system. An applicant must set out the work program it proposes to implement should it be granted the exploration permit. The applicant must satisfy the relevant regulatory body that it has adequate financial resources and technical expertise in order to achieve the works set out in its proposed work program. An influential factor will be the applicant’s previous performance in respect of other petroleum exploration tenure, both in Australia and internationally.

Acquiring an interest in an existing title

Acquisition of assets or acquisition of shares
Generally, an investment in the Australian petroleum industry will either involve acquisition of a direct interest in the assets of a petroleum project (including the relevant licences), or acquisition of shares in a company that owns an interest in a petroleum project.

There are advantages and disadvantages associated with both asset and share purchases (including the tax treatment of each type of transaction) so it is important for prospective investors to discuss which method is most suitable for their objectives with their legal and commercial advisers.

Acquisition of assets and farm-in agreements
Interests in petroleum titles are capable of being bought and sold. Transfers of an interest in a title will be subject to the approval and registration by the applicable authority. The creation of any interest over a title (referred
to as a ‘dealing’) will also require approval and registration by the applicable authority. Arrangements classified as dealings include joint venture agreements, joint operating agreements, farm-in agreements (also called farm-out agreements) and private royalty agreements.

Farm-in agreements are a regular occurrence in the Australian petroleum industry, particularly where an investor is seeking to acquire an interest in a petroleum project during its exploration phase. Under a farm-in agreement, the farmee (being the party wishing to acquire an interest in the petroleum title) enters into an agreement with the farmor (being the titleholder). Under the agreement, the farmee agrees to fund particular exploration costs or make a capital contribution, in order to earn an interest in the title. Generally, once the farmee earns this interest, it will form an unincorporated joint venture with the farmor for the further exploration of the title and consequent production of petroleum. Joint venture structures are discussed further below.

Acquisition of shares in company holding a petroleum title

The level of regulation and method for acquiring shares in a company will depend on whether the company is a listed public company, unlisted public company or private company. In contrast to a purchase of assets, purchasing the shares in a company results in the purchaser acquiring the business vehicle, meaning that all contracts will be automatically acquired and there may not be a need to obtain third-party consent. However, acquiring a business through the purchase of the shares in a company results in the purchaser acquiring all the liabilities of the company. To mitigate this risk, the purchaser may obtain warranties and indemnities from the seller.

Foreign investment approval

The Foreign Acquisitions and Takeovers Act 1975 (Cth) (the FATA), the associated regulations and the Commonwealth Government policy provide the framework for foreign investment in Australia. Under this regime, where a foreign person proposes to acquire an interest in an Australian business, corporation or land, they may be required to notify the Foreign Investment Review Board (FIRB). FIRB advises the Commonwealth Treasurer, who is ultimately responsible for approving (or blocking) the proposal.

In relation to privately owned foreign investors, prior foreign investment approval is not required before making an application for an exploration permit, the grant of exploration acreage or in relation to the consequent development of any petroleum discovery. However, notification and approvals may be required for farm-in activities, equity acquisitions or acquisitions of existing interests in petroleum titles and facilities, subject to certain thresholds. Specifically, foreign persons must notify FIRB before acquiring:

- an interest of 15 per cent or more in an Australian business or corporation that is valued at more than A$248 million; or
- an offshore company whose Australian subsidiaries or gross assets are valued at more than A$248 million.1

1. These monetary screening thresholds apply for 2014. The thresholds are subject to annual indexing. Higher thresholds apply to US and New Zealand investors.
Foreign persons must also notify FIRB before acquiring:

- an interest which provides the right to ‘occupy’ Australian urban land and the term of the lease or licence is likely to exceed five years; or

- an interest in an arrangement involving the sharing of profits or income from the use of, or dealings in, Australian urban land, regardless of the value of the interest.

As such, foreign persons must notify FIRB before acquiring an interest in a petroleum production licence, and may also be required to notify FIRB prior to the acquisition of an interest in an existing exploration permit or retention licence.

In relation to foreign government investors, foreign investment approval is required before making a ‘direct investment’ in an Australian company, establishing a new business or acquiring an interest in land, regardless of the value. This reference to land can include the grant or acquisition of any interest in a prospecting, exploration or production tenement.

The Treasurer is empowered to prohibit a proposal if it is considered to be contrary to the national interest. While the FATA does not define the concept of ‘national interest’, nor provide any guidelines on how it is to be assessed, the policy states that there are five factors typically considered by the Treasurer. These factors are: national security; competition; other government policies; impact on the economy or the community; and the character of the investor. Where a proposal is notified to FIRB, the Treasurer has 30 days from the date of the proposal to make a decision. However, where the proposal is particularly complex, the Treasurer may make an interim order extending examination period for a further 90 days. Applicants will be notified of the Treasurer’s decision within 10 days of it being made.

**Joint ventures**

It is very common in the Australian petroleum industry for petroleum activities to be conducted as a joint venture. Joint ventures typically involve two or more companies coming together, usually by way of a joint venture agreement, to work together on a project. A joint venture is usually used for a specific project or venture. The joint venture can either be incorporated (where the joint venturers together form a company) or unincorporated (where the joint venturers hold the underlying assets in proportion to their participating interests).

Parties in an unincorporated joint venture will enter into a joint venture agreement (a ‘JVA’) or joint operating agreement (a ‘JOA’) which governs the arrangements for the operation and management of the project. The agreement will generally outline the scope and duration of the venture, participating interests, obligations of the parties, entitlements to production and provisions relating to default, liability, assignment, withdrawal and rights of pre-emption. It should be noted that unincorporated joint ventures are particularly common in the Australian petroleum industry.
Other considerations relevant to petroleum projects

Investing in petroleum projects may also require appropriate due diligence on various other legal issues, including:

- environment;
- native title and cultural heritage;
- occupational health and safety;
- employment regulation;
- tax; and
- competition law.
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We have a number of other specialists who can advise on a wide range of issues.