Newfoundland Labrador

Government of Newfoundland and Labrador
Department of Natural Resources

December 7, 2017

[redacted]

Dear [redacted]

Re: Your request for access to information under Part II of the *Access to Information and Protection of Privacy Act* (File # NR-91-2017)

On November 8, 2017, the Department of Natural Resources received your request for access to the following records/information:

> **Please provide .pdf copies of all presentations prepared for and/or provided to NOIA or CAPP since January 2017 related to the proposed/actual implementation of the new Offshore Oil Royalty Regulations and/or new generic oil royalty**

You subsequently advised that you were seeking **the pdf copy of the presentation that was prepared for and given to the NOIA Board in June 2017.**

I am pleased to inform you that a decision has been made by the Department of Natural Resources, confirmed by the Deputy Minister, to provide access to the requested information and the records are attached.

As set out in section 42 of the Act you may ask the Information and Privacy Commissioner to review the department's decision to provide access to the requested information. A request to the Commissioner must be made in writing within 15 business days of the date of this letter or within a longer period that may be allowed by the Commissioner. Your request should identify your concerns with the department's response and why you are requesting a review.

The request for review may be addressed to the Information and Privacy Commissioner is as follows:

Office of the Information and Privacy Commissioner

2 Canada Drive
P.O. Box 13004, Stn. A
St. John's, NL. A1B 3V8

Telephone: (709) 729-6309
Toll-Free: 1-877-729-6309
Facsimile: (709) 729-6500

Pursuant to section 52 of the Act, you may also appeal directly to the Supreme Court Trial Division within 15 business days after receiving the department's decision.

Please be advised that responsive records will be published following a 72 hour period after the response is sent electronically to you or five business days in the case where records are mailed to you. It is the goal to have the responsive records posted to the Completed Access to Information Requests website within one business day following the applicable period of time. Please note that requests for personal information will not be posted online.

For further details about how an access to information request is processed, please refer to the Access to Information Policy and Procedures Manual at http://www.atipp.gov.nl.ca/info/index.html.

If you have any questions regarding the processing of your request, please feel free to contact me by telephone at 729-0463 or rhynes@gov.nl.ca.

Sincerely,

Rod Hynes
ATIPP Coordinator

Generic Offshore
Oil Royalty Regime

Context

- Currently the province has multiple oil royalty terms which were:
  - Designed to attract exploration and development;
  - Negotiated on a project-by-project basis or fall under *Royalty Regulations, 2003;* and
  - Based on the same calculation engine with various rates, tiers & return allowance
- Multiple terms show progression in the industry but create uncertainty for the explorer/investor. Investors need certainty on fiscal terms to help inform investment decisions.
- Compounding effect of return allowance in current royalty structure represents a significant risk to NL as project delays and cost increases have the effect of deferring or preventing the higher tier royalties.
- NL is a jurisdiction with increased prospectivity.
- Establishing a generic offshore oil royalty regime for future projects is important to continue the process of building for the long-term future of the province’s petroleum industry and creating certainty.

Existing Oil Royalty Regimes

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- All of the Province's existing oil royalty terms have two components:

  1. Basic Royalty:
     - Levied on gross revenue
     - Rates range from 1% – 10%

  2. Net Royalty:
     - Multiple tiers levied on net revenue. Payable after recovery of costs, cost uplifts and return allowances
     - Tier 1 Rates range from 20% – 30%
     - Tier 2 Rates range from 10% – 12.5%
     - Additional Royalty
       – Applies to recent projects and is linked to profit levels and crude oil price
       – Rates range from 2.5% - 12.5%

Issues with Existing Royalty

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- Cost Uplifts
  - A cashless expense that negatively impacts royalty payments
  - Allowed percentage increase on eligible project costs:
    - 5% + CPI adjustment on pre-development costs
    - 10% on operating costs
    - 1% on capital costs and abandonment costs
  - Does not incentivize project cost control

- Return Allowance
  - Defined percentage interest holders earn on eligible project costs. Rates range from 5% + LTBR to 18% + CPI. Cashless cost is compounded monthly.
  - Producers effectively earn a guaranteed return on investment before higher profit royalties become payable.
  - Compounding effect represents a significant risk to NL as project delays and cost increases have the effect of deferring or preventing the higher tier royalties.

New Offshore Oil Royalty

Newfoundland Labrador

- Builds on the new land tenure system, updated resource assessments and ongoing seismic acquisition program by Nalcor Energy.
- The new royalty was developed that embodies the following principles:
  - Enables fiscal certainty to the explorer/developer with a predictable, transparent and simplified regime that is internationally competitive.
  - Sufficiently flexible to adapt to different types of <u>economic</u> projects in the NL offshore.
  - Rebalances NL revenue risk and obtains higher royalties from projects with increasing profitability with protection for developers in low profit environments.
  - Applies to future projects – not subject to individual project negotiation.

New Offshore Oil Royalty

Newfoundland Labrador

- Central to the new regime is the concept of cost recovery and profitability as measured by a transparent ratio of cumulative project revenue over cumulative project costs.
- This ratio is referred to as the R-Factor or R where:

  R = (cumulative gross sales revenue and incidental revenue less cumulative transportation costs less cumulative basic and net royalty paid up to prior month) ÷ (cumulative pre-development, capital & operating costs)

- R-Factor compares actual dollars earned with actual dollars spent. In the petroleum industry many companies rank investments using financial profit investment ratios similar to R, i.e., no cashless costs.

New Offshore Oil Royalty

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Basic Royalty:

- to begin at first production and increase with project cost recovery
- fixed basic royalty rates linked to revenue over cost index (R Factor)

R Factor (R)	Basic Royalty Rate (BRR)
First Oil to $R < 0.25$	1%
$0.25 \le R < 1$	2.5%
$1 \le R < 1.25$	5%
$R \ge 1.25$	7.5%

Net Royalty:

- to begin with project cost recovery
- sliding scale net royalty rates driven by revenue over cost index (R Factor)

R Factor (R)	Net Royalty Rate (NRR)
$R < 1$ (R_{min})	0%
$1 \le R \le 3$	10% (NRR_{min}) - 50% (NRR_{max})
$R > 3$ (R_{max})	50%

- The new regime has a basic and net royalty with both linked to cost recovery and profitability as measured by one R-Factor (R) calculation.
- Basic royalty rates range from 1% to 7.5% with step increases linked to the R-Factor.
- Net royalty is set to one tier with sliding scale - flexible rates ranging from 10% to 50%. Rates linked to same R-Factor as defined for basic royalty. Basic royalty is a credit against net royalty.
- Royalty calculations are to be compiled on a monthly basis.
- The new regime does not include return allowances, uplifts and CPI adjustments on project costs.

Benefits of New Structure

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- Is a progressive, principled approach with a focus on project cost recovery and profitability.
- Removal of uplifts and return allowances makes the system more transparent. Reduces and rebalances risk to the province on its ability to benefit from upside resource revenues.
- Automatically responds to changing profitability of projects.
- Is internationally competitive. R-Factors are well understood by industry and are currently included in other jurisdictions.
- Provides certainty to companies in evaluating NL for offshore exploration investment and companies planning to develop existing discoveries.

Offshore Oil Royalty Regulations

- *Offshore Oil Royalty Regulations* will be the vehicle for legislating the new royalty.
- *Offshore Oil Royalty Regulations* are based on the *Royalty Regulations, 2003* and both will operate simultaneously:
  - Offshore Oil Regulations will apply to new projects on a go-forward basis.
  - Royalty Regulations, 2003 will continue to apply to existing projects.
  - A consequential amendment to the Royalty Regulations, 2003 will be required.
- Self-contained new *Offshore Oil Royalty Regulations* vs. amending *Royalty Regulations, 2003*:
  - Drafting amendments for two different royalty calculations became too complex and time consuming.
  - White Rose Framework Agreement and the Hebron Fiscal Agreements interact with parts of the *Royalty Regulations, 2003* and should not interact with the *Offshore Oil Royalty Regulations.*

Offshore Oil Royalty Regulations

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- The *Royalty Regulations, 2003* were reviewed to identify and mitigate issues in the *Offshore Oil Royalty Regulations*. Policy issues identified and corrected are:
  - Records are now to be made available for audit in the Province resulting in less travel costs for audit.
  - Arbitrations are no longer a part of the dispute process.
  - Transportation out-charter revenue and tanker classifications.
  - Removal of confidentiality for penalties.
- The review of the *Royalty Regulations, 2003*, identified non-policy issues such as spelling errors, typos, inconsistent wording, etc. These issues have been corrected in the *Offshore Oil Royalty Regulations.*

Summary

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- The new royalty has been approved.
- The new royalty regime provides fiscal certainty to offshore explorers and investors.
- The new royalty is sufficiently flexible to adapt to different types of economic projects in the NL offshore.
- The new royalty regime is internationally competitive and the approach is in use in other jurisdictions.

The Authority Process
Norway & NL

Newfoundland Labrador

	Norway	Newfoundland and Labrador (NL)
Fiscal regime	Fiscal requirements in place • Well regulated and understood. • Exploration Tax Credit introduced in 2004.	Legislated Royalty Regime in place since 1996, however, a policy of negotiation has been the norm. • Fiscal, Equity and Benefits Agreement (FEB). • Need to negotiate early.
Development approval	PDO (Plan for Development and Operations) • Early insight from government. • The OD attends Partner Licence Committee meetings from exploration through out the licence period (development and operation phase) • PDO issued at DG3 • Decision within 6 months.	DP (Development Plan) • Approval is a Fundamental Decision • Negotiated Benefits Agreement with Province in advance of DP and Benefits Plan (BP) submission • The DP approval process takes a minimum of 2 years from submittal.
Environmental Impact Assessment	KU - Same process as NL	EIA - Same process as Norway

Strong Compliance with Accord Acts = Strong Reputation and Effective Operations

From Statoil Presentation to MUN Economics Department Workshop

NL Royalty Regimes & Timelines

Newfoundland Labrador

Hibernia (Original Lands)	Royalty Contractual Agreement (1990)
Terra Nova	Legislated Regime (Petroleum & Natural Gas Act), Regulations (Interim Dec. 2001 / July 2003)
White Rose (Generic Regime Return Allowance Regime)	Legislated Regime (Petroleum & Natural Gas Act), Regulations (July 2003)
White Rose Expansion	Royalty Contractual Agreement (2007)
Hebron	Royalty Contractual Agreement (2008)
Hibernia (South Extension)	Royalty Contractual Agreement (2010)

Prospectivity vs Fiscal Attractiveness
Wood Mackenzie, 2016 Fiscal Benchmarking

Newfoundland Labrador

Figure 2: Fiscal attractiveness vs Prospectivity indices