

Financial institutions
Energy
Infrastructure, mining and commodities
Transport
Technology and innovation
Life sciences and healthcare



Status of Offshore Oil and Gas and Considerations Relating to Article 82: An Industry Perspective

W. Wylie Spicer Q. C.
of Counsel
April 16, 2014
Norton Rose Fulbright Canada LLP

Outline

1. UNCLOS Article 82
2. Current offshore drilling activity.
3. Applications to the CLCS.
4. The path to development - what industry needs to know.
5. Practical considerations regarding the "payments" due under Article 82.
6. Interpretation Guidelines: production; value; and site.
7. Conclusions

1. UNCLOS Article 82:

Payments and contributions with respect to the exploitation of the continental shelf beyond 200 nautical miles

1. The coastal State shall make payments or contributions in kind in respect of the exploitation of the non-living resources of the continental shelf beyond 200 nautical miles from the baselines from which the breadth of the territorial sea is measured.
2. The payments and contributions shall be made annually with respect to all production at a site after the first five years of production at that site. For the sixth year, the rate of payment or contribution shall be 1 per cent of the value or volume of production at the site. The rate shall increase by 1 per cent for each subsequent year until the twelfth year and shall remain at 7 per cent thereafter. Production does not include resources used in connection with exploitation.
3. A developing State which is a net importer of a mineral resource produced from its continental shelf is exempt from making such payments or contributions in respect of that mineral resource.
4. The payments or contributions shall be made through the Authority, which shall distribute them to States Parties to this Convention, on the basis of equitable sharing criteria, taking into account the interests and needs of developing States, particularly the least developed and the land-locked among them.

1. UNCLOS Article 82:

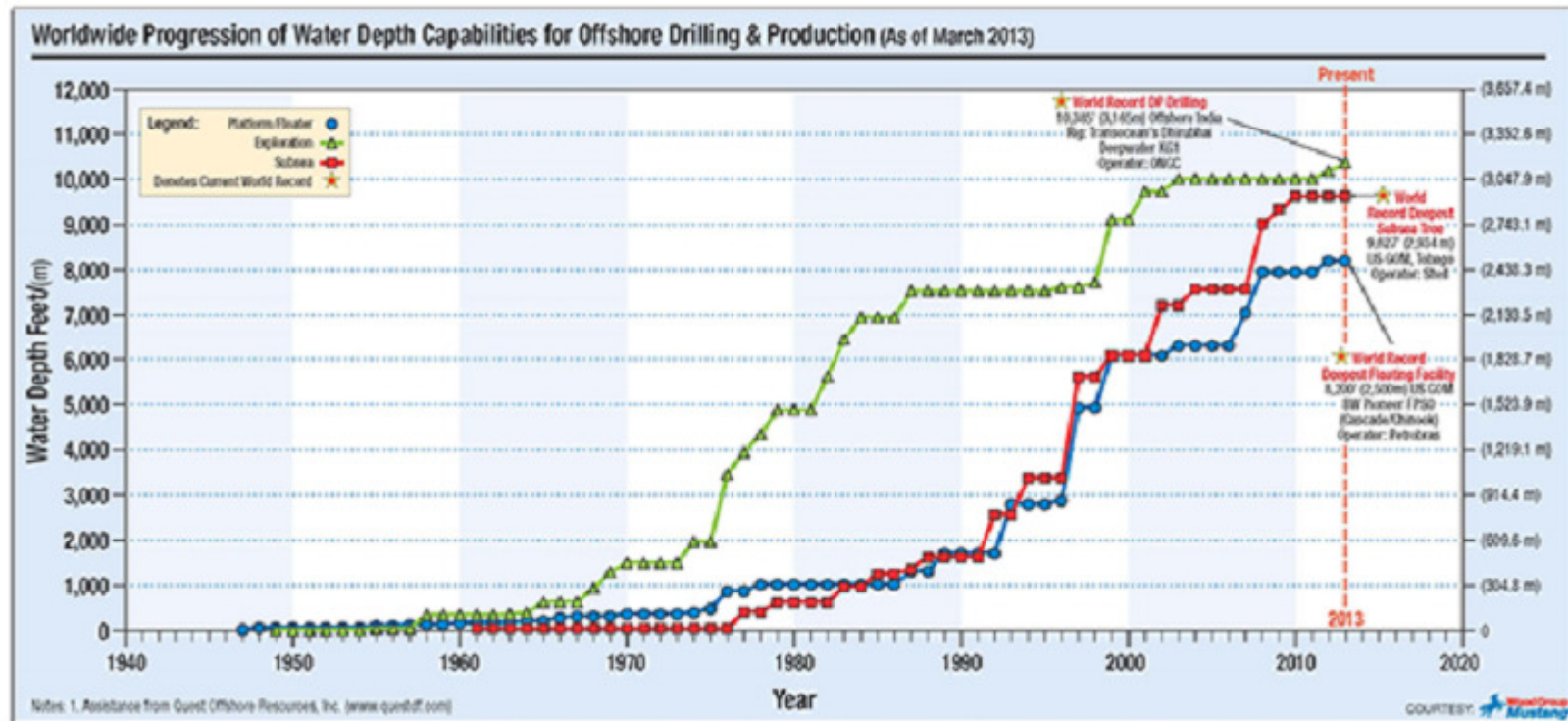
Payments and contributions with respect to the exploitation of the continental shelf beyond 200 nautical miles

1. The coastal State shall make payments or contributions in kind in respect of the exploitation of the non-living resources of the continental shelf beyond 200 nautical miles from the baselines from which the breadth of the territorial sea is measured.
2. The payments and contributions shall be made annually with respect to all production at a site after the first five years of production at that site. For the sixth year, the rate of payment or contribution shall be 1 per cent of the value or volume of production at the site. The rate shall increase by 1 per cent for each subsequent year until the twelfth year and shall remain at 7 per cent thereafter. Production does not include resources used in connection with exploitation.
3. A developing State which is a net importer of a mineral resource produced from its continental shelf is exempt from making such payments or contributions in respect of that mineral resource.
4. The payments or contributions shall be made through the Authority, which shall distribute them to States Parties to this Convention, on the basis of equitable sharing criteria, taking into account the interests and needs of developing States, particularly the least developed and the land-locked among them.

2. Current offshore drilling activity.

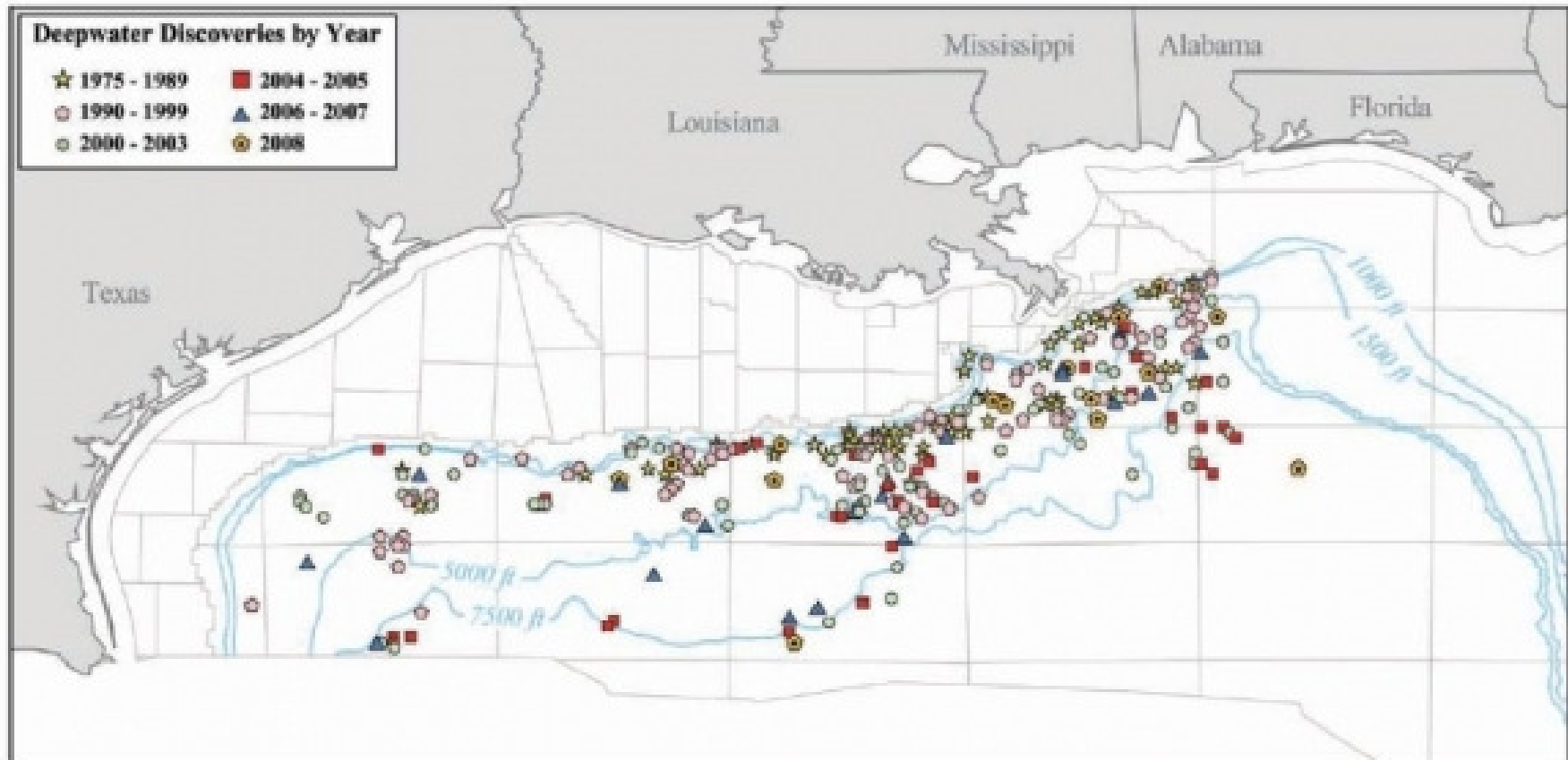
- Much has changed since UNCLOS was finalized.
- Move to drill for oil and gas in deeper water:
 - Gulf of Mexico
 - West Coast Africa
 - Brazil
 - East Coast Canada
 - Russia
 - Norway

2. Current offshore drilling activity.



2. Current offshore drilling activity.

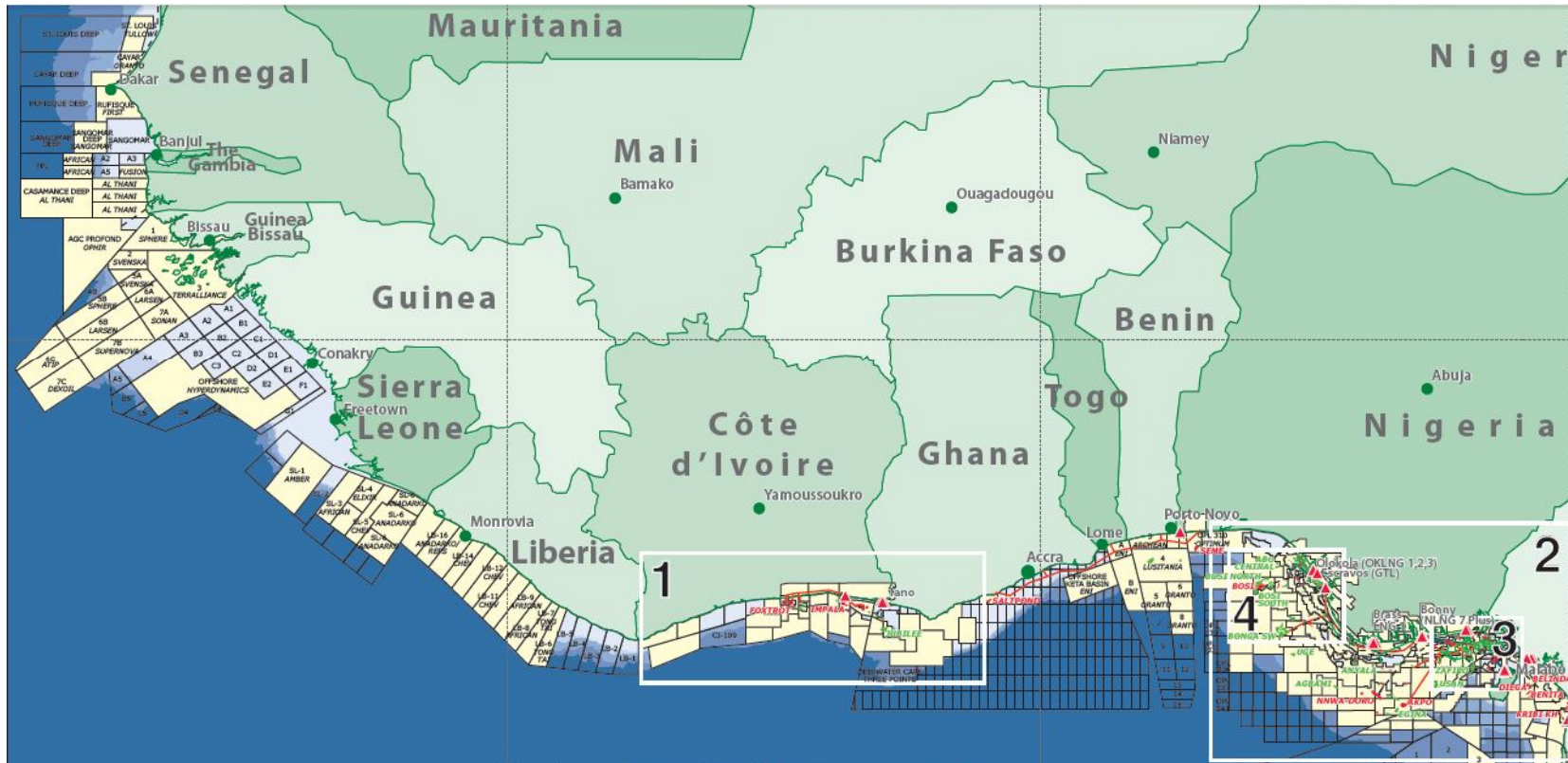
Deep Water Discoveries by year (Gulf of Mexico, USA)



Source: Minerals Management Service, *Deepwater Gulf of Mexico 2009: Interim Report of 2008 Highlights*

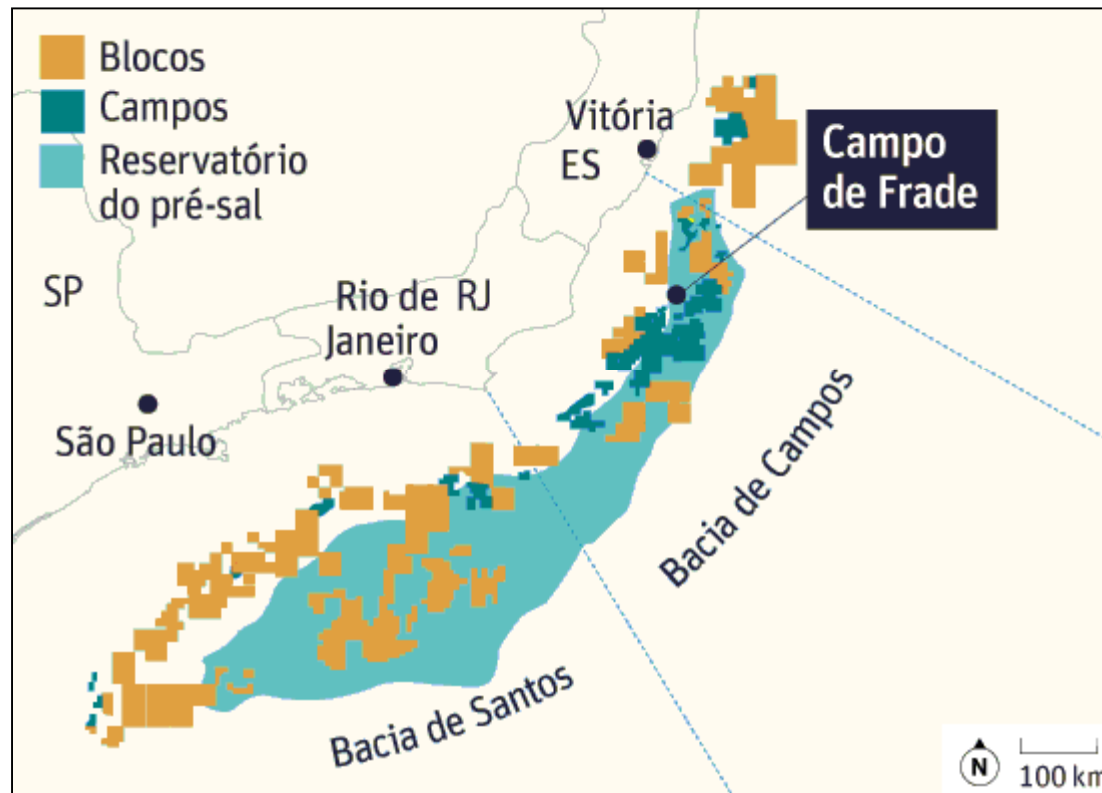
2. Current offshore drilling activity

West Africa Exploration Blocks



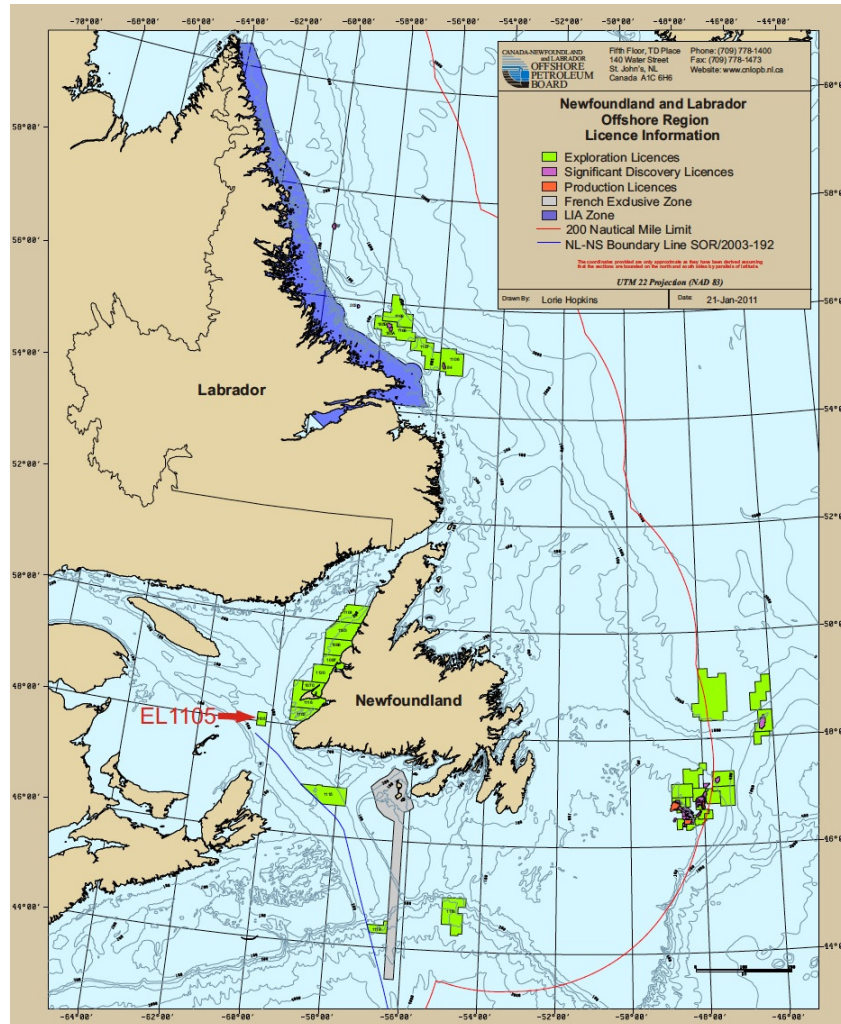
2. Current offshore drilling activity

Offshore Exploration Blocks - Brazil



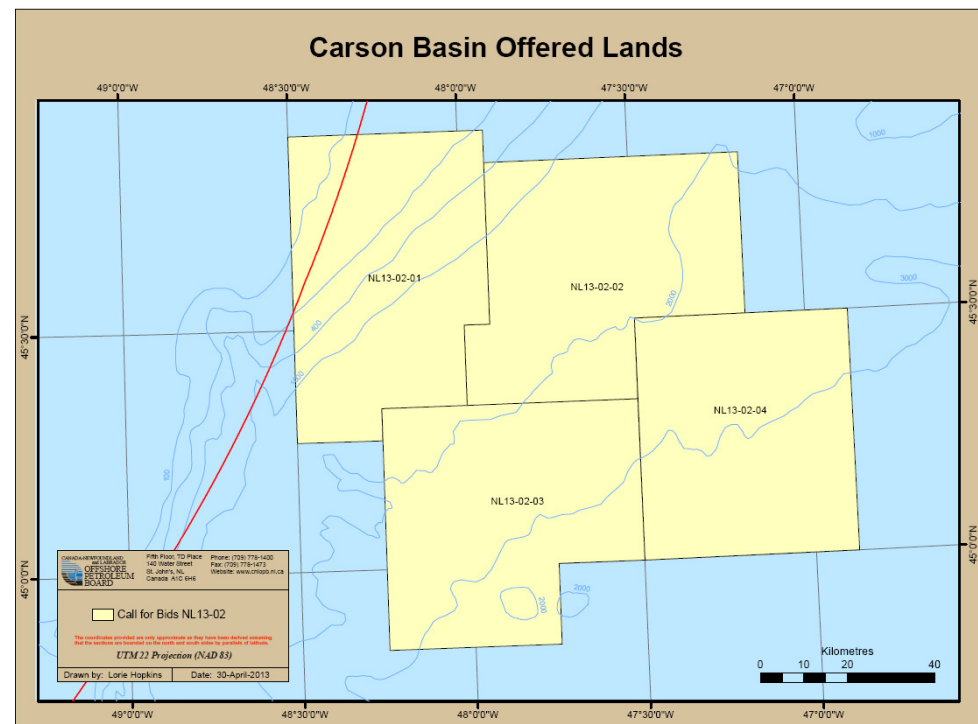
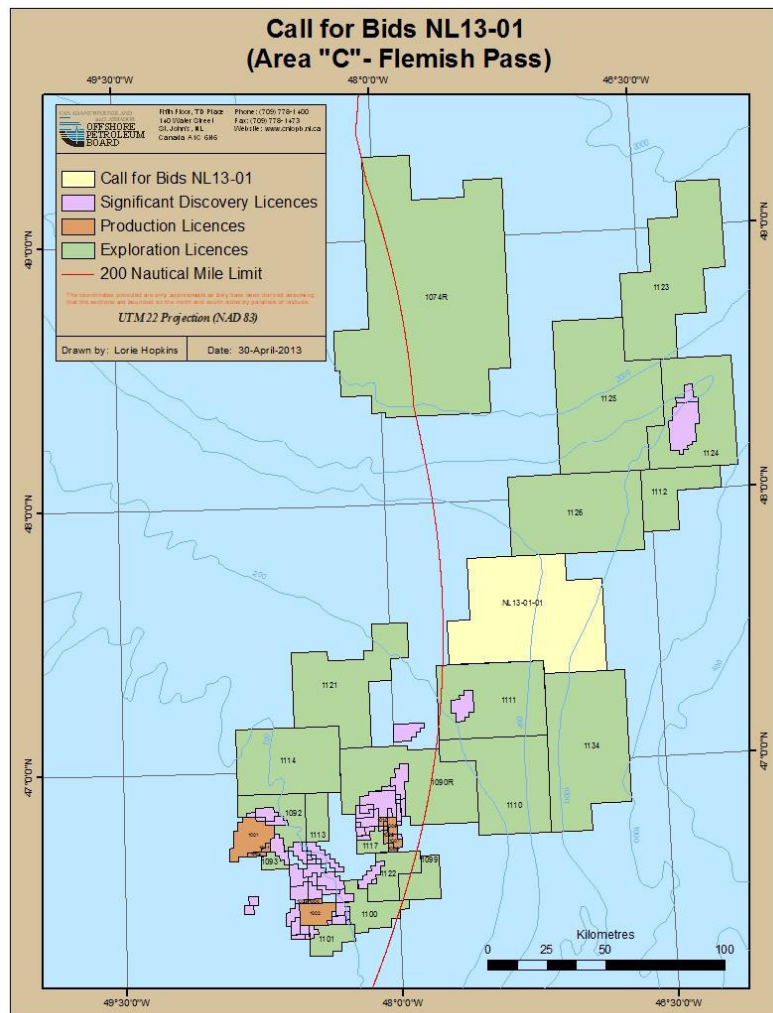
2. Current offshore drilling activity

East Coast Canada



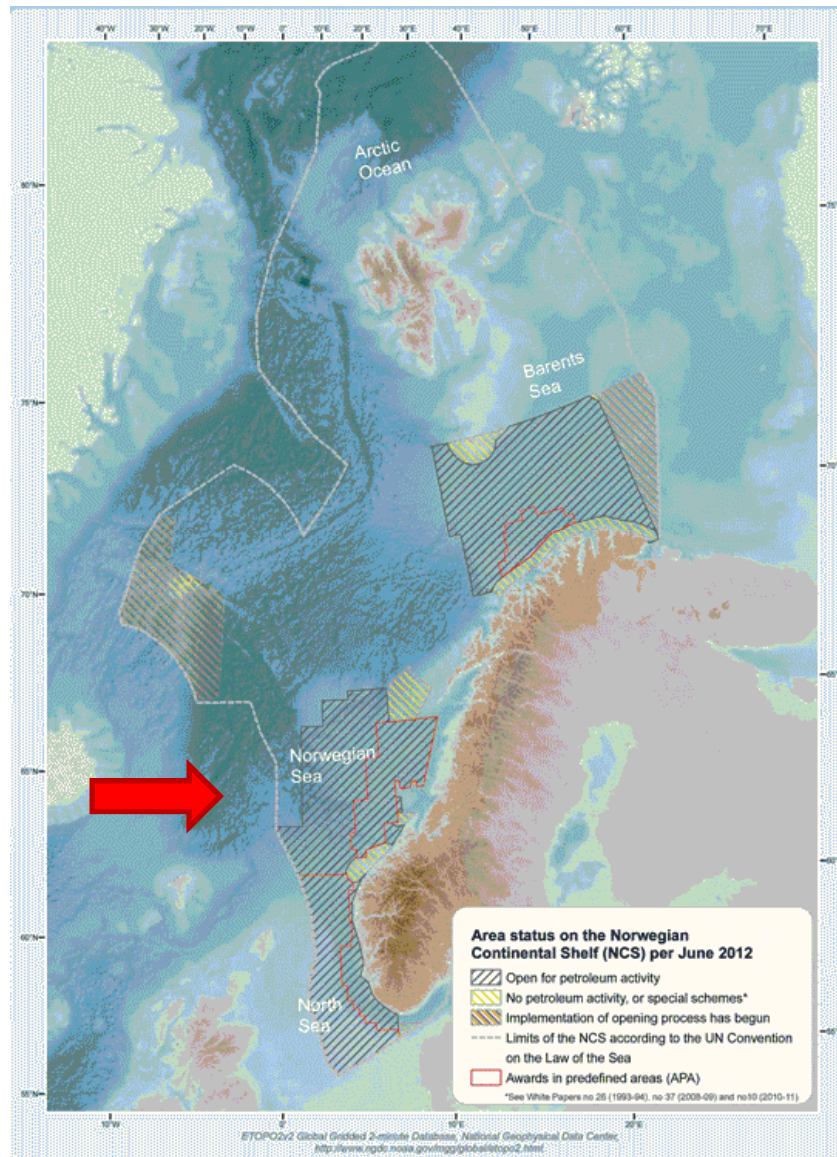
2. Current offshore drilling activity

East Coast Canada, Flemish Pass and Carson Basin



2. Current offshore drilling activity

Norwegian
Sea



2. Current offshore drilling activity

Russia, Shtokman Field (Barents Sea)



3. Applications to the CLCS.

	Submission by [State]	Date of submission	Presentation to the CLCS*
1	Russian Federation	20-Dec-01	See CLCS/32
2	Brazil	17-May-04	See CLCS/42
3	Australia	15-Nov-04	See CLCS/44
4	Ireland - Porcupine Abyssal Plain	25-May-05	See CLCS/48
5	New Zealand	19-Apr-06	See CLCS/52
7	Norway - in the North East Atlantic and the Arctic	27-Nov-06	See CLCS/54
19	United Kingdom of Great Britain and Northern Ireland - in respect of Hatton Rockall Area	31-Mar-09	See CLCS/64
20	Ireland - in respect of Hatton-Rockall Area	31-Mar-09	See CLCS/64
38	Nigeria	07-May-09	See CLCS/64
48	India	11-May-09	See CLCS/68
49	Trinidad and Tobago	12-May-09	See CLCS/66
50	Namibia	12-May-09	See CLCS/66
51	Cuba	01-Jun-09	See CLCS/66
57	Guyana	06-Sep-11	See CLCS/74
58	Mexico - in respect of the polygon in the Gulf of Mexico	19-Dec-11	See CLCS/74
61	Denmark - in respect of the Southern Continental Shelf of Greenland	14-Jun-12	
62	Tuvalu, France and New Zealand (Tokelau) - in respect of the area of the Robbie Ridge	07-Dec-12	See CLCS/80
63	China - in Part of the East China Sea	14-Dec-12	See CLCS/80
64	Kiribati	24-Dec-12	See CLCS/80
69	Angola	06-Dec-13	
70	Canada - in respect of the Atlantic Ocean	06-Dec-13	
71	Bahamas	06-Feb-14	

Over 76 extended continental shelf applications received to date, many from existing offshore mineral producers.

3. Applications to the CLCS.

- Although there is no necessary connection between Article 82 and 76 it is noteworthy that the number of states making applications under 76 is significantly greater than was originally contemplated.
- A considerable number of such applications seem to be driven by the potential for resource extraction.
- Canada, Norway and the USA are already notifying lessees of obligations under UNCLOS.

4. The path to development - what industry needs to know.

- Major resources producers are constantly evaluating exploration opportunities around the world.
- Only the investments with the most attractive rates of return proceed beyond exploration.
- Deep offshore resource recovery is capital intensive and high risk.

4. The path to development - what industry needs to know.

What goes into making a final investment decision (FID)?

- FID is the calculation of the net present value of expected future cash flows as well as anticipated rates of return
- Factors to consider include:
 1. Calculation of estimated costs including:
exploration costs; production costs; maintenance costs; cost of capital and contingency costs
 2. Anticipated cash flows based upon:
forecasted prices; rates of return; commodity hedging; long term purchase agreements; spot prices etc.
 3. Estimated quantity of resource recoverable (life of the reservoir):
existing vs. future technologies

4. The path to development - what industry needs to know.

What does this mean to the International Seabed Authority?

- Already significant uncertainty.
- Limited number of players with the experience and resources necessary to execute a project beyond 200 nm.
- Regulatory uncertainty affects several aspects of the FID decision, and could dissuade developers from proceeding.

5. Practical considerations regarding the "payments" due under Article 82.

- Some jurisdictions have multiple levels of government involved in resource recovery.
- Separation of the federal obligation to make payments to the ISA (as a coastal state) and the provincial entitlements to financial cash flows.
- Some jurisdictions collect a "tax" instead of a "royalty".

6. Interpretation Guidelines: production, value, and site.

- What do these words mean?
- To what extent are deductions eligible?
- Where is "value" defined?
 - Fair market value?
 - Well-head value?
- Payments are due annually, but when is value determined? Annually? Monthly?
- What is "production"
 - gross production?
 - net production?
- What does "site" mean? What if there are multiple producing wells on one lease?

6. Interpretation Guidelines: "production", "value", and "site".

- Does production include:
 - Test production?
 - Resources re-injected into the reservoir to enhance production?
 - Wastage?
 - Spillage?
 - Flared substances?
 - How much resource can a producer consume?
- How are exclusions to payment obligations determined (ie. developing states)? Are exemptions permanent?
- Who is required to make payments?

7. Conclusions

1. Although there is no certainty that any particular state would utilize a ISA glossary of terms in determining what the words of 82 are meant to mean, it can only be helpful for the O&G industry to advise what the common understanding is of these terms. For one thing, if states were to utilize these understandings it has the possibility of making the FID process a bit more straightforward. It is likely that the 82 payment will in some way come from the royalty/tax structure of the payor state. It just makes sense for the industry to have its voice, as I understood it did, when the time lines and %s of Article 82 were created. Now that the time is approaching when 82 will come to life it seems sensible to ask the industry what are the rules they use to determine cost and return.
2. In recognition that the real issues of 82 implementation are very much current, I would urge the ISA to quickly go ahead with the Beijing recommendation concerning the operative words of 82 and that it devise a methodology to ensure that the industry experience in utilizing these concepts for generations plays an important part.



NORTON ROSE FULBRIGHT

Disclaimer

Norton Rose Fulbright LLP, Norton Rose Fulbright Australia, Norton Rose Fulbright Canada LLP, Norton Rose Fulbright South Africa (incorporated as Deneys Reitz Inc) and Fulbright & Jaworski LLP, each of which is a separate legal entity, are members ("the Norton Rose Fulbright members") of Norton Rose Fulbright Verein, a Swiss Verein. Norton Rose Fulbright Verein helps coordinate the activities of the Norton Rose Fulbright members but does not itself provide legal services to clients.

References to "Norton Rose Fulbright", "the law firm", and "legal practice" are to one or more of the Norton Rose Fulbright members or to one of their respective affiliates (together "Norton Rose Fulbright entity/entities"). No individual who is a member, partner, shareholder, director, employee or consultant of, in or to any Norton Rose Fulbright entity (whether or not such individual is described as a "partner") accepts or assumes responsibility, or has any liability, to any person in respect of this communication. Any reference to a partner or director is to a member, employee or consultant with equivalent standing and qualifications of the relevant Norton Rose Fulbright entity.

The purpose of this communication is to provide information as to developments in the law. It does not contain a full analysis of the law nor does it constitute an opinion of any Norton Rose Fulbright entity on the points of law discussed. You must take specific legal advice on any particular matter which concerns you. If you require any advice or further information, please speak to your usual contact at Norton Rose Fulbright.