

Exploration shock

Recommendations from ICAC could force change in the exploration business model

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The New South Wales Independent Commission Against Corruption (ICAC) has proposed radical changes to how coal exploration licences should be granted in the state. The changes have the potential to turn on its head the way exploration activity has been funded in Australia. Investment risk would be raised if the ICAC approach became standard practice.

During the public inquiry into the conduct of former New South Wales (NSW) resources minister Ian MacDonald by the ICAC, commissioner David Ipp and counsel-assisting expressed frequent disbelief at what have been commonplace practices in the Australian resources industry. They were particularly unimpressed by the way in which early stage resources companies have been funded.

It is not uncommon, for example, for exploration licences to be granted prior to a company tapping public markets to fulfil its obligations under the terms of a licence. ICAC wants to stamp this out. It believes funding should be in place before a licence is granted.

Four aspects of the ICAC recommendations, if implemented, would force a change in the exploration-company business model.

First, ICAC has recommended that companies demonstrate their financial ability to complete required exploration work before a licence is granted. With the acquisition of a licence also being made tougher in other ways, investors may prove reluctant to put up funds without the certainty of knowing whether a licence will come their way. This is a risk beyond existing uncertainty over whether exploration itself will prove successful.

Second, ICAC has recommended that public consultations on land use should precede the granting of an exploration licence. ICAC does not want licences granted in the first instance if interest groups are going to prevent mining later by opposing an application to mine.

Those against mining in places such as the Hunter Valley, where there are competing land uses, are hardly likely to take a backward step if given the chance to put a case against an exploration licence. Limiting the scope of land use enquiries will prove difficult once the requirement is fixed in law. An enquiry will impose an additional material cost on a potential explorer. It could cause a significant delay in getting activities under way and be another reason for investors to run scared.

Third, ICAC is proposing an "exponentially escalating lease rent" to make it progressively more expensive for a company to hold an exploration tenement without moving to development.

This would be a particularly tough condition in a weakening market environment. A company could not choose to conserve capital, as many are opting to do now, because the more it delayed activity the greater the costs it would incur. Some might fail financially, as a consequence, adding to market instability.

The New South Wales government may also find tenements are handed back early to avoid the possibility of a rapid rise in payments. This is precisely what ICAC is intending should happen. The government will have to decide whether this is a desirable outcome and a sensible cost for weeding out a renegade politician.

Fourth, if ICAC had its way, exploration permits would be subject to competitive bidding.

The terms and conditions on which exploration licences are granted vary from state to state. Outcomes have been mixed and some consideration of the best method is warranted. The way in which the Australian exploration industry conducts itself may not always be in the best interests of the nation. It is questionable, for example, whether the A\$70 billion (US\$66.6 billion) spent since 1990 has delivered an adequate national return for an economy short of capital.

Companies engaging in exploration with too limited financial resources can undermine the integrity of public markets. A proliferation of companies with inadequate skill bases also reduces the likelihood of investor expectations being realised and siphons funds away from potentially more successful companies better able to contribute to national growth.

ICAC also found that the guidelines for granting licences in New South Wales were so poorly defined that even corrupt behaviour by minister Macdonald "did not immediately stand out as unusual to an external observer".

The risk for the industry is that it treats the ICAC recommendations as dealing with corruption and, therefore, not relevant to its interests. The industry could also be intimidated into a meek response at the thought of having to argue against a crime fighting body while possibly aligning itself with some of the more colourful members of the Sydney community. Failing to engage robustly with the government, however, could guarantee adverse changes.

The government, for its part, could also feel uncomfortable questioning the authority of ICAC on these matters. It might not wish to drag the commission into the political fray. To avoid political heat itself, the government might prefer to simply accept the recommendations.

But the upshot of ill-considered change to the system of allocating exploration licences could be a lower share price and the diversion of capital from New South Wales to elsewhere in Australia or overseas. In the extreme, investors could simply abandon support for exploration in the state. ▼



The Hunter Valley in New South Wales

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