Storting proposition no 36 (2000-2001)

OWNERSHIP OF STATOIL

AND

FUTURE MANAGEMENT OF THE SDFI

1. Objectives and challenges

1.1 The principal objectives of petroleum policy

Oil and gas resources represent a substantial part of the country's national wealth, and must be administered in a long-term perspective. The principal objectives for these petroleum activities can be summarised as follows:

Value creation, welfare and employment

- Ensure that oil and gas resources yield the highest possible value-added and help to secure welfare and employment. Welfare also embraces safeguarding life and health at a level which as a minimum is on a par with other parts of the welfare state.

Internationalisation

- Contribute to an internationalisation of our petroleum-related industry on the basis of its own competitiveness. That will help to extend the life of this industry beyond the duration of Norwegian oil and gas resources.

The environment and energy

- Combine a role as a large energy producer with a pioneering national role on environmental issues.

These three objectives are interdependent and form the basis for the government's petroleum policy.

State ownership, the main theme of this proposition, relates particularly to the first objective, but could also have great significance for the current internationalisation process. Ownership of Statoil and the state's direct financial interest (SDFI) is intended to contribute to value creation, welfare and employment to the benefit of the whole Norwegian population.

To meet these goals, it is important that oil and gas operations are organised in a way which optimises the utilisation of the resources. The organisation of state ownership is important in this context. The task facing us is to develop and adapt the structure to meet new and major challenges, so that we can achieve the overall objectives in the best possible way.

On the basis of these principal objectives, the government has specified the following principles for oil and gas policy:

- All oil and gas deposits on the Norwegian continental shelf (NCS) belong to the community, with the Norwegian state exercising this right of ownership.
- Oil and gas production will be regulated in a way which safeguards sustainable development and ensures responsible and long-term administration. On this basis, the state awards exploration and production licences for specified periods to the oil companies.
- Petroleum activities are very significant for the Norwegian economy and for our common welfare. They must therefore be subject to clear political management and control, and meet high standards of health, safety and environmental protection.
- These resources must be administered to the benefit of the whole population and future generations. An overall objective for the government's petroleum policy is that the largest possible share of value creation from oil and gas operations accrues to the community.

- The state’s cash flow from petroleum activities derives from taxes on the oil companies, revenues from the SDFI and dividend from Statoil and Norsk Hydro. The government will continue to make active use of these instruments to safeguard the community’s assets and revenues in future.
- An important consideration for the government is to ensure that operations on the NCS contribute to industrial development in Norway in relation to exploration and production activities, developments, operation and maintenance, land-based processing of oil and gas, technology development and research.
- The Norwegian supplies industry forms an important part of the country’s overall petroleum community, and much of the technological development in this sector occurs precisely in the interaction between suppliers and oil companies. We want Norway to retain a competitive and profitable oil and gas industry which contributes to employment and increased value creation, and which can compete over contracts both at home and abroad.
- The government will follow up these considerations and principles through legislation, licensing policy, national ownership of resources, and state participation in oil and gas operations through the SDFI and our two oil companies.

1.2 Principal challenges

The principal challenges and key trends which are significant in an ownership and resource management perspective are outlined below:

More mature continental shelf[1]

The resource base on the NCS is substantial. It covers fields in production, fields under consideration, fields without development plans and undiscovered resources. See figure 1.1. About 20 per cent of Norway’s petroleum resources had been produced by the beginning of 2000. Considerable oil and gas resources accordingly remain to be discovered and produced. Possibilities for making large new finds, primarily of gas, are particularly good in the deepwater areas of the Norwegian Sea.

Extensive areas of the NCS have moved into a more mature phase. This applies particularly to the North Sea. Discoveries are fewer and smaller, and making them commercial is more demanding. A number of fields show a declining production profile. The challenges faced in recovering as much as possible of the resources and in utilising existing infrastructure are growing. A number of fields will be shut in and abandoned in coming years.

Developing these mature resources in a profitable manner is more demanding than in the case of the largest oil and gas fields.

A good basis could also exist for increased cooperation between the UK and Norwegian continental shelves — at both government and company levels.

[1] A more detailed description of the resource base on the NCS is provided in the White Paper *St.meld. nr. 39 (1999-2000)*.

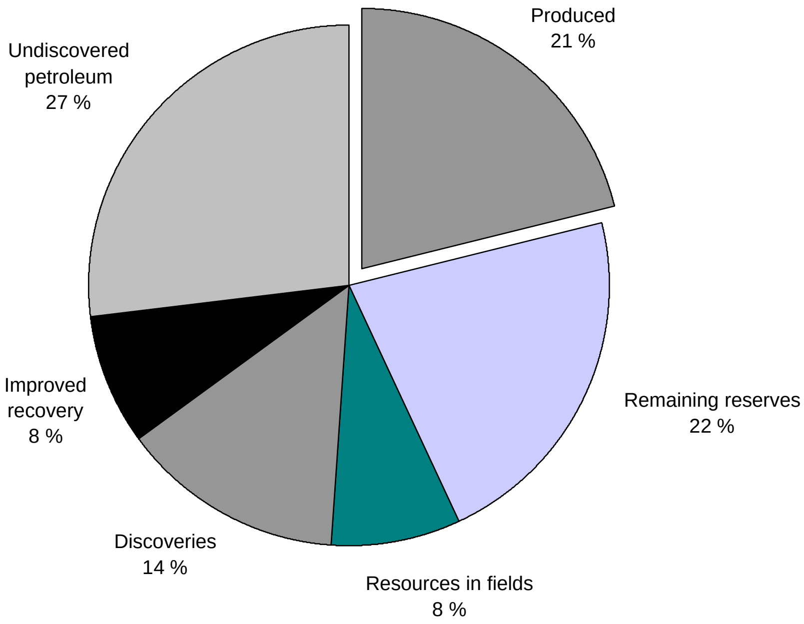


Figure 1.1: Petroleum resources on the NCS at 1 January 2000 by class of resource

Source: Norwegian Petroleum Directorate.

Licensee structure

The licensee composition and decision-making structure in many Norwegian offshore production licences are complex, with a number of participants and small holdings for both operators and partners. Ownership on the NCS is often compared with the historical strip farming system.

Apart from TotalFinaElf, ExxonMobil and BP, which have their main holdings in the southern part of Norway's North Sea sector, operators on the NCS have an average licence interest of 20 per cent. Between them, the two largest partners have an average holding of 25 per cent.

Big differences in licensee composition exist between the various production licences in specific geographical areas. That makes it even more demanding to find good solutions across licences and groups of companies. One example is coordinated use of infrastructure. Operating costs relating to fields and areas are substantial, and a considerable potential exists for increased production through extended operation of fields and phasing new satellites into them. Today's licensee composition and decision-making structure is badly adapted to the requirements for reducing costs and achieving increased production.

A restructuring which aimed to give larger holdings to operators and to achieve fewer but bigger licence partners would contribute to increased value creation on the NCS. That would benefit the state through taxes, cash flow from the SDFI and ownership of Statoil and Norsk Hydro.

The SDFI gives the state an instrument for helping to restructure offshore licence interests.

Internationalisation and globalisation

International oil companies have secured access over the past few years to petroleum resources in countries previously not open to them. New petroleum provinces have been opened to private interests. And provinces which were closed are in the process of being reopened. Oil and gas operations are pursued today in more than 100 countries world-wide. Figure 1.2 shows areas which have been opened over the past decade.

For the individual petroleum province, this development means increased competition over capital and the best human resources in the international companies. That applies particularly as low-cost regions, such as Middle Eastern countries, once again invite foreign companies to invest.

Internationalisation offers new opportunities, but also reinforces the challenges facing us on the NCS in obtaining a good commitment by the best companies. The NCS is one of a number of options available to oil companies when they set priorities for where to invest and use resources. By comparison with a number of petroleum provinces, the cost of exploration, development and production on the NCS is relatively high. Moreover, the level of taxation is higher than in other petroleum provinces with a corresponding level of costs.

Internationalisation represents an important strategy for the future progress of Norway’s oil and gas industry. Although large petroleum resources remain to be produced on the NCS, the potential for value creation by Norwegian companies will increasingly relate to international operations. Both Statoil and Norsk Hydro have established good positions in other countries. A number of Norwegian supplies companies also have important positions in other countries and continents.

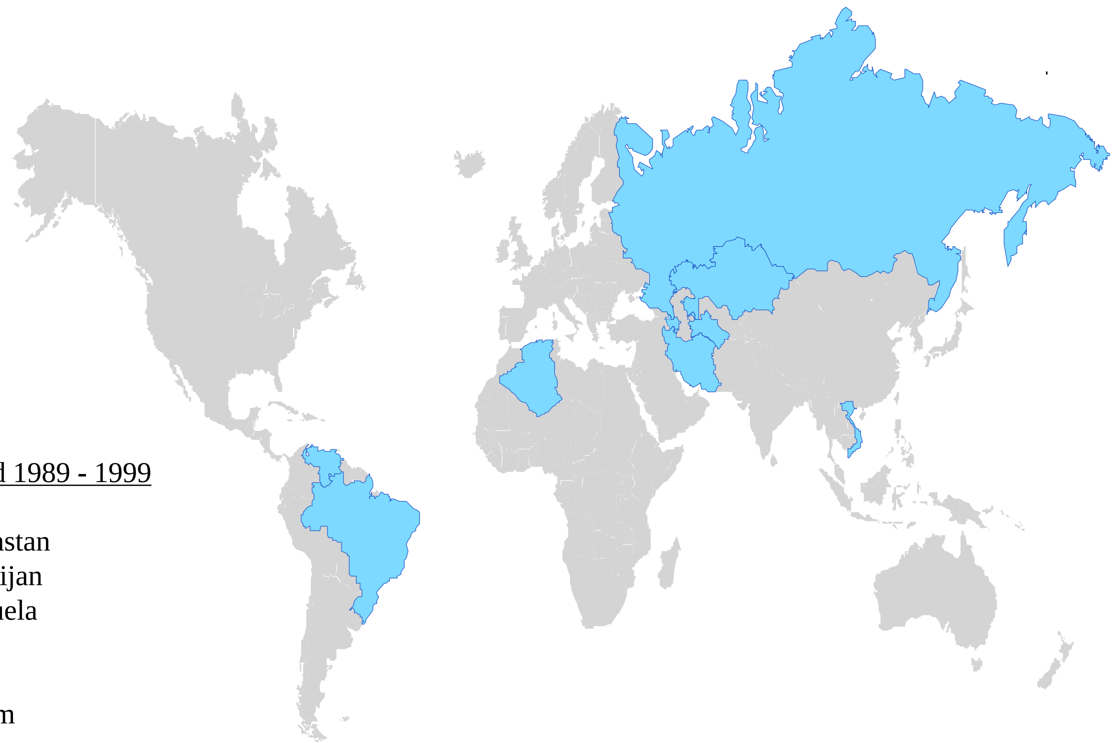


Figure 1.2: Opening of new areas

Source: UBS Warburg.

Consolidation

The oil and gas industry has displayed a strong trend towards consolidation in recent years. A similar development has occurred in other sectors, such as telecommunications, finance and the electricity industry. This consolidation trend is illustrated in table 1.1, which provides an overview of acquisitions and mergers in 1996-2000. The most important examples in an international context are BP’s mergers with Amoco and later with Arco, the merger of Exxon and Mobil, and the mergers of Total, Fina and later Elf. The merger announced between Chevron and Texaco is also substantial. Norsk Hydro’s acquisition of Saga Petroleum shows that Norwegian companies are involved in this development.

Table 1.1: Acquisitions and mergers, 1996-2000

COMPANY TRANSACTION	TIMING	VALUE(IN USD BN)
Mobil/ Amoplex	1996	1.6
BP/Mobil (joint venture)	1996	1.6
Shell/Texaco (joint venture)	1996	4.0

Burlington/LL&E	1997	3.0
Texaco/Monterey	1997	1.4
Occidental/Elik Hills	1997	3.7
Ashland/Marathon	1997	2.7
Arco/UTP	1998	2.7
BP/Amoco	1998	48.2
Kerr-McGee/Oryx	1998	3.1
Exxon/Mobil	1998	78.9
Total/Fina	1998	12.8
Repsol/YPF	1999	15.2
BP Amoco/Arco	1999	27.2
Norsk Hydro/Saga*	1999	4.9
TotalFina/Elf	1999	53.5
Chevron/Texaco	2000	35.8
Other**	1996-1999	204.1
Total	1996-1999	468.6

* In cooperation with Statoil, which acquired about 25 per cent of Saga's portfolio of interests in production licences.

** Only transactions worth more than USD 100 million.

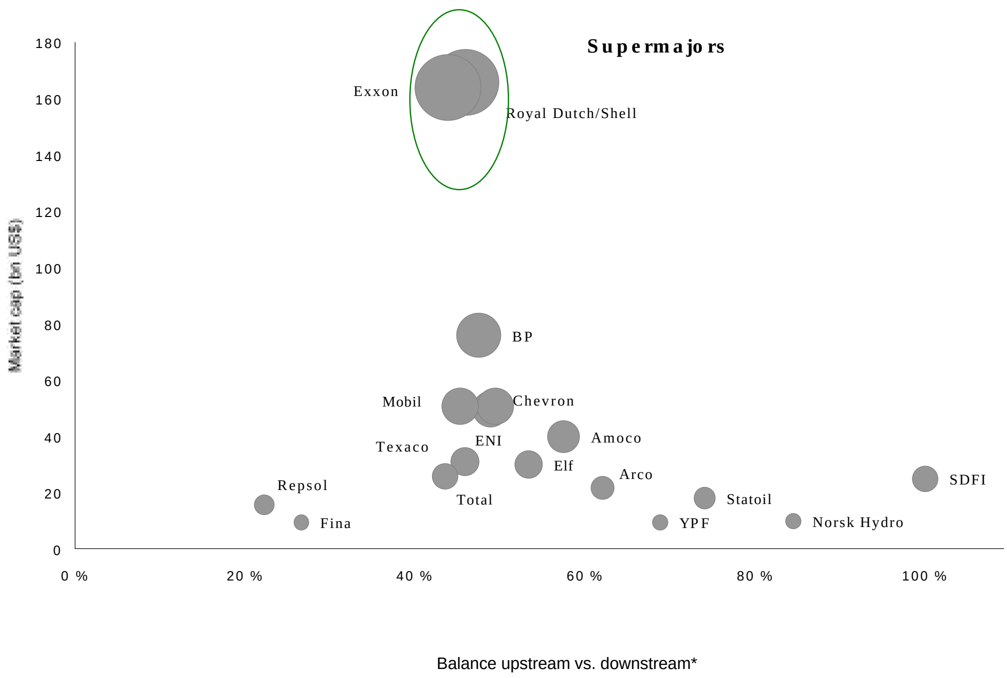
Source: UBS Warburg.

Figure 1.3 also provides a perspective on the consolidation trend, showing developments from August 1998 to October 2000. The figure presents market value (vertical axis) and balance between upstream and downstream operations (horizontal axis) for the largest listed oil and gas companies as well as for Statoil and the SDFI. One hundred per cent means that the companies only have upstream operations.

As the figure indicates, the number of companies has decreased and some of them, particularly the largest, have become significantly bigger. The group of "super majors" is up from two, Exxon and Royal Dutch/Shell, to three, ExxonMobil, Royal Dutch/Shell and BP. There has been a contraction in the intermediate category, from nine companies with a market value of USD 20-100 billion in August 1998 to four in October 2000.

Furthermore, the companies have a tendency to balance their operations between upstream business and downstream capacity.

August 1998



October 2000

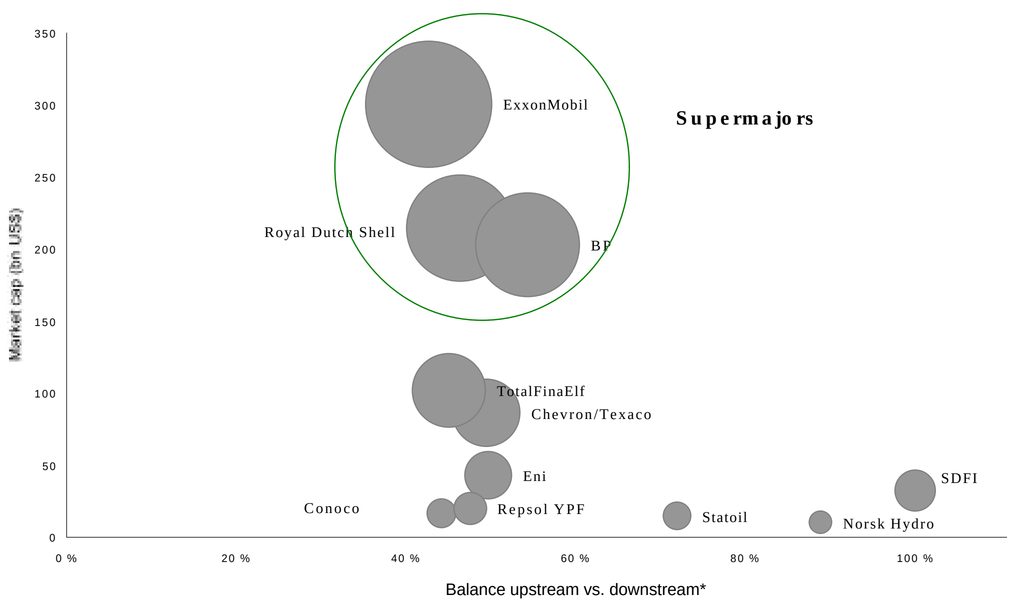


Figure 1.3: Consolidation

*Production/(production and refinery capacity)

Source: UBS Warburg.

These transactions have taken place for several reasons. One important motivation has been to achieve synergies, particularly on the cost side. Companies have been under considerable pressure to enhance earnings through cost savings.

The consolidation trend has consequences for the whole oil and gas industry, since the new companies created through this process show clear competitive advantages. Substantial funds have been liberated as a result of implemented sales and recapitalisation of the new companies. This cash can be used for new acquisitions.

Consolidation is also significant for competitive challenges between companies and for the player picture on the NCS. The biggest companies will normally focus on larger interests and fewer positions, for instance.

Changes in the European gas market

Developments in the European gas market are very important for Statoil and the state's economic interests on the NCS. Structural changes in Europe's gas and electricity markets, driven by increased competition, convergence between industries and new framework conditions, present a big and demanding challenge. The European Union's electricity and gas directives are helping to open the way to more direct competition between alternative suppliers towards end-users in the market. Some countries in continental Europe are showing a tendency to move both further and faster in opening markets to competition than is required by the EU directives. Introducing the gas directive could strengthen convergence between the gas and electricity markets.

Restructuring and the introduction of third-party access to transmission and distribution pipelines could create new commercial opportunities for companies on the NCS. Norwegian producers will have greater access in future to reaching end-users directly, or to becoming involved in projects further down the value chain. On the other hand, structural changes in the gas market will present a challenge for extending the type of long-term sales contract which has hitherto secured the development of gas projects on the NCS. Security of supply will continue to be important in future.

Business development in the gas companies is characterised by a focus on value creation opportunities and market positions along the whole value chain. Gaz de France, Ruhrgas and a number of the German electricity companies are competing to buy their way into distribution and transport in a number of European countries. Upstream, for instance, Gazprom has formed alliances with Royal Dutch/Shell, ENI, Ruhrgas, Wintershall, BASF and Gasunie to secure access to markets and capital for realising new projects. Sonatrach has invited BP and other international upstream companies to join new projects and to participate in marketing the gas from these.

Summary

On this basis, the government would sum up the challenges facing us as follows:

- Petroleum activities are our most important export industry, with substantial opportunities for further industrial development, improved competitiveness and international participation. Extending experience, expertise and established market positions is important in order to ensure that Norway retains its position as a leading energy nation, by giving Norwegian oil companies and the supplies industry a solid foundation for establishing strong positions in international energy markets.
- Promising opportunities continue to be offered by the NCS. So far, roughly 20 per cent of known oil and gas reserves in these waters have been recovered. Proven reserves provide a big potential for future operations on the NCS. This is to say they can support production of oil for 20-25 years and gas for close to a century. In addition come possibilities for new discoveries and an improved recovery factor for each well as a result of technological advances.
- In other words, substantial remaining reserves are available and it is still possible to make many profitable discoveries. But these reserves will in many cases be less accessible and thereby more demanding to produce. It will be important to lay the basis for efficient use of these reserves through exploration and production licences issued for specified periods, so that operations on the NCS can maintain their competitiveness.
- A principal feature of the Norwegian oil policy which has proved effective so far is that active competition between several competent companies helps to ensure the best possible use of resources. In this way, we ensure that they sharpen themselves against each other — not least in terms of geological knowledge and exploration models, development and transport solutions, and reduced greenhouse gas emissions.

- International markets for Norwegian natural gas are changing rapidly and are thereby characterised by uncertainty. To ensure that the value of Norwegian gas resources can be realised in line with our principles, we must lay the basis for ensuring that Norway — through Statoil — can continue to possess a strong European oil, gas and energy company in future. This is to say a company which can compete on equal terms over production, distribution and marketing.
- Development of the domestic market for direct use of natural gas in industry, transport, district heating and other applications must continue. Great opportunities will be offered in coming years for new modes of using and processing gas resources in such activities as fish farming, coastal shipping and ferry traffic, industrial use of bio-technology, and further development of existing industry. The government is also laying the basis for this through a separate action plan for domestic use of natural gas.
- We have witnessed a number of mergers and acquisitions across national boundaries in the oil and industry. To secure further development of expertise and asset values in Norway's oil companies and supplies industry, the basis must be laid for them to continue seeking assignments in other countries.

Further development of state involvement in Norwegian petroleum activities must be focused on the opportunities and challenges for our long-term gas administration presented by these changes.

Consequences for state involvement

Given the challenges we face, strengthening operations on the NCS will be important. A careful assessment must be made of the organisation and composition of state involvement in the petroleum sector. The government will focus on long-term administration of oil and gas resources:

- which strengthens our society industrially through national and international commitments which will provide the basis for secure jobs
- *at the same time* as we take account of government fiscal considerations in order to safeguard and develop the welfare state.

A good basis exists for improving the efficiency of the offshore sector and for continuing to develop national industrial communities, both at home and internationally, in our most important industry. This will provide positive spin-offs for land-based industry and centres of expertise in Norway.

Long-term gas management presents a very special, important and demanding challenge.

All these conditions will affect the competitiveness of Norway's offshore sector. Continuing to develop and strengthen the competitiveness of the NCS will be crucial for ensuring optimum resource management and for extending international involvement.

The most important considerations underlying the development of state involvement which the government intends to implement are:

- safeguarding state revenues
- continuing progress for Norway's oil industry, both nationally and internationally
- enhancing the competitiveness of Norway's offshore sector
- ensure long-term gas management as an integrated part of these three elements.

This proposition presents the government's assessments of and proposals on the way state ownership should be organised to achieve the overall objectives of petroleum policy.

2. Summary

2.1 Background

Norway's oil and gas resources belong to the whole Norwegian community and must be managed to the best advantage of present and future generations. Ensuring that the community secures the largest possible share of value creation from oil and gas operations accordingly represents a overriding objective of the government's oil and gas policy.

Changes in market and competitive conditions in the oil and gas industry necessitate adjustments to achieve this goal and to continue safeguarding employment, high value creation and a strong Norwegian oil and gas industry. It is important that this industry both discharges its responsibilities on the Norwegian continental shelf (NCS) and is able to hold its own internationally.

The government is accordingly presenting proposals for an improved organisation of the state's ownership of oil and gas resources.

2.2 Opening for new owners in Statoil

The government proposes to open up for more owners of Statoil by listing the company on the stock market. Expanding ownership will supply new expertise, partners and capital. Statoil will remain a Norwegian-based company. Its head office, with associated top management, decision-making authority and strategy functions, will be located in Norway. The state will retain at least two-thirds of the shares in the company.

New owners corresponding to 10-25 per cent of the company's value will be brought initially in through the listing. This will primarily be achieved by issuing new shares in the parent company, Den norske stats oljeselskap a.s, combined with the sale of part of the state's shareholding, with placements in both Norwegian and international capital markets.

Statoil will be given the opportunity to conclude equity-based strategic alliances with other companies. This can only be done after the company has been listed.

2.3 Restructuring of the SDFI

The government proposes that holdings corresponding to 20 per cent of the asset value of the SDFI are included in a restructuring of state involvement, providing the state achieves satisfactory terms. The state will retain direct interests corresponding to 80 per cent of the SDFI's asset value. The interests which the government envisages selling to Statoil will account for about 15 per cent, while those it envisages selling to Norsk Hydro and other companies will account for roughly five per cent.

As part of the restructuring, the government also proposes a swap between the state and Den norske stats oljeselskap a.s which involves a reduction in the state's ownership interests in Europipe II and selected fields, and an increase in its ownership interests in Norpipe and Statpipe.

Furthermore, the government proposes that the reorganisation should include a change in the ownership structure of the crude oil terminal at Mongstad to give the state a holding.

2.4 All transactions will be implemented at market value

The government proposes that Statoil should pay cash for part of the SDFI assets transferred to it, and receive the remaining transfer as an equity contribution. The division will be determined partly in relation to the best capital structure for the company.

Other companies will pay cash for SDFI assets they receive.

2.5 The SDFI in future licence awards

The government envisages that the state will continue to be able to take SDFI assets in future licensing rounds.

2.6 New company to manage the SDFI

The government proposes the establishment of a new state-owned limited company to manage the SDFI portfolio of holdings retained by the state in production licences, pipelines and land-based plants.

This new company will fulfil its purpose without possessing the same expertise as traditional oil companies. New state participant interests will be managed by the company. The company will not apply for licences on its own account. It will not be given operatorships. Activities in which the company is involved will be functionally related to petroleum activities on the NCS. SDFI assets will be managed by the company at the state's risk. Expenditures and revenues relating to the SDFI will continue to be channelled over the central government budget.

The government believes that the most appropriate location for the company is Stavanger.

A separate Odelsting proposition to provide statutory regulation of this company will be presented in the near future.

2.7 New transport company for natural gas

The government proposes the establishment of an independent company to transport natural gas on the NCS. It is proposed to organise this undertaking as a limited company.

It is envisaged that all technical operations will continue to be pursued by the organisations which discharge them today under contract with the newly-established transport company. This means that the new company will concentrate its activities on system operation, licence administration and overall supervision of the whole transport infrastructure on the NCS.

For the present, this company will be owned by the state until a durable form of ownership has been found for the pipeline systems on the NCS.

It is envisaged that all companies with responsibility for gas pipelines and transport-related facilities will be treated in the same way.

2.8 Safeguarding asset values in a listing

The government will work for a stock market listing which safeguards its financial interests in the best possible way.

During the spring of 2001, the government will determine a date for the listing. For planning purposes, work is being pursued to lay the basis for a listing of Statoil in the summer of 2001. A sale of SDFI assets to Statoil will be implemented before the listing. Establishment of the management company for the SDFI and the transport company for natural gas will also precede the listing. Sales of SDFI assets to companies other than Statoil can be implemented in parallel with the sales process for Statoil, or with a time lag.

2.9 Statoil to sell oil and gas

The government does not envisage making any significant organisational changes in the sale of the state's oil and gas. Statoil will accordingly continue to handle these sales.

2.10 Legal assessments

The government has carried out extensive legal assessments of the various proposals, including an evaluation of legal issues relating to the European Union and the European Economic Area. In the government's view, its proposals can be implemented within existing legal frameworks.

3. Background

3.1 The place of petroleum activities in the Norwegian economy

Over the past 35 years, petroleum activities have developed into an important part of the Norwegian economy and have made a large contribution to developing Norway's welfare state. This sector is a substantial contributor to state revenues and to overall value creation. Norwegian petroleum activities also play an important role in an international context. Norway ranks as the world's third largest oil exporter. We are also one of the largest suppliers of natural gas to Europe.

The contribution of the petroleum industry to overall Norwegian production, measured by this sector's share of gross domestic product, was about 15 per cent in 1999. That proportion has been relatively stable for a considerable period, but almost a quarter of overall value creation is expected to derive from petroleum activities in 2000. This increase primarily reflects the high oil price. Value creation by the oil and gas sector is now higher than the combined contribution from manufacturing industry in Norway.

State revenues from petroleum activities have varied as a result of oil price changes. In the early 1980s, these revenues accounted for about 20 per cent of the state's overall income. This was the same proportion as in 1997, although production in that year was four times higher than in the first part of the 1980s. In 1998 and 1999, state revenues from petroleum activities totalled just under 10 per cent of its total income, primarily as a result of low oil prices. Government petroleum revenues for the present year are expected to represent about a quarter of overall income. This proportion has never been higher.

The export value of petroleum activities has also varied as a consequence of oil price fluctuations. Throughout the 1990s, the petroleum sector's share of overall exports has been in the order of 30 per cent or more. In 1999, it accounted for roughly 35 per cent of total exports. This share is expected to be in the order of 50 per cent for the present year.

Investment related to Norwegian petroleum activities accounts for a substantial proportion of total capital spending in Norway. This share amounted to roughly 25 per cent in 1999, and is expected to be 20 per cent this year. The share of petroleum investment in total capital spending has varied over time. Such variations have been very significant for the level of activity in the mainland economy.

Roughly 75 000 people are employed in petroleum-related activities. This corresponds to about three per cent of total employment in Norway.

3.2 The state's petroleum wealth and revenues from the sector

The state has substantial petroleum wealth. They comprise several components with different characteristics in terms of return, time profile and risk. These are:

- the value of future taxes and duties
- the value of future net cash flow from the SDFI
- the value of the state's equity in Statoil and Norsk Hydro.[2]

The net present value of future taxes and duties is estimated at NOK 620 billion. This includes corporation tax at 28 per cent, special tax at 50 per cent, royalty, carbon dioxide tax and the area fee. The tax system has so far accounted for the larger part of the value derived by the state from petroleum activities.

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[2] The state's share of the oil and gas side of Norsk Hydro.

Net present value of future cash flow from the SDFI is estimated at NOK 660 billion. The efficiency and competitiveness of Norwegian offshore operations are important for securing the highest possible revenues from tax and the SDFI.

In June 1999, the market value of the equity in Statoil was estimated at roughly NOK 120 billion.[3] This figure is expected to have increased since then.

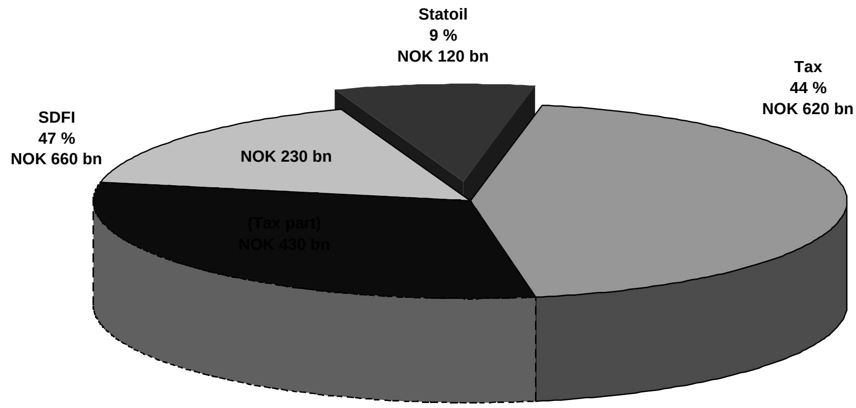

Figure 3.1: The state's petroleum wealth[4]

Sources: Ministry of Petroleum and Energy, UBS Warburg.

Calculations of the net present value of the SDFI and tax at a real discount rate of seven per cent have been based of figures from the National Budget for 2001. The Ministry will present new overall estimates for offshore petroleum activities in the normal way, at the earliest in the Long-Term Programme for 2002-2005.

No observable market valuation is available for the various components of Norsk Hydro, such as its oil and gas division. Estimates from Pareto Securities give the state's share of oil and gas operations in Norsk Hydro a value in the order of NOK 25 billion.

The various cash flows accruing to the state will encompass revenues from taxes and duties, net cash flow from the SDFI, and dividends from Statoil and Norsk Hydro.

Revenues from petroleum activities are placed in the Government Petroleum Fund. The income side of this fund comprises the state's net cash flow from the petroleum sector as well as the return on the fund's assets. Its outgoings consist of an annual transfer to the Treasury which corresponds to the petroleum revenues used in the budget — in other words, to cover the oil-corrected deficit.

The fund has two purposes:

- to serve as a buffer which provides greater freedom of action in economic policy if the oil price or activity in the mainland economy fall;
- to be an instrument for handling government financial challenges relating in part to an ageing population combined with a declining level of petroleum revenues.

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[3] Warburg Dillon Read estimates the value at NOK 111 billion, while the DnB Markets estimate was NOK 126 billion.

[4] For calculation purposes, the illustration assumes that 65 per cent of the value currently related to the SDFI would have accrued to the state as tax revenues were these assets held by companies.

At the end of 1999, the market value of the fund was about NOK 220 billion. The national budget for 2001 estimates that its value at the end of 2000 will be roughly NOK 385 billion.

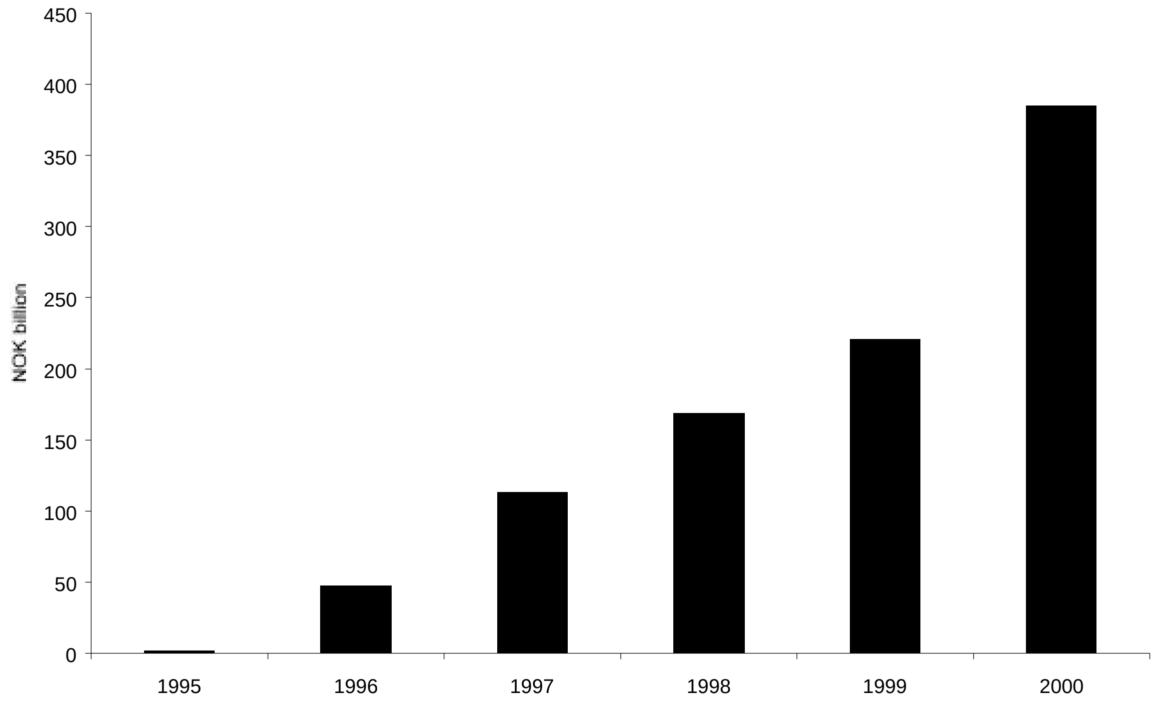

Figure 3.2: The Government Petroleum Fund

Source: Ministry of Finance.

3.3 Prospects

Investment

Activity in the petroleum sector is expected to decline in coming years from the high levels recorded in 1998 and 1999. See figure 3.3, which shows estimated future levels of investment on the NCS. Keeping investment as high as it was in these years is neither a goal in itself nor realistic. But it is important to avoid a sharp contraction in activity, and to contribute to a more stable level of operation on the NCS and in the supplies industry.

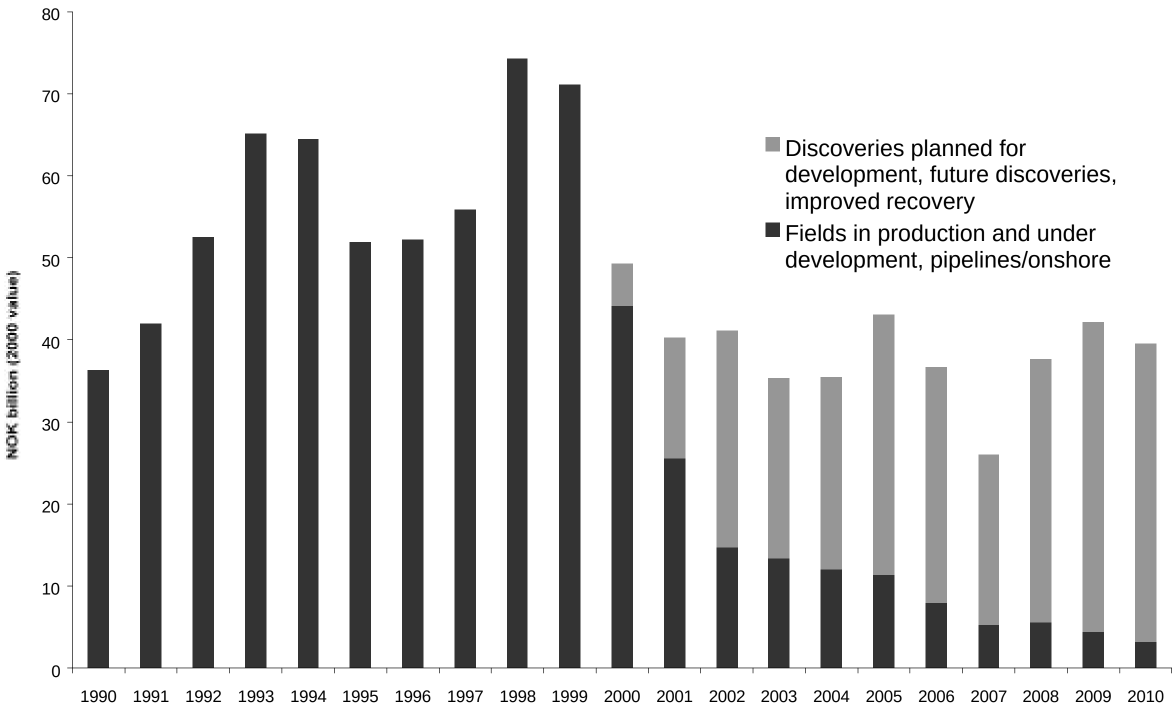

Figure 3.3: Investment on the NCS from 1990, and estimated spending until 2010

Sources: Norwegian Petroleum Directorate, Ministry of Petroleum and Energy.

Oil production

Norwegian oil production increased steadily from its beginning in 1971 to the mid-1990s. Output has been stable over the past four years, at roughly three million barrels per day. Production from the NCS is expected to peak over the next few years before going into a gradual decline. In order to moderate this fall in coming years, new oil discoveries must be made and resources not presently covered by development plans brought on stream.

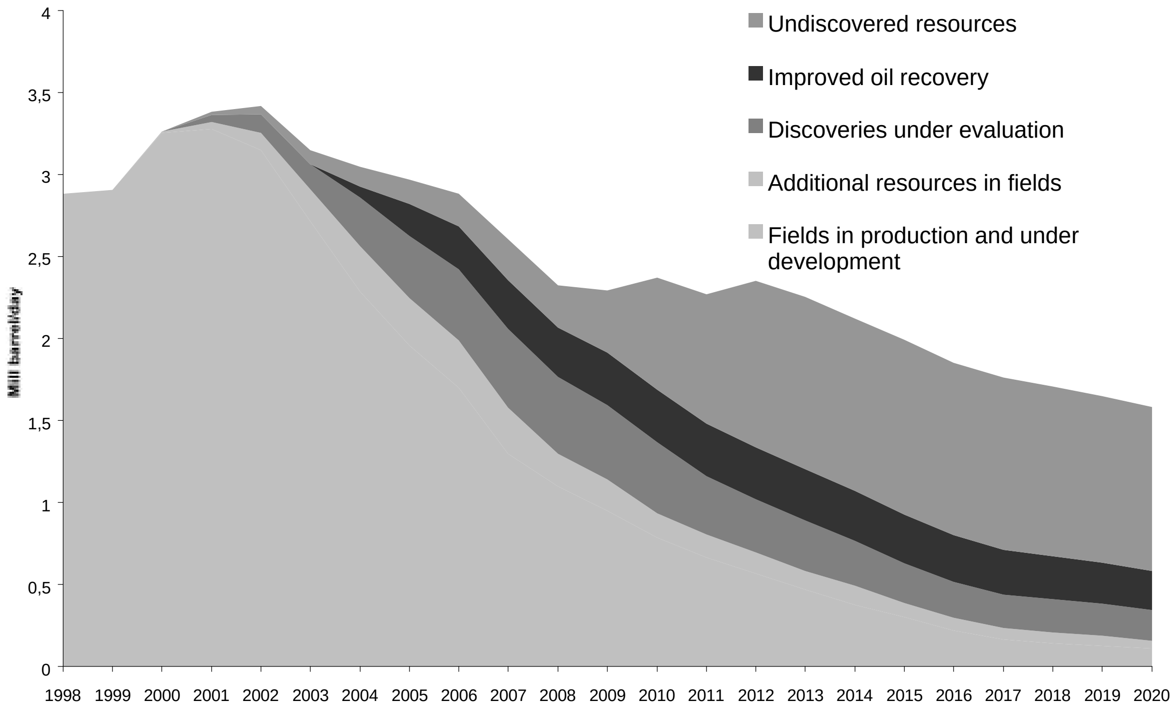

Figure 3.4: Forecast oil production from the NCS

Sources: Norwegian Petroleum Directorate, Ministry of Petroleum and Energy.

Gas production

Natural gas will gradually come to play a more important role in Norwegian petroleum activities. Gas currently accounts for some 20 per cent of overall petroleum production. This proportion will rise in coming years. Gas operations have entered a period of rapid build-up. Agreed long-term gas sales commitments will rise from about 55 billion standard cubic metres (scm) in 2000 to roughly 70 billion scm in 2004. See figure 3.5. Possible additional sales will further increase export volumes. Substantial investment has been made in gas operations on the NCS, and existing long-term gas sales agreements are expected to yield revenues on the order of NOK 800-1 000 billion.

As the figure shows, substantial volumes of sold gas remain to be allocated to specific fields.

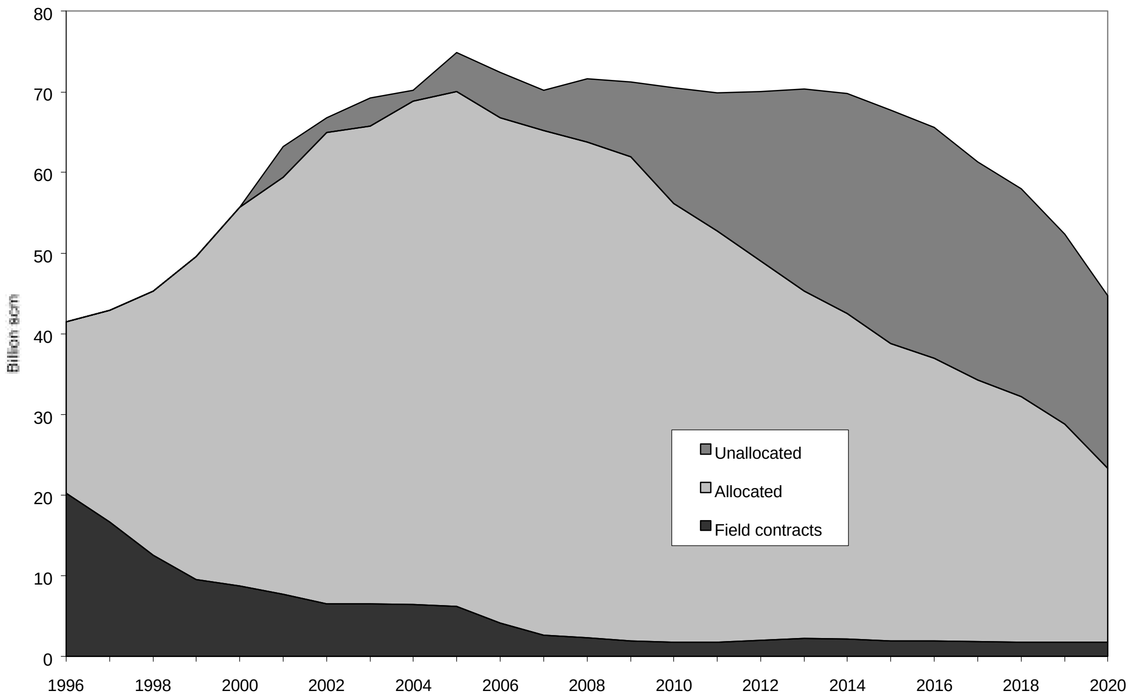

Figure 3.5: Contractual delivery commitments for natural gas from the NCS.

Sources: Norwegian Petroleum Directorate, Ministry of Petroleum and Energy.

3.4 Industrial development

When commercial petroleum deposits were proven on the NCS in the late 1960s, developing national expertise and industry as well as to secure the highest possible revenues for the community became important objectives.

Norwegian expertise on oil and gas operations was limited at the time. Very few companies in Norway had experience of such activity. The basis for building up a new industry was nevertheless present, partly because of proximity to the oil and gas fields, a highly-educated workforce and industries with experience of maritime operations and construction.

We now have an industry which is both technologically leading and internationally competitive in many areas, and which accounts for substantial value creation. The potential for continued value creation is substantial.

Build-up and development of Norwegian oil companies

The build-up and development of three Norwegian oil communities has been a central pillar of Norway’s oil and gas policy since the early 1970s. This was partially inspired by experience in other countries. Statoil as wholly state-owned, Norsk Hydro as partly state-owned and Saga Petroleum as a private limited company have individually and collectively been very important commercial cornerstones of the industry.

Statoil was established in 1972 as the state's commercial instrument in petroleum activities. It was long a privileged national state-owned oil company, which found expression not least in licence awards. Norsk Hydro and Saga Petroleum were also accorded certain privileges in the early years.

Statoil has developed into an international oil company which pursues operations on equal terms with other companies and in several business areas: exploration for and production of oil and gas, refining, petrochemicals, marketing and other activities. The company has gradually expanded its operations outside Norway over the past decade, particularly in oil and gas production. This international commitment to exploration and production is expected to become increasingly significant for the company. Statoil is no longer used as an instrument of petroleum policy.

Norsk Hydro was already a substantial industrial group before Norway's Oil Age began. Participation on the NCS has expanded the scope of its operations. As with Statoil, Norsk Hydro has expanded internationally both upstream and downstream.

Saga Petroleum was the smallest of the three Norwegian companies, and the only one without a direct state shareholding. Its operations were concentrated on exploration for and production of oil and gas, primarily in Norway but also abroad. Saga was acquired by Norsk Hydro in 1999. In that context, some of Saga's holdings in production licences were sold on to Statoil.

Through their operations on the NCS, Statoil and Norsk Hydro have grown into two of the largest companies in Norway. However, both are small in international terms.

Other Norwegian companies

Other smaller Norwegian oil companies have also been involved in petroleum activities. Only three of these — Pelican, Ugland and DNO — currently participate on the NCS, and then with small interests in certain minor fields. No Norwegian companies other than Statoil, Norsk Hydro and Saga have held operatorships on the NCS.

Foreign companies

Most of the big foreign oil companies are or have been involved on the NCS. Among the foreign companies, the largest continue to play the most central roles — with BP, ExxonMobil, Royal Dutch/Shell and TotalFinaElf in the lead. The medium-sized and small companies as a group are more weakly represented, although individual companies in this category (such as Phillips Petroleum, Conoco and ENI) have a substantial involvement.

The balance between Norwegian and foreign companies has changed over time. In the first offshore licensing round, in 1965, the Norwegian share of the awards was nine per cent. This picture had changed by the third round. The foreign companies received only a small share of interests, not least because Statoil received 50 per cent of all awards.

Foreign companies operate about 20 per cent of the oil resources in producing fields, fields approved for development and discoveries in the planning phase, and about 10 per cent of gas resources in producing fields.

Foreign companies have contributed to the build-up of the Norwegian oil and gas industry through their provision of capital, expertise and technology. From a value-creation perspective, it is extremely important that leading foreign companies continue to play a role in Norway's oil industry together with the Norwegian companies.

Fabrication and supplies industry

An important objective of Norwegian oil and gas policy has been to build up and develop the country's own supplies industry.

Norwegian suppliers eventually secured major development assignments on the NCS, while making a commitment at the same time to developing new technology in cooperation with the oil companies. A competitive Norwegian supplies industry has gradually developed, and is represented today in most segments of the market. More than 50 per cent of deliveries to field developments on the NCS in recent years have come from Norwegian suppliers. Norway's supplies sector has also proved competitive in the world market, and occupies a leading position in several market segments. That applies particularly to technology for deepwater developments.

Norway's fabrication and supplies industry now faces major challenges caused by a gradual maturing and expectations of a lower level of investment on the NCS, substantial and faster technological advances, structural changes in the oil and supplies industries and not least stronger global competition over contracts.

At a time of reduced activity and changed demand, the supplies industry must adapt its structure and capacity to the new market position. Moreover, the emergence of new technology and development solutions will change the structure of the supplies industry, and restructuring will be necessary. Parts of the industry must find new market segments to safeguard future operations and growth, while other parts will experience expansion in established core areas or through strengthening their expertise in areas where activity has so far been limited.

The ability to pursue technology development will be crucial to future success. Companies must adapt their business to future development solutions and market conditions, while preserving and extending their key expertise.

We currently possess strong independent research institutions, and heavyweight Norwegian research communities have been established with their base in Statoil and Norsk Hydro and with the supplies industry and independent research bodies as active collaborators. At the same time, the foreign oil companies are stimulated to pursue research in Norway. To promote further technology development, the authorities and the supplies industry have jointly established the Demo 2000 programme for project-oriented technology development. This takes the form of a broad-based collaboration between foreign and Norwegian oil companies, suppliers and research institutions. Activities in Demo 2000 focus on faster development and maturing of new technology and field developments on the NCS, while simultaneously developing these technological solutions with an eye to the international market.

3.5 State participation in the petroleum sector

A range of instruments have been used by the government over time to achieve its goals in the petroleum sector. Taxes, duties, and various forms of state participation and ownership have been key factors in securing the largest possible revenues for the state from this activity. The combination of and weight given to these different instruments have changed character over the period since operations began and down to the present day.

Exploration formed the principal activity in the initial period of Norway's petroleum activities, up to the end of the 1960s. There was no state participation, but the companies were required to pay royalty on production.

The authorities negotiated the first agreements on state participation in the second offshore licensing round, in 1969-71. Some of these, known as net profit agreements, gave the state the right to a certain percentage of the profit from possible discoveries. Others, called option agreements, gave the state an option to participate in the event of a commercial discovery.

A new oil nation such as Norway faced substantial challenges in terms of expertise, technology, organisation and government policy. It was accordingly natural and necessary that the state should ensure the establishment of further methods for obtaining revenues, industrial development, and management and control. The formal legal system was necessary, but not seen as sufficient. It was also resolved to establish Statoil as a commercial instrument for the state.

An important basis for petroleum activities in Norway is that resources on the NCS belong to the Norwegian state. There has been cross-party agreement that oil and gas resources should be exploited to the benefit of the whole population.

In order to safeguard Norway's economic and industrial policy interests, there was broad political consensus that the state had to play a central role in safeguarding national interests in this capital-intensive and technologically-advanced industry.

The award of the Statfjord blocks in 1973 introduced a new pattern for agreements on state participation. Statoil became a direct party to licence agreements, with a 50 per cent interest in each block. The company did not pay costs incurred during the exploration phase, which were met by the other partners. This carried interest arrangement was also extended in some subsequent agreements to other Norwegian oil companies. Carried interest was later confined to the SDFI’s share of costs. The arrangement was abolished in 1992.

The sliding scale was introduced in 1974. This gave the state an option, in approving development plans, to increase its interest up to specified levels when a field was declared commercial. The sliding scale was abolished in 1993.

The SDFI was established in 1985, partly to avoid Statoil obtaining an overly dominant influence in individual licences and in the industry as a whole, and to prevent the bulk of cash flow from this sector being channelled through Statoil. Nevertheless, the latter was to continue to have an important role in petroleum activities, in part as business manager for the SDFI. Statoil was also given greater commercial freedom than before.

An important government financial instrument in the petroleum sector has been company taxation. Various duties relating to individual elements in the industry have also been adopted, such as royalty, the area fee and the carbon dioxide tax.

Through the system of taxes and duties, various arrangements for state participation, and ownership in Statoil and Norsk Hydro, the state had secured a substantial share of revenues from this sector.

3.6 New organisation of state involvement

Petroleum policy instruments have been assessed and adapted in response to the challenges faced at any given time. The ability to make the necessary modifications has been crucial.

The petroleum sector has now entered a new epoch.

To exploit new opportunities and meet new challenges, other instruments must be evaluated and existing ones used in a more efficient way. Ownership is one of the most important instruments at the government’s disposal.

The government believes the time is right to reassess the use of state ownership in oil and gas operations.

It has chosen to structure this work around four principal areas:

- the ownership structure of Statoil
- restructuring the SDFI
- managing the SDFI
- gas infrastructure

Gas management represents an important integrated part of all these principal areas.

The Ministry has engaged both financial and legal advisers.

An extensive dialogue has also been conducted by the Ministry with representatives from the oil and gas industry, particularly Statoil but also Norsk Hydro, other companies and interest organisations.

Statoil and Norsk Hydro were asked to submit their assessments and views in writing to the Minister of Petroleum and Energy.

In a letter of 30 April 1999, the board of Statoil was asked to explain the company’s views on the future development of Statoil and the SDFI. The board responded on 13 August 1999 in a report to the Minister of Petroleum and Energy. This document is attached in its entirety to the proposition as appendix 1.

An extensive dialogue has subsequently been conducted between the Ministry and Statoil, in which a number of considerations have been addressed in separate documents from the company. The most important of these are:

- The caretaker arrangement for the SDFI (8 October 1999), which forms appendix 2 of this proposition.
- The further development of Statoil and the SDFI: the effect on state revenues from petroleum activities (10 November 1999).
- Statoil's evaluation of the potential for increased value creation on the NCS offered by a commercialisation of the SDFI's holdings (3 December 1999).
- A risk analysis of Statoil's international operations (18 February 2000)
- The organisation of Statoil (18 February 2000).
- Merging Statoil with the SDFI and a partial privatisation of Statoil — a presentation of Statoil's views (22 February 2000).
- Potential for value creation in the NCS — core areas (15 November 2000).

In a letter of 25 June from the Minister of Petroleum and Energy, Norsk Hydro was asked to evaluate key trends on the NCS, including the company's views on possible structural changes in the state's involvement. Norsk Hydro expressed its opinion in a report to the Minister of Petroleum and Energy on 1 September 1999. See appendix 3.

Through the Norwegian Oil Industry Association (OLF) and the Norwegian Oil Licensees Association (Norret), the other companies on the NCS made a joint statement to the Minister of Petroleum and Energy in a letter of 10 November 1999. See appendix 4.

In a letter of 29 March 2000, the Confederation of Norwegian Business and Industry (NHO) made a contribution to the issue. See appendix 5.

4. Recommendations from the Statoil board

As a basis for its work, the Ministry of Petroleum and Energy asked the board of Statoil in a letter of 30 April to explain the future development of Statoil and the SDFI. The board submitted its report, "Further development of Statoil and the SDFI", on 13 August 1999. It forms appendix 1 to this proposition. An extensive dialogue has subsequently been conducted between the Ministry and Statoil, in which a number of aspects have been addressed in separate documents from the company. See section 3.6.

This chapter provides a summary of Statoil's views. It builds essentially on the board's report of 13 August. Statoil has submitted extensive evaluations and more specific information to the Ministry since 13 August on the further development of the SDFI and on the increase in value creation offered by a commercialisation of SDFI assets in Statoil. This chapter accordingly also includes a summary of that submission from Statoil.

4.1 Summary and recommendations from the board's report of 13 August 1999

The following reproduces the main part of chapter 2: "Summary and recommendations" in the report of 13 August.

"**A changing oil and gas industry**

Major changes have happened to the general conditions governing the petroleum sector in recent years.

- Markets for oil and gas are being affected by sweeping changes. Opening of markets and new technology have helped to boost world capacity for petroleum production. At the same time, new areas have been opened for exploration and production. Markets for natural gas and other energy products are being liberalised, and competition between producers is increasing. Available global production capacity for oil and gas significantly exceeds demand today. Only the exercise of market power by key producing countries in Opec prevents a sharp fall in oil prices.
- As a resource area, the Norwegian continental shelf has matured and is approaching maximum production. Several of its biggest fields have already gone off plateau, and are moving towards tail production. The discovery rate also shows a general maturing, with fewer finds in recent years and with each discovery typically significantly smaller and more demanding to develop than the major resources proven in the 1970s and 1980s. Opening new resource areas for international participation means that the Norwegian continental shelf faces sharper competition than ever. Nevertheless, the potential still exists for significant new finds and for stable long-term gas production well into the next century. Technological advances and new forms of development and production have helped to reduce unit costs sharply, and this trend is likely to continue in coming years.
- The oil and gas industry is undergoing an extensive restructuring through mergers, acquisitions and the formation of new alliances. This trend can be seen in all stages of the value chain. Much of it has been driven by more stringent demands from capital markets for the return on capital to owners. Viewed as a whole, oil and gas companies have failed to deliver satisfactory results in the 1990s and the industry's profitability is below average for the industrial sector in general.
- Future price trends for oil and gas are highly uncertain. Over the past 20 years, the real price of oil has tended to decline and this development is likely to continue - even though there may be periods when prices are relatively high. New measures to limit greenhouse gas emissions could not least have a negative impact on product prices. Over the past year, players in the industry have tightened their requirements for expected return on new investment. New projects must be able to deliver satisfactory results even at an oil price close to USD 10-12 per barrel.

These changes affect both Norway as an oil nation and the Norwegian state as a commercial player in the petroleum sector. Many of the elements in Norway's present petroleum policy were defined about 15 years ago. At that time, expectations on the development of prices and the competitive standing of Norway's offshore sector were very different than they are today.

Norway's petroleum resources account for a large proportion of its national wealth, and the state's share of these assets comprises several elements - expected future tax revenues, the value of direct ownership through the SDFI and the value of companies owned directly or indirectly by the state. Good management of these assets is essential in maximising their overall value. The board's starting point is that official policies need to be adapted to the new circumstances in order to ensure the highest possible value creation, and thereby also a high value for the state's interests in and revenues from petroleum activities.

The state's direct commercial involvement in the petroleum sector comprises its shareholding in Statoil as well as the SDFI. In addition, it ranks as the largest shareholder in Norsk Hydro, a substantial player in Norway's offshore sector. This document discusses how the state as owner should organise its relationship with Statoil and the SDFI in order to maximise the value of these commercial interests and to ensure that Statoil can remain a competitive player in the international oil and gas industry.

Statoil needs a new ownership structure

Statoil has developed strongly over the almost 30 years since it was created. The group currently has some 18 000 employees and pursues operations in 23 countries. This year's valuations give it an estimated market value of roughly NOK 110-125 billion.

The group started out as a player on the Norwegian continental shelf with certain privileges, established with a view to serving as the government's operational instrument in implementing petroleum policy. Today, Statoil competes on equal terms with all other players and is no longer a management tool for the state. The state's instruments for exercising control of the petroleum industry are found in its legislative, regulatory and licensing powers.

Under the European Economic Area (EEA) agreement, it would be illegal for the government to treat Norwegian companies more favourably than other offshore players.

Ownership can affect a company's competitiveness through both its form and its content. The form of ownership determines how the company is organised - a foundation, a cooperative, state-owned or listed on a stock exchange, for instance. This in turn helps to influence how a company's performance is supervised and measured. A listed company, for instance, will be subject to daily measurement of its results by capital markets and its performance will prompt changes in its current market value. On the other hand, the content of ownership deals with the owner resources made available to the company, such as capital, expertise and market positions. Over time, both form and content of an ownership structure will influence the company's resource base, incentive structure and efficiency, and thereby also the development of its results and the return received by the owner. Statoil's most important competitors are organised today as companies with tradeable shares owned through capital markets.

Statoil's present ownership structure presents several challenges. The state has a number of responsibilities in addition to being the group's owner. It acts as regulator, administrator, legislator and tax collector, to name but a few. Over time, the state will find it ever more demanding to discharge all these functions while simultaneously acting as commercial owner of Statoil, partly because Statoil's competitive picture has become more complicated and because conflicting goals will exist between the various roles to be played by the state. This presents a challenge for both owner and group. Today's ownership structure means that Statoil is not exposed to the same market control as its competitors. On the other hand, the group is directly rooted in the Norwegian political system in a manner which does not apply to the other players. That influences both its internal culture and its commercial freedom of action. Using the capital market is a crucial element in the extensive restructuring now under way in the industry, partly in the form of share swaps or through the use of shares as payment. Over time, today's ownership structure in Statoil could develop into a significant competitive disadvantage, which would not be beneficial for the owner.

Since Statoil is no longer an instrument of Norwegian petroleum policy, it does not need to remain wholly owned by the state. Apart from today's caretaker model for the SDFI, none of the responsibilities discharged by Statoil are of a nature which requires full state ownership. The board accordingly believes that the group and the owner would be served by changing the ownership structure so that the group gains private co-owners and a stock exchange listing. A new ownership structure would mean that Statoil is "normalised" in relation to its competitors. At the same time, the division of roles and responsibilities in Norwegian petroleum policy will become clearer when the state is no longer Statoil's sole owner.

The Norwegian equity capital market is small in an international context. In the board's view, the state's most important ownership role in Statoil should be to ensure that the group maintains its national affiliation. As a result, the state should retain a shareholding in Statoil which makes it possible to keep the group as a Norwegian-based player in international energy markets. How far the state needs to remain a majority shareholder to accomplish this objective is as much a political as an industrial and commercial question.

The need to commercialise the SDFI

The SDFI was established to prevent Statoil's cash flow from becoming so large that it represented a management problem in itself for the Norwegian economy. To achieve this, most of Statoil's interests in Norwegian offshore licences were split into two components - one for Statoil and the other for the SDFI. The government has allocated SDFI interests to itself in subsequent licensing rounds, and the SDFI ranks today as the biggest Norwegian offshore licensee and producer. The SDFI's income and expenses are posted directly in the central government budget. Statoil acts as business manager for the SDFI and sells all its petroleum. A number of factors are relevant when considering the serviceability of the SDFI as a government instrument. These include:

- the significance of the arrangement for the competitive standing of Norway's offshore sector, including the way the arrangement influences incentives for the players in the different phases - exploration, development and production — and thereby for total value creation on the NCS
- the relationship between the arrangement's profitability and risk, relative to other ways of managing the same resources
- how the arrangement influences decisions and incentives for the caretaker (Statoil)
- the owner's opportunities to use the SDFI to secure and further develop important market positions as markets are deregulated and changed.

Combined with Norway's petroleum tax regime, the SDFI makes it possible to secure a high proportion of value creation on the NCS for the state. However, additional revenue can only be obtained from the SDFI if the state accepts an investment and market risk in addition to the risk inherent in its role as tax collector and company owner. At times of major and highly profitable developments, this risk will not appear to be a problem.

As the Norwegian continental shelf has matured and discoveries have become smaller, it has become more difficult to meet profitability requirements. New Norwegian offshore developments will typically cover smaller fields, be more technologically demanding and have higher unit costs than before. At the same time, substantial value lies in ensuring the most effective possible operation of existing fields which are in decline.

Markets for Norwegian oil and gas are experiencing sweeping change - not least in European gas markets which involve fundamental Norwegian interests.

In such circumstances, the SDFI arrangement will appear less appropriate - in part because its scope could help to undermine incentives for the companies offshore and because the arrangement faces clear inherent constraints on securing market positions with its own resources.

Responsibility for the SDFI's commercial development rests with the caretaker (Statoil). Today's caretaker model requires Statoil to maximise the value of the state's overall interests (Statoil and the SDFI) in offshore licences and in selling its petroleum. In certain circumstances, this decision-making model can mean that Statoil must opt for solutions which are not the most profitable for it as a group. At the same time, the SDFI's investments are limited to upstream operations on the Norwegian continental shelf. The arrangement has not established positions in sales, marketing or refining. Statoil is required to sell the SDFI's oil and gas, but the present Norwegian accounting system for crude oil sales (the norm price) means that it will not always be commercially profitable for the group to maximise the value of the state's oil. In other words, the present caretaker model suffers from the weakness that it is not always profitable for the caretaker to maximise the SDFI's interests and that it imposes a complex structure of goals on the caretaker. A caretaker model of this kind cannot continue over time without damaging both the caretaker and the SDFI.

More generally, present conditions in the Norwegian offshore sector call for an assessment of the serviceability of the SDFI by comparison with alternative policy measures. The SDFI is expected to provide a very substantial net cash flow. Nevertheless, the bulk of these revenues are income which the government would otherwise have received as taxes. As an arrangement, the SDFI represents a very special form of state-owned commercial operation. It has no organisation or business strategy of its own. The board's analyses show that the market value of its resources is substantially higher than the value which can be realised under today's management model. From that perspective, the SDFI does not contribute to maximising the state's offshore value creation. The difference between the SDFI's market value and its present asset value provides an expression for the cost which the state as resource owner must bear because its resources are not being managed in a fully commercial manner.

For its part, the board can see no reason why the state should bear these costs. On the basis of an overall assessment, it would therefore recommend that the owner should consider whether to discontinue the SDFI as a policy instrument and to commercialise the resources currently placed in the SDFI - in other words, reallocate them to a company. This can be done in several ways, and it would be appropriate for the government to consider how these resources might be used to strengthen the companies in which it has equity interests. For its part, the board would recommend that the government selects a solution which maximises the overall value of its Statoil and SDFI ownerships - in other words, that the future development of Statoil and the SDFI are assessed together. See section 2.4.

Should the government not wish to commercialise all the SDFI's resources for various reasons, the board believes that a new caretaker model must be established for the remaining SDFI portfolio. In that context, the board would advise *against* creating possible new administrative bodies to handle such a caretaker role. The latter should be handled by one or more of the commercial players in Norway's offshore sector in a way which provides the right incentives.

A larger and more competitive Statoil

A need arose 15 years ago to limit Statoil's growth in order to prevent the group becoming too large in relation to the rest of the Norwegian economy. In today's competitive market, however, Statoil is a small player both financially and in relation to reserves and production. The restructuring pursued in the oil and gas industry over recent months has enhanced this relative position.

Although Statoil will not be able to match the biggest players in the industry for size, the group has a need to expand. It has established several positions which, viewed overall, provide a foundation for maintaining and increasing oil and gas production despite an anticipated decline in output from the Norwegian continental shelf. This is necessary to safeguard continued development of Statoil through the next century.

The group also has an opportunity to establish a stronger position as an integrated gas company in Europe. At present, it ranks as a substantial producer of and operator with natural gas from the Norwegian continental shelf. The bulk of the gas it trades belongs to the SDFI, however, and Statoil as a group is not big enough to compete strongly with the key players in today's European gas market. Positions need to be built along the value chain for natural gas in order to participate in the expected growth. It is important for the state, through the SDFI and Statoil, to exploit the market positions achieved in order to achieve additional value based on Norwegian natural gas.

Because the state owns both Statoil and the SDFI, it has a unique opportunity to establish a company with the size and resource base to be a powerful competitor in international markets.

This company would need to rank alongside the medium-sized international integrated oil and gas companies. Giving Statoil a stronger gas position could allow it to act as a unique player and investment opportunity. At the same time, the state could realise greater value from its overall equity interests - in other words, enhance the value of its assets. This would be possible because the SDFI's resources are more valuable when held by a company than under the present system, and because capital markets give weight to size, financial strength and diversification when pricing players in the oil and gas industry.

The purpose of increasing Statoil's size is to make it possible for the group to continue developing its international positions, diversify its portfolio and achieve significant production in areas outside the Norwegian continental shelf. In particular, the board would stress the potential for value creation offered by building up a position for Statoil as a central gas company in Europe.

As a result, the board would recommend that Statoil be strengthened with all or significant parts of the SDFI's portfolio and that the group then secures a stock exchange listing and is partially privatised. Such an operation would allow the owner to realise a substantial rise in value, both in the form of cash from selling down its holding in the new company and through the enhanced value of the equity interests the state is expected to retain. Viewed overall, the board's recommendations offer an opportunity to enhance the value of the state's petroleum assets while simultaneously reallocating these assets to financial instruments. Discontinuing the SDFI as a policy instrument would also help to limit part of the state's direct exposure to developments in the oil and gas industry.

The board believes that the oil and gas sector will remain a key Norwegian industry for many decades to come. Having Norwegian-based players who are competitive in this business, both at home and internationally, is important to Norway. Earlier Norwegian decisions on oil and gas policy mean that the government today has considerable freedom of action in shaping its use of policy instruments. The board believes the time has come to utilise this freedom to realise asset values and to create a sound and competitive commercial player with its roots in Norway.

Summary of the board's recommendations ...

The board makes three recommendations on the future development of Norwegian state involvement in petroleum activities:

- that Statoil's ownership structure be changed to provide the group with private shareholders and a stock exchange listing
- that this new group be strengthened with all or a significant part of the resources currently held by the SDFI in order to enhance the value of the state's commercial interests and to create a robust and powerful Norwegian-based player in international markets
- that a new caretaker arrangement be created for that part of its resources which might not be reallocated to a commercial company."

4.2 Further amplification of Statoil's views

As mentioned in the introduction to this chapter, Statoil has amplified and submitted more specific information on the way a commercialisation of SDFI assets could be used to achieve a substantial increase in value creation on the NCS. This is explained in the document "Merging Statoil with the SDFI and a partial privatisation of Statoil — a presentation of Statoil's views", submitted in February 2000. In this report, Statoil's assessments are summarised as follows:

"A comparison between expected value creation off Norway and in similar areas of the UKCS reveals a value potential on the NCS totalling tens of billions of kroner. An important reason why it has proved difficult to realise this potential in Norway is that licence interests held by operators and licensees are too small, and that licence groups which need to cooperate to enhance value creation are too complex.

Complicated licence structures mean that decisions on coordinating production functions, wholly or partly shutting in platforms, phasing in new fields and so forth are more difficult to reach. An extensive restructuring of interests in the relevant licences could ensure that they are held by three-four companies with sufficiently substantial holdings to take the required decisions and adopt the necessary measures.

A strong player is needed to take the lead in a necessary restructuring, and to make active use of SDFI interests in this work. A number of examples exist — including cases from the NCS — of failed attempts at radical operational improvements in an area. These failures often reflect the absence of an 'area entrepreneur' strong enough to push through necessary changes. A company with large interests in relevant licences can position partners through sales and swaps. This makes it possible to gain a 'winning constellation' of three-four companies with a shared vision and strategy for the changes required — and with the decisiveness to implement it.

Good insight into Norway's overall offshore field portfolio and a well-established commercial relationship with all the players are important for negotiating changes to licence holdings which can form the basis for an extensive restructuring through the use of swaps as well as sales. This would establish a structure of licence interests in all the core areas which is better adapted to optimal value creation than could be achieved through purposeful individual sales of SDFI assets by the government, directly or through an agent.

A revitalised market in Norwegian offshore licence interests would help all operators and players to reinforce their core-area positions. Ensuring that central players are strengthened in their key operatorships in important resource areas could be desirable for the government...

Changing the structure of licence interests on the NCS could contribute to gains under three main headings:

- Reduced exploration, development and operating costs as a result of better collaboration between licences within an area.
- Increased production and reserves within an area as a result of reduced unit costs and better coordination of exploration operations.
- Improved utilisation of the infrastructure between areas.

The Tampen area of the Norwegian North Sea provides a good illustration of the potential present in Norway's offshore sector and the challenges faced in seeking to realise it. Gains in this region relate primarily to:

- More coordinated operation of existing installations and optimal utilisation of local platforms.
- Extended plateau production as a result of lower unit costs and recovery of local gas resources.
- Opportunities to develop Tampen into a hub for gas from areas further north.

However, the total value creation potential can only be achieved through decisions within each licence and across licence boundaries. Portfolio adjustments must aim to strengthen the role of operators in their core areas. This will promote both incentives and thrust (owner position) to identify improvement potentials and push through decisions. Two or more other players must also be involved across the area who, together with the operator, have sufficient vigour in a decision-making process."

5. State ownership

5.1 Introduction

Substantial equity positions are held by the Norwegian state in domestic industry. The background for such state ownership has varied. It is motivated in some cases by assessments and decisions made in response to circumstances at a specific time. In others, the state's involvement is based to a greater extent on a more integrated and holistic strategy.

Reconstruction had the highest priority in the immediate post-war period. This involved a commitment to industrialisation which would help to rebuild the country. National industry policy made a strong contribution to active state participation. The desire was for national control of production in particularly important companies and sectors, and for greater industrial self-sufficiency.

The state has also acquired the ownership of companies for regional policy motives, in order to provide equal access to infrastructure and to safeguard jobs. In the financial sector, the state acquired substantial equity positions as a result of the banking crisis.

Great emphasis has been placed, both in Norway and in a number of other countries, on national control of natural resources and their processing. Historically, national oil companies have been established in both producing and importing countries to give the state control over oil and gas as strategic commodities.

It was also natural for Norway to utilise state ownership as an instrument in petroleum activities. From the start, the state has had a substantial equity involvement in the Norwegian petroleum sector, which has been rooted in broad political consensus.

Consideration was given in the early 1970s to assigning the principal role in Norwegian oil operations to Norsk Hydro. At that time, the state shareholding in this company was increased from 47 to 51 per cent. However, arguments were advanced for establishing a new wholly-owned state oil company and these had broad political support. The result was a threefold division of the company structure in the Norwegian oil sector: one wholly state-owned, one partly state-owned and one private limited company. A unanimous Storting approved the establishment of Statoil in 1972.

Good administration of resources in common ownership requires that the state is also a good owner. The government announced in its accession statement that it would "review the organisation of state ownership to identify the arrangements which provide us with the best results and an orderly division of responsibilities."

This proposition presents proposals for amending state ownership in the petroleum sector — its equity in Statoil and administration of the SDFI.

5.2 Developments in other countries

National oil companies have historically been established in many European, South American and Asian countries to secure economic, political and operational control of a nation's oil and gas resources. In addition, many countries aimed to safeguard national energy supplies through wholly state-owned energy companies.

About 80 nations in the capitalist part of the world had wholly or partly state-owned oil companies in the mid-1980s.[5] The USA was one of very few exceptions.

However, the trend has changed fundamentally.

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[5] Source: Klapp, Merrie Gilbert (1987): *The Sovereign Entrepreneur. Oil Policies in Advanced and Less Developed Capitalist Countries.* Cornell UP, London

Over the past 15 years, there has been an extensive trend towards privatisation. A number of nations have resolved to privatise their national oil companies. Norway is one of the few countries in the OECD area which still has a wholly state-owned oil company.

There are three principal reasons why former state-owned oil companies have been privatised:

i. *Efficiency considerations*. Emphasis has been given to the presumption that private owners are better suited to looking after a company's commercial interests than the state. While state-owned companies must often take account of considerations other than the purely commercial, private companies can focus to a greater extent on efficiency and profitability, which leads to higher value creation.
ii. *The desire to separate the roles of owner and regulatory authority*: A broad understanding has developed that the state's interests can be safeguarded in a better and more orderly fashion through legislation, regulations, individual decisions and so forth, rather than through state ownership.
iii. *Financial*: In many cases, fiscal motives have been an important reason for privatisation.

The trend has been strongest when these three factors pull in the same direction.

Some of the largest wholly or partly state-owned companies in the industry have been privatised in this period. See table 5.1. British Petroleum (UK), Total and Elf (France), Repsol (Spain) and YPF (Argentina) have become wholly private companies. ENI (Italy), Petrobras (Brazil), Petro-Canada (Canada), Fortum (Finland) and others have been partially privatised. The privatisation trend has extended in recent years to eastern Europe and Asia, embracing Russian companies such Gazprom and Lukoil as well as PetroChina and Sinopec (China), to mention some examples. One consequence of this privatisation trend is that Statoil's competitors and partners are by and large fully or partially private companies.

Table 5.1: Privatisations in the oil and gas sector

Company	Country	Year privatised	State ownership today (%)
Western Europe			
BP	UK	1977 – 1987	0
Total	France	1992 – 1997	0
Elf Aquitane	France	1991 – 1995	0
Repsol	Spain	1989 – 1997	0
ENI	Italiy	1995	36.3
OMV AG	Austria	1987	35
Hellenic Petroleum	Greece	1998	62
Fortum	Finland	1998	75.4
Americas			
Petro-Canada	Canada	1991	18.3
YPF (kjøpt av Repsol)	Argentina	1993 – 1999	0
Petrobras[6]	Brasil	1997	52.9
Eastern Europe			
MOL	Hungary	1995	25
PKN	Poland	1999	54.4
Gazprom	Russia	1996	38.4
Lukoil	Russia	1996	15.6
Surgutneftegaz	Russia	1998	0
Asia			
PTTEP	Thailand	1993	61
PetroChina	China	2000	90
Sinopec	China	2000	55

Source: UBS Warburg.

5.3 Ownership of Statoil

The state plays a number of roles in the petroleum sector in addition to being the owner of Statoil. It is the regulator, administrative authority and licensing authority. The state also wants to maximise the socio-economic results of overall operations on the NCS.

Statoil as a political instrument

When Statoil was established in 1972, it was regarded as important to have a wholly-owned state company in order for the state to derive the maximum benefits from and achieve the desired control over developing the country's petroleum resources.

In an early phase, Statoil was assigned a number of duties in addition to its commercial ones. These have gradually been taken over by the state as the administrative authority. Statoil was for a time awarded 50 per cent of each production licence and thereby had very significant influence as a licensee. The company also had great influence on the approval of development plans, on decisions to exercise the sliding scale and, in special cases, on the transfer of operatorships. Although the

[6] Gjelder salg av preferanseaksjer til internasjonale investorer. Ordinære aksjer har vært eid av private investorer siden 1970-tallet.

decision-making authority for such issues rested with the Ministry, Statoil had a right and a duty to submit proposals.

This is not the case today.

Statoil’s role in Norwegian oil and gas policy has changed character considerably over the past 10-15 years. The company operates today under the same commercial terms as the other participants on the NCS, and is no longer an instrument of petroleum policy. Through its caretaker responsibility for the SDFI, however, the company is required to use value creation for the state’s overall involvement as its basis when ranking alternative decisions. See section 6.2.6. This can mean that decisions which the management is required to take could be influenced by considerations other than the company’s own commercial interests.

As a result, full state ownership is no longer a necessary or appropriate instrument for realising principal petroleum policy objectives. These are achieved through policies on tax and duties, licensing policy, legislation, regulations and individual decisions, and by otherwise laying the basis for the best possible utilisation of our oil and gas resources. These instruments have been developed over several decades, and substantial expertise and experience have been gained on what should be managed and how this management should be pursued.

The European Economic Area agreement has moreover affected the sector directly and through secondary legislation. This means that Statoil cannot be given special advantages and must compete on equal terms with other companies. Even if the opposite was desired, Norway’s obligations under the EEA agreement accordingly mean that ownership of Statoil cannot be used as a political instrument.

International operations

Statoil is no longer solely engaged in developing Norwegian oil and gas resources. The company has long since — and with broad support from its owner — stepped out of the NCS. It has secured a number of good positions in other petroleum provinces.

Large remaining petroleum resources, particularly gas, are available on the NCS, and these will form the basis for substantial industrial activity over several decades. But a growing proportion of Statoil’s investment — and eventually value creation — will relate to its international commitment. Internationalisation is a central and essential strategy for ensuring continued growth and value creation as the NCS matures and the level of activity there declines.

Since 1991, the international part of Statoil’s business has accounted for roughly 30 per cent of its total investment and exploration costs. At 31 December 1999, the book value of Statoil’s international oil and gas reserves amounted to about 15 per cent of its total reserve base. According to the company, some 40 per cent of its discovered but not stated resources lie outside Norway.

As an oil and gas company, Statoil is involved in operations which present different types of risk. That applies to operations both inside and outside Norway, Different activities carry different types of risk: geological, technical, financial and political. Rational decision-makers will require a balance between risk and expected return. Based on the material available today, nothing suggests that the expected return on Statoil’s foreign investment will fail to offset the risk.

Although a balance exists between risk and expected return, one alternative for the state is to involve more owners in the group so that more players can assess the company’s ability to accept different types of risk. This would also free up state capital and reduce its risk exposure to the company’s dispositions.

Statoil was established to help ensure that the largest possible share of the rent from the NCS fell to the Norwegian community. As a steadily growing part of its business is pursued abroad and as the company internationalises, it will become less natural — for this reason also — to have the state as sole owner.

Industrial restructuring

Like Norsk Hydro, Statoil is an international company today. As outlined in section 1.2, the petroleum industry has undergone substantial changes in recent years. Developments are rapid. Competition has sharpened. Swift and continuous adaptation to a changing environment is crucial to success. Today's ownership structure makes it demanding for Statoil to participate in the restructuring of the industry on a commercially adequate basis. The company is unable to use its own shares in settlement of a transaction, for instance. Most mergers in the oil and gas industry have occurred precisely in this way. A change in ownership structure will increase Statoil's commercial freedom of action and open new opportunities for the company, while giving it the same framework conditions as its competitors, including Norsk Hydro.

Strengthened owner supervision

Costs need to be reduced, efficiency improved and value creation enhanced in Statoil and on the NCS in general. Statoil is the largest operator on the NCS, and its performance accordingly has very great significance for cash flow from the SDFI and for tax revenues. The company moreover plays a very important role in Norwegian gas management.

Given Statoil's key position in Norwegian oil and gas operations, it is important that the company is efficient. This benefits the owners in the form of dividend, increased tax revenues and higher cash flow from the SDFI. The other licensees and suppliers will also benefit from Statoil being a good and efficient company.

Introducing more owners to Statoil will expand the breadth of owner supervision. Developments in the company's value will be an important signal and put greater pressure on the company to take decisions which contribute to enhanced value creation. Better owner supervision is expected to yield a stronger focus on long-term good operation and profitability, and thereby to produce a more efficient company.

The government proposes to introduce more owners to Statoil

The government has concluded that the introduction of more owners and a stock market listing will safeguard the community's interests more effectively than the present structure.

- Sole ownership of Statoil by the state is no longer appropriate or necessary in order to achieve important social objectives.
- International agreements (particularly the EEA agreement) mean that ownership of Statoil cannot be used as a political instrument.
- Statoil is an international company which must strength its positions abroad in future. This involves different risks and makes the company more demanding to own.
- Through the introduction of more owners, the company will obtain the same commercial terms as its competitors — including Norsk Hydro.
- The introduction of more owners will tidy up and clarify the state's various roles in the petroleum sector. Statoil's role as a commercial player will also be clearer, which could have a positive effect on internal decision-making processes and help to make the company more efficient.
- Developments in the company's value will give an important signal and put greater pressure on the company to take decisions which benefit value creation.
- Statoil will secure greater flexibility to expand its operations through the use of shares as payment. The company will be able to participate more effectively in the consolidation under way in the petroleum sector, should this be considered desirable.
- Competitiveness and value creation in both Statoil as a company and on the NCS as a whole will be strengthened if more owners are invited into the company.
- Statoil operates in a commercial environment where virtually all the players — customers, partners and suppliers — are privately-owned.

Statoil's national base will be secured

The introduction of more owners will reduce the state's influence over the company. How large this reduction will be depends on what proportion of the company is sold to others. The degree of influence with different equity holdings can be summarised as follows:[7]

- Ninety per cent of the shares gives the right to acquire the remaining shares in the company.
- Two-thirds of the shares gives a qualified majority. The owner can then unilaterally decide to implement mergers and amend the articles.
- Fifty per cent of the shares gives an ordinary majority. This is required, for instance, when electing members of the corporate assembly and the board.
- One-third of the shares gives negative control. The owner can prevent mergers and amendments to the articles. A Norwegian location for the head office in Norway can be specified in the articles.
- Ten per cent of the shares confers the right to request an investigation by the probate court.
- Five per cent of the shares confers the right to demand an extraordinary general meeting.

Statoil will remain a Norwegian-based company. Its head office with associated top management, decision-making authority and strategy functions will be located in Norway. But a national base for the company does not require full state ownership.

After the introduction of other owners, the special legal provisions for state-owned limited companies will no longer apply to Statoil. The government will no longer select its directors directly, but elect members of the corporate assembly who then elect directors to the board. It will no longer be possible for the company's general meeting to set a higher dividend for the company than the board proposed or finds acceptable. The government will no longer be able to override decisions by the corporate assembly on issues relating to:

- investments which are substantial in relation to the company's resources
- rationalisation of or changes to operations which would mean major changes to or redeployments of the workforce.[8]

One consequence of this is that the present management arrangements for the SDFI must be changed. See section 6.4.

The state should retain at least two-thirds of the shares in the company.

Strategic alliances

One way to ensure that Statoil progresses as a competitive international energy company could be alliances with other companies. This would allow Statoil to secure new and strengthened expertise, access to markets and a broader resource base.

In this context, a number of different forms of strategic alliance can be conceived with regard to the scope and organisation of such cooperation, equity structure and perspectives.

An alliance must be commercially-based. However, it is fully possible for two companies to collaborate without equity changes. See Statoil's earlier alliance with BP. Nevertheless, combining commercial collaboration with ownership positions is fairly normal. This approach provides a clear expression of greater commitment.

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[7] See the Act on Public Companies Limited by Shares.

[8] See section 6-37 in the Act on Public Companies Limited by Shares

The government wishes to give Statoil the opportunity to conclude this type of strategic alliance with other companies. Collaboration projects with other companies must be considered in an acceptable way by the company’s decision-making bodies, including the board and the general meeting.

Possible strategic owners should not be introduced to Statoil before a listing. A listing will establish a market value for Statoil, which the government regards as necessary before possible equity-based alliances are concluded with other companies.

Introduction of more owners — scope

Subject to the state retaining at least two-thirds of the shares in Statoil, the government will draw up a strategy for introducing more owners which ensures the best possible financial result.

Volume, liquidity and market capacity must be taken into account in this context.

It is moreover important to incorporate new owners on a scale which gives investors confidence that the state as owner will give Statoil the freedom to develop its strategy on the basis of commercial goals.

These considerations can be secured by initially incorporating new owners corresponding to 10-25 per cent of the company’s value. This will be achieved primarily by issuing new shares in the parent company, Den norske stats oljeselskap a.s, combined with selling part of the state’s shareholding. Shares will placed in both Norwegian and international capital markets. It should be announced at the same time that the state’s holding could be reduced to 67 per cent over time.

In addition, it will be specified that Statoil is to be run on commercial principles in the same way as other listed companies. A share sale on this scale will also be in proportion to market demand and ensure the liquidity of the share.

For further details see chapter 10, which describes the actual listing process.

5.4 Conclusion

The government proposes to open up for more owners in Statoil by listing the company on the stock market. Expanded ownership will provide new expertise, partners and capital. Statoil will remain a Norwegian-based company. Its head office with associated top management, decision-making authority and strategy functions will be located in Norway. The state will retain at least two-thirds of the shares in the company.

New owners corresponding to 10-25 per cent of the company’s value will initially be brought in through the listing. This will be achieved primarily by issuing new shares in the parent company, Den norske stats oljeselskap a.s, combined with selling part of the state’s shareholding. Shares will be placed in both Norwegian and international capital markets.

Statoil will be given the opportunity to conclude equity-based strategic alliances with other companies. This can first happen after the company has been listed.

6. The state's direct financial interest (SDFI)

6.1 Introduction

The SDFI was established with effect from 1 January 1985 by dividing most of Statoil's production licences on the NCS into a direct financial interest for the state (the SDFI) and a commercial share for Statoil. An SDFI share has been included in nearly all production licences awarded since its establishment.

This arrangement is a field-specific instrument in that the share is adapted to the profitability and resource potential of the individual production licence. The objective for long-term management of these holdings is to achieve the highest possible revenues for the state. The SDFI represents substantial value and revenues for the state.

6.2 The present arrangement

6.2.1 Reserves and production

According to Statoil's definition of reserves, the SDFI's oil and gas reserves totalled about 1 550 million scm of oil equivalent (corresponding to 9.8 billion barrels) at 31 December 1999, with oil accounting for 35 per cent and gas for 65 per cent.

Table 6.1: An overview of proven SDFI reserves

SDFI	1997		1998		1999	
	oil mill scm	gas bn scm	oil mill scm	gas bn scm	oil mill scm	gas bn scm
Reserves at 1 Jan	589	972	552	982	553	1004
Revised estimates	12	7	28	10	11	6
Enlargements, finds and improved recovery	24	19	43	31	48	10
Acquisition of reserves	0	0	0	0	9	3
Production	-73	-15	-70	-19	-73	-22
Reserves at 31 Dec	552	982	553	1004	548	1000

Proven reserves represent calculated volumes of oil, gas and NGL which, based on analyses of geological and technical data, can be recovered with a reasonable degree of certainty from known reservoirs under prevailing financial and operating conditions. Oil includes NGL.

Source: Statoil

The state is a direct participant through the SDFI in more than 150 production licences on the NCS. Much of its reserves and production are concentrated in a few large fields.

SDFI production of oil and NGL totalled 461 million barrels in 1999 (1.26 million barrels per day) and accounted for roughly 40 per cent of Norwegian oil production. Sales of SDFI gas amounted to 22 billion scm in 1999. This corresponded to about 45 per cent of Norway's gas exports.

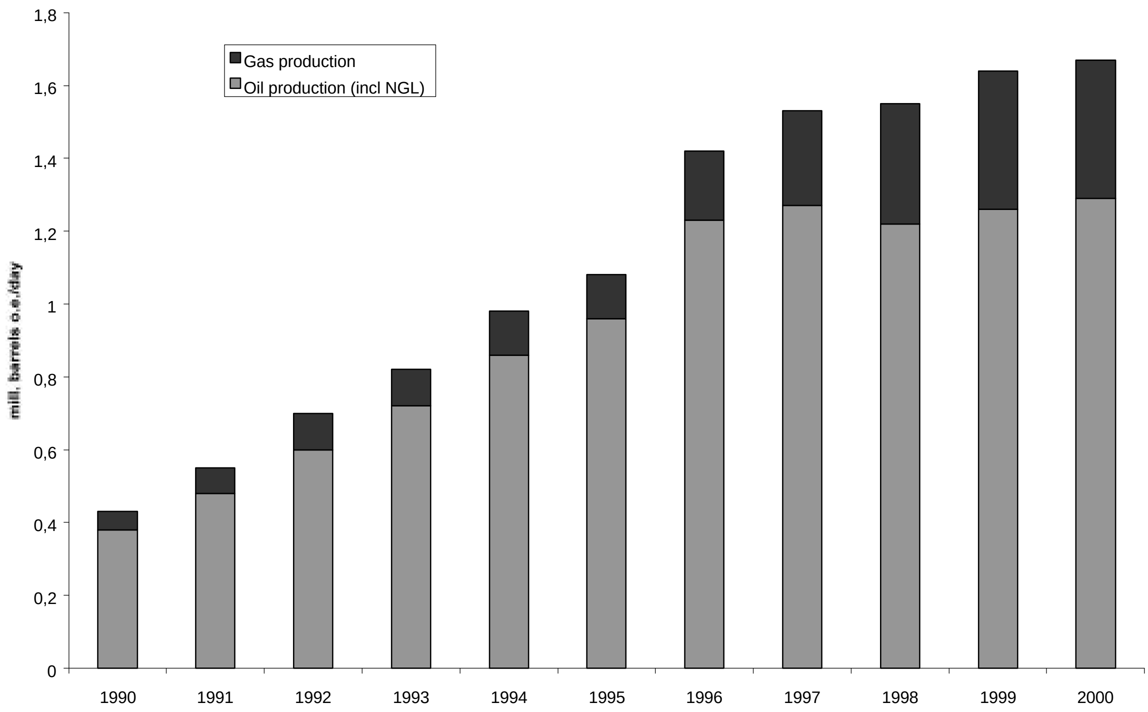

Figure 6.1: The SDFI's share of oil and gas production in millions of barrels of oil equivalent per day, 1990-2000

Source: Statoil, Ministry of Petroleum and Energy.

After rising steadily from the establishment of the arrangement in 1985 until 1996, SDFI oil production has been relatively stable in recent years. Gas output was low until 1996, but has gradually increased since then. In figure 6.1, SDFI oil and gas production in 2000 is based on a forecast for the present year, see Storting proposition no 19 (2000-2001).

6.2.2 Shares in licensing rounds

State participation has varied over time in both form and scope. The state has participated through Statoil since 1973, and also directly through the SDFI since 1985. The table below provides an overview of the average share allocated to the SDFI in the various offshore licensing rounds before possible exercise of the sliding scale.

Table 6.2: Average SDFI share of awards in licensing rounds before possible exercise of the sliding scale

Licensing round	Year of award	Average SDFI interest
9th	1985	30.0 per cent
10A and B	1985-86	30.3 per cent
11A and B	1987-88	30.8 per cent
12A and B	1988-89	28.5 per cent
13th	1991	28.9 per cent
14th	1993	37.6 per cent
15th	1996	27.2 per cent
Barents Sea project	1997	22.9 per cent
North Sea round	1999	18.7 per cent
16th	2000	15.0 per cent

Source: Ministry of Petroleum and Energy

In place from the ninth to the 13th rounds, the sliding scale provision gave the state an option to increase its interest when a field was declared commercial. Exercise of the scale has given the SDFI a high share in several large fields. As the NCS has matured, and the potential for large and very profitable fields has declined, the level of the SDFI share has gradually been reduced. Nor does the SDFI have a share in all production licences. The focus is on production licences expected to offer high profitability and/or resource potential. In recent years, moreover, it has become increasingly important to provide companies with sufficiently large shares to ensure effective recovery of the petroleum resources.

6.2.3 The SDFI’s share of remaining resources

Through its direct interests, the state is the largest owner of resources on the NCS. It held 44 per cent of Norway’s remaining reserves in fields on stream, fields approved for development and discoveries in the planning phase through the SDFI at 1 January 2000.

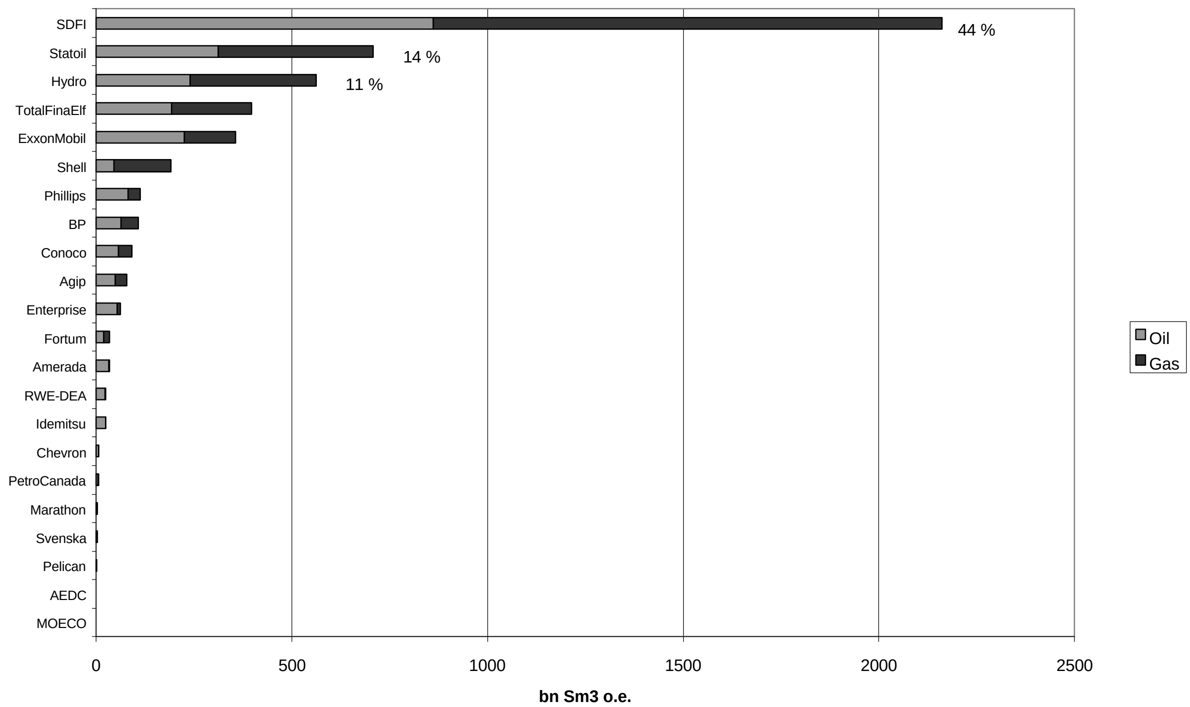

Figure 6.2: Remaining reserves in fields on stream, fields approved for development and discoveries in the planning phase by licensee at 1 January 2000

Source: Ministry of Petroleum and Energy, Norwegian Petroleum Directorate.

6.2.4 Interests in pipelines and land-based plants

Pipelines and land-based plants are necessary for producing and selling the resources and for maximising value creation on the NCS. Through the SDFI, the state holds direct interests in most of the oil and gas pipelines and land-based plants associated with Norway's offshore sector. However, it does not hold interests in Statpipe or the crude oil terminal at Mongstad, for instance. The SDFI share varies from five per cent in Norpipe Oil AS (from 2005) to 64 per cent in Haltenpipe. The state has taken a direct interest in the order of 50-60 per cent in the latest transport systems to be developed.

See chapter nine for a more detailed presentation of the natural gas infrastructure.

6.2.5 Net cash flow from the SDFI

From the establishment of the SDFI in 1985 until 31 December 1999, the state invested about NOK 302 billion in 2000 prices through the arrangement. This capital spending has laid the basis for a high net cash flow from the SDFI since 1996 and in coming years. Until 1996, the annual net cash flow from the SDFI was below NOK 9 billion — or negative — as a result of the high level of investment.

Table 6.3: SDFI cash flow in 1990-99 in NOK billion, 2000 prices

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Receipts	27.5	33.8	36.5	41.7	43.0	46.3	71.9	80.9	62.6	76.6
Expenditures	18.4	26.8	32.3	41.5	43.0	36.3	34.7	38.5	47.5	50.3
Net cash flow	9.1	7.0	4.2	0.2	0.0	10.0	37.2	42.4	15.1	26.3

At 31 December 1999, the state had received a net return of about NOK 82 billion in 2000 prices since the SDFI was established in 1985.

Net cash flow from the SDFI in 2000 is expected to be about NOK 98 billion. See Storting proposition no 19 (2000-2001).

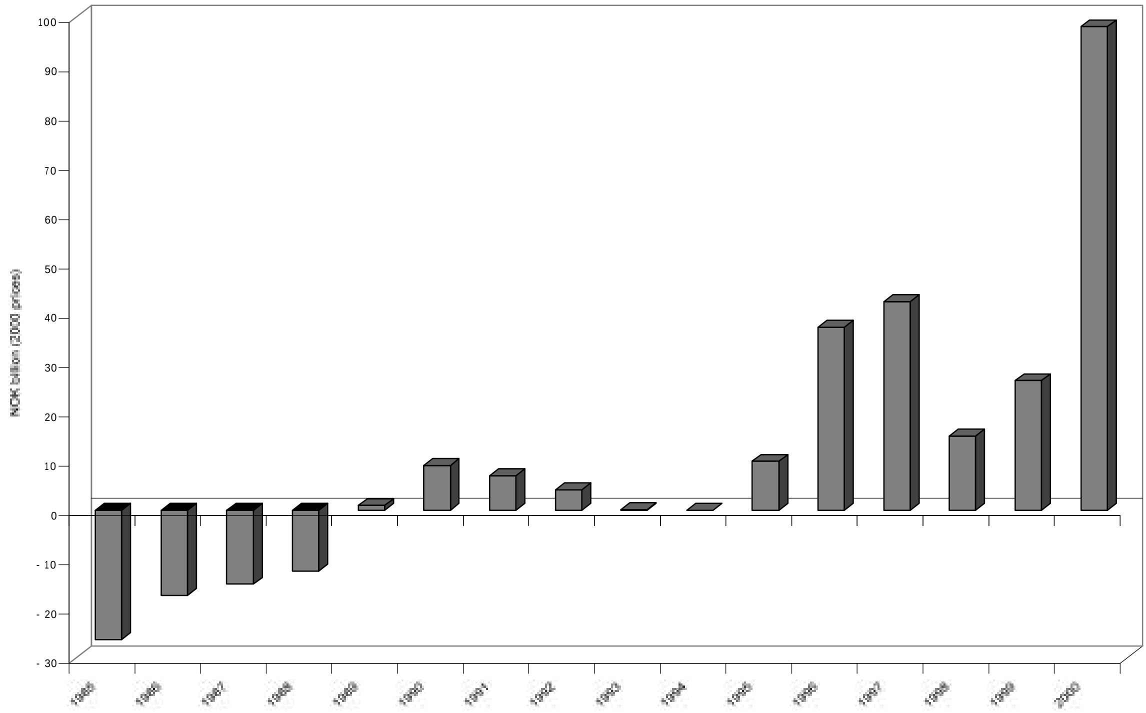

Figure 6.3: Annual net cash flow for the SDFI in NOK billion at 2000 prices

Source: Ministry of Petroleum and Energy.

At the request of the Ministry, Statoil's auditor has prepared a report which provides a more detailed overview of cash flows relating to the SDFI.

6.2.6 The present management system

According to article 11 in Statoil's articles of association, the company's board is responsible for supervising overall state participation in the offshore sector — in other words, Statoil and the SDFI. This means that Statoil handles operational and management functions for the SDFI on behalf of the state through its ordinary technical and administrative organisation.

The Minister of Petroleum and Energy represents the state as sole owner of Statoil through the general meeting, which is the company's highest authority.

Decision-making structure

As the general meeting of the company, the Minister appoints its board with the exception of the employee representatives.[9] The board is responsible for Statoil's operations, including the management of the SDFI. The main rule is that Statoil manages the state's commercial interests through the SDFI on a wholly independent basis, within the appropriation limits determined by the central government budget.

The ordinary provisions of the Companies Act also apply to Statoil, but the Act includes certain special rules for state-owned limited companies which strengthen the position of the general meeting in those enterprises where the state owns all the shares (sections 20-4 to 20-6). Through article 10 in Statoil's articles of association, the state has further strengthened its opportunities for supervision and control by comparison with the provisions of the Companies Act. The article specifies that the company's board must submit to the general meeting all matters which must be presumed to be of political importance and/or which may have essential effects on the nation and its economy. These include:

[9] See the Companies Act, section 20-4, and section 6-4.

- plans for the coming year
- medium-term perspectives
- significant changes in such plans and perspectives
- plans for projects of significant size in relation to the company's overall operations
- issues which appear to require equity or loan capital from the state
- plans to engage in new forms of business on a substantial scale.

The general meeting decides whether it wishes to note the board's submissions, or whether it wants to approve or amend them.

The existing management model

Report no 21 (1991-92) to the Storting established a management model which lays down rules for Statoil's management of the state's overall involvement — in other words, Statoil and the SDFI. The principal objectives of Statoil's management are to ensure that the state as owner obtains the highest possible return on invested capital over time, and that decisions and supervision of the business are based throughout on commercial, cost-effective and safe operation.

The management model lays down criteria to be applied by Statoil in ranking its projects. Report no 21 (1991-92) to the Storting specifies that:

"Value creation for the state's overall involvement will be applied by Statoil as the basis for ranking different options when taking decision. This means that the outcome for Statoil plus the SDFI, and separately for Statoil and the SDFI, will be calculated and assessed for all investment decisions. For a project to be considered for implementation, it must yield satisfactory profitability both for the overall involvement assessed on the basis of the state's required return and for Statoil assessed on the basis of the company's required return. Given the requirement to ensure the best possible outcome for the state's overall involvement, weight will also be given to evaluating the division of value creation between Statoil and the SDFI."

An efficient and functioning management model is important to ensure high value creation from the state's involvement on the NCS.

Relationship between the state and Statoil

The share reserved to the state in the licences is formally allocated to Statoil, regardless of whether or not Statoil is awarded its own share. However, Statoil has its own interest in most of the licences with an SDFI share. Statoil manages the overall interests of the company and the SDFI in the partnerships. Only one vote is cast by Statoil in the partnership on behalf of the company and the SDFI jointly. Externally, Statoil serves as the licensee and as owner of its own interests and the SDFI combined. Statoil concludes agreements and makes the necessary dispositions for the state's participation interests and the state's petroleum, in the same way as for the company's own participation interests and petroleum.

In the underlying relationship between Statoil and the state, however, the state has full ownership rights to its participation interests. The SDFI's holdings are not shown in Statoil's balance sheet. The state itself finances the investments and operating costs which correspond to its direct interests.

Sale of the state's oil

An important principle of Norwegian sales policy has been to achieve a high degree of combined sales in order to achieved efficient selling and the highest possible revenues.

Article 11 of Statoil's articles of association makes the company responsible for selling the SDFI's oil and also gives it the right and duty to dispose of royalty oil which the state elects to take in kind. Statoil is required to identify the best sales solution for the total volume of state oil.

Settlement of accounts between Statoil and the state is based on the norm price. This is set by the Petroleum Price Board, and will correspond to the price at which petroleum could have been traded between independent parties in a free market. Regulations for settling accounts between the SDFI and Statoil were specified in Report no 22 (1985-86) to the Storting:

"The government has resolved that revenues from Statoil's sale of all oil corresponding to the state's direct financial involvement will be settled between the state and Statoil on the basis of the norm price with a 30-day credit period from the date of the sale; in other words, normal commercial credit terms for oil sales. This settlement will be based on the norm prices rather than Statoil's realised prices in order to ensure that prices are not directly influenced by Statoil."

The following applies when a norm price has not been set (see Report no 14 (1987-88) to the Storting):

"When settling accounts between the state and Statoil for Statoil's sale of royalty oil and petroleum corresponding to the state's financial interest, the Ministry will set settlement prices on the basis of prices obtained and other comparable valuations in those cases where a norm price has not been set. Substantial weight will normally be given to prices obtained when settling accounts, and special reasons ought to exist before a settlement can be based on prices significantly higher than those actually obtained. Such special reasons could apply, for instance, when petroleum is transferred between parties with a direct or indirect community of interests."

When the system of settling accounts for the SDFI's oil on the basis of the norm price was established in 1986, Statoil was selling 200 000 barrels per day of its own oil and 100 000 barrels per day of the state's oil. Total production from the NCS today exceeds three million barrels per day (including SDFI and Statoil oil as well as royalty oil). The SDFI's share is about 1.8 million barrels per day, three times larger than Statoil's own volumes, and is rising.

On the basis of its business manager responsibility, Statoil is a substantial player in the crude oil market. Europe represents the most important market for Norwegian crudes. The steady expansion in volumes available makes it more challenging to achieve the best possible price for this oil, particularly for cargoes going outside Europe. Statoil has gradually expanded its marketing and sales organisation, and now has sales offices in Stavanger, London, the USA and Singapore. The company has also invested in the crude oil terminal at Mongstad and leased storage capacity in Asia. Together with refining agreements in several countries, these measures are aimed at achieving the highest possible sale price for Norwegian crude. Statoil's transaction or marketing costs associated with the sales are not covered.

Sale of the state's gas.

Gas sales contracts are negotiated by the Gas Negotiating Committee (GFU). Signed contracts are allocated to *contract fields*, which are thereafter responsible for fulfilling the contracts with the buyers. Delivery rights under these contracts can nevertheless be assigned wholly or partly to one or more third fields, known as *delivery fields*. Rights and obligations in contract and delivery fields are allocated proportionately to the licensees in these fields. The state's gas is covered by Statoil's gas contracts.

The state's net cash flow

Although Statoil is the formal holder of the SDFI's holdings, the management arrangement assumes a clear internal financial division in the relationship between Statoil as manager and the state as owner of the SDFI assets. The financial aspects of the state's own interests are kept separate from Statoil and are not included in the company's accounts.

Every year, the Storting appropriates the funds required in order for Statoil, on behalf of the state, to pay that part of investment and operating costs which corresponds to the state's own interests. Revenues accrue as an annual cash flow to the state after the state's share of investment and operating costs has been deducted. The net result on an annual basis is presented in special accounts kept by Statoil. Revenues and expenditures are recorded in the central government budget and accounts under the various income and expenditure items. Statoil produces an annual income statement for the SDFI. This is based on the accruals principle. For reporting to the central government accounts, the SDFI's accounts are converted to a cash basis. The state's net revenues from its participation in petroleum activities are not liable to tax, and the net cash flow is calculated before tax. The Office of the Auditor General has ultimate responsibility for auditing the SDFI's accounts.

The financial division between Statoil and state participation interests is implemented before the preparation of Statoil's accounts for the operations pursued by the company on its own account. Although Statoil manages the state's participation interests, this accordingly does not appear in Statoil's own accounts.

As a limited company, Statoil is subject to the Accounting Act's requirements for annual reporting in the form of an annual report, income statement and balance sheet.

Organisation of Statoil's responsibility as business manager for the SDFI

Statoil decided in 1999 that a member of its corporate executive committee should be responsible for the SDFI caretaker function in the company. Organisationally, this caretaker function would continue to be discharged within Statoil on the basis of two different models.

In production licences where Statoil participates both with its own financial interest and as business manager for the SDFI, the caretaker function for the latter is discharged by the company's regular organisation. One result is that those parts of Statoil's organisation responsible for dealing with fields in which Statoil has a share also take care of the SDFI share. This traditional model has been practised since the SDFI was established in 1985.

The European Council of Minister's directive 94/22/EC on the conditions for granting and using authorisations for the prospection, exploration and production of hydrocarbons (the licensing directive) has been incorporated into Norwegian law with effect from 1 September 1995 and applies for production licences awarded after that date. It does not have retroactive effect. The licensing directive meant that a new model had to replace the traditional management approach for SDFI production licences which have been awarded after the directive came into effect, and in which Statoil does not have a share of its own. The directive's provisions require that the business manager role is performed in a way which separates cash flows and information accruing to the business manager as a direct participant in petroleum activities and as business manager respectively. Since the SDFI was established, a clear division has existed between the cash flows accruing to Statoil as a company and as business manager for the SDFI. Where information flows are concerned, organisational changes have been made in Statoil which satisfy the requirements of the directive. A separate unit has been established in Statoil to manage the SDFI in production licences where the company has no interests of its own but participates as business manager for the SDFI. Other units in Statoil do not have access to information obtained by the company in its capacity of business manager for the SDFI in these production licences.

Statoil made adjustments to its portfolio of production licence interests in 1997 in order to concentrate its involvement on certain selected core areas. This increased the number of production licences in which the company participates only as the SDFI business manager. These principally represented production licences awarded before the licensing directive came into force. For practical reasons, however, the Ministry has nevertheless determined that the caretaker function in such licences will be discharged through the separate unit which manages the SDFI in production licences where Statoil participates only as the SDFI business manager.

6.3 Statoil's view of the present caretaker arrangement

In its report of 13 August 1999 and a letter of 8 October 1999 to the Ministry, Statoil's board has expressed its view of today's caretaker arrangement. The board believes that the caretaker model could present problems because its structure does not provide the right incentives. This is reinforced by the fact that the production and reserve base relating to the SDFI is three times larger than that relating to Statoil's own shares. The board identifies several considerations which it regards as significant in this context.

In certain circumstances, the decision-making model could mean that Statoil must choose options which are not the most profitable for it as a company.

SDFI investments are confined to upstream operations on the NCS. The arrangement has not established positions in sales, marketing or refining.

The board also notes that Statoil is required to sell the SDFI's oil and gas, but that the present (norm price) settlement system for crude oil means it will not always be commercially profitable for Statoil to maximise the value of the state's oil.

In addition, the board observes that the cost of maintaining an adequately-dimensioned organisation falls on Statoil alone.

The board sums up this position as follows:

"In other words, the present caretaker model suffers from the weakness that it is not always profitable for the caretaker to maximise the SDFI's interests and that it imposes a complex structure of goals on the caretaker. A caretaker model of this kind cannot continue over time without damaging both the caretaker and the SDFI."

Statoil accordingly has several objections to the present caretaker arrangement.

6.4 Consequences of a decision to introduce more owners to Statoil for the present management arrangement

A decision to introduce more owners to Statoil has consequences for the SDFI management arrangement. Article 19 of the Constitution states that:

"The King shall watch over the management of the estates belonging to the state, and its privileged controls and monopolies, to ensure that they are administered in the manner determined by the Storting and to the best advantage of the community". The Storting has full authority to issue instructions on the management of the state's estates, but the King has the right and duty to "watch over" the way these estates are managed.

As mentioned above, the SDFI's holdings are formally awarded to Statoil. Externally, Statoil serves as the licensee and owner of the company's own share and the SDFI combined. *However, participation interests held by the state through the SDFI are the state's property and must be managed in accordance with article 19 of the Constitution.*

This have been achieved at present in that management of the SDFI rests with a wholly state-owned limited company, Statoil, subject to the special provisions for such enterprises in the Companies Act and with the Minister as the company's general meeting. In that capacity, the Minister appoints the board of the company with the exception of the employee representatives. The board has a duty to assess which matters should be submitted to the general meeting as the highest decision-making authority in the company. In addition, the board has a duty under article 10 of the articles of association to submit all matters to the general meeting which must be presumed to be of political importance and/or which may have essential effects on the nation and its economy. Statoil's responsibility for managing the SDFI is specified in article 11. *This gives the government the necessary opportunities for supervision and control of the SDFI, and today's organisation accordingly confirms with the Constitution.*

Introducing more owners to the company would exclude Statoil from the special rules in sections 20-4 to 20-6 of the Companies Act. The extended competence conferred on the general meeting by these rules will thereby no longer apply, *and the Minister will no longer have the power provided by the present arrangement to issue instructions*.

Directors of the company will be elected by the company's corporate assembly, which is elected in turn by the general meeting and the company's employees. In accordance with the Act on Public Companies Limited by Shares, the corporate assembly will be the decision-making authority in issues relating to investments which are substantial in relation to the company's resources, and to rationalisation or reorganisation of operations which would mean major changes in or redeployment of the workforce.[10]

The state will be one of several owners of the company, with the right to attend the company's general meeting.

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[10] See the Act on Public Companies Limited by Shares, section 6-37.

The provisions in article 10 cannot be retained.

These considerations mean that introducing more owners to Statoil will require changes to the present management arrangement for the SDFI.

6.5 Conclusion

The SDFI represents substantial state assets and revenues. Through this arrangement, the state is a direct participant in more than 150 production licences as well as in pipelines and land-based plants. Statoil takes care of operational and commercial functions for the SDFI on behalf of the state. The company has fairly serious objections to the present caretaker arrangement, and notes that its structure does not provide the right incentive. Introducing more owners to Statoil will require changes to the present management arrangement.

7. Further development of state involvement in petroleum activities

7.1 Introduction

A decision on a partial privatisation of Statoil provides a good opportunity to undertake a reassessment of overall state involvement. The principal question is how this opportunity should be utilised to achieve the largest possible value creation for the community.

Taking an overall view of Statoil and the SDFI in connection with a change in state involvement is important not only because this will best clarify the opportunities available, but also because changes to Statoil's ownership structure will have consequences for the SDFI.

The discussion above shows that changes will be needed in the *management* of the SDFI when Statoil is partially privatised. Given the conflicts of interest identified with the existing arrangement by the present caretaker, Statoil, it would have been reasonable to assess such changes regardless of the question of Statoil's ownership.

The government will focus on the opportunities offered by a restructuring.

7.2 The attitude taken to further development of state involvement

The oil and gas resources are our common property, and must be managed in a way which benefits the whole population.

Together with the tax system, state ownership has been important in securing revenues from petroleum activities for the community. This will also form the basis for the common ownership strategy which the state seeks for its majority shareholding in Statoil and for the SDFI.

Managing our common property has made it possible to safeguard employment and extend the welfare state. State ownership has also been important for developing oil companies with an ownership base in Norway.

At the same time, participation by foreign and private-sector companies has contributed expertise and technology crucial for value creation, and thereby for the community's revenues from petroleum activities.

In this way, fruitful interaction between Norwegian and foreign as well as state and private ownership has been a characteristic of the development of our petroleum activities from their beginnings to the present day.

Norwegian petroleum activities faces big opportunities and challenges as a result of international changes and developments on the NCS. As an oil and gas nation, we are well equipped to meet these challenges. Through a restructuring of state involvement, the structure and efficiency of the offshore sector can be improved while national industrial communities can be strengthened and further developed both nationally and internationally. We must actively exploit the available opportunities.

7.2.1 State involvement in a wealth management perspective

The state has opted for various forms of involvement. From a wealth management perspective, the state has chosen to realise its petroleum wealth with the aid of several instruments. See section 3.2.

This petroleum wealth breaks down as follows:

- the value of future taxes and duties
- the value of future net cash flow from the SDFI
- the value of the state's equity holdings in Statoil and Norsk Hydro

Figure 7.1 illustrates the composition of the state's petroleum wealth. It also shows flows from these wealth components to the petroleum fund and their relation to the central government budget.

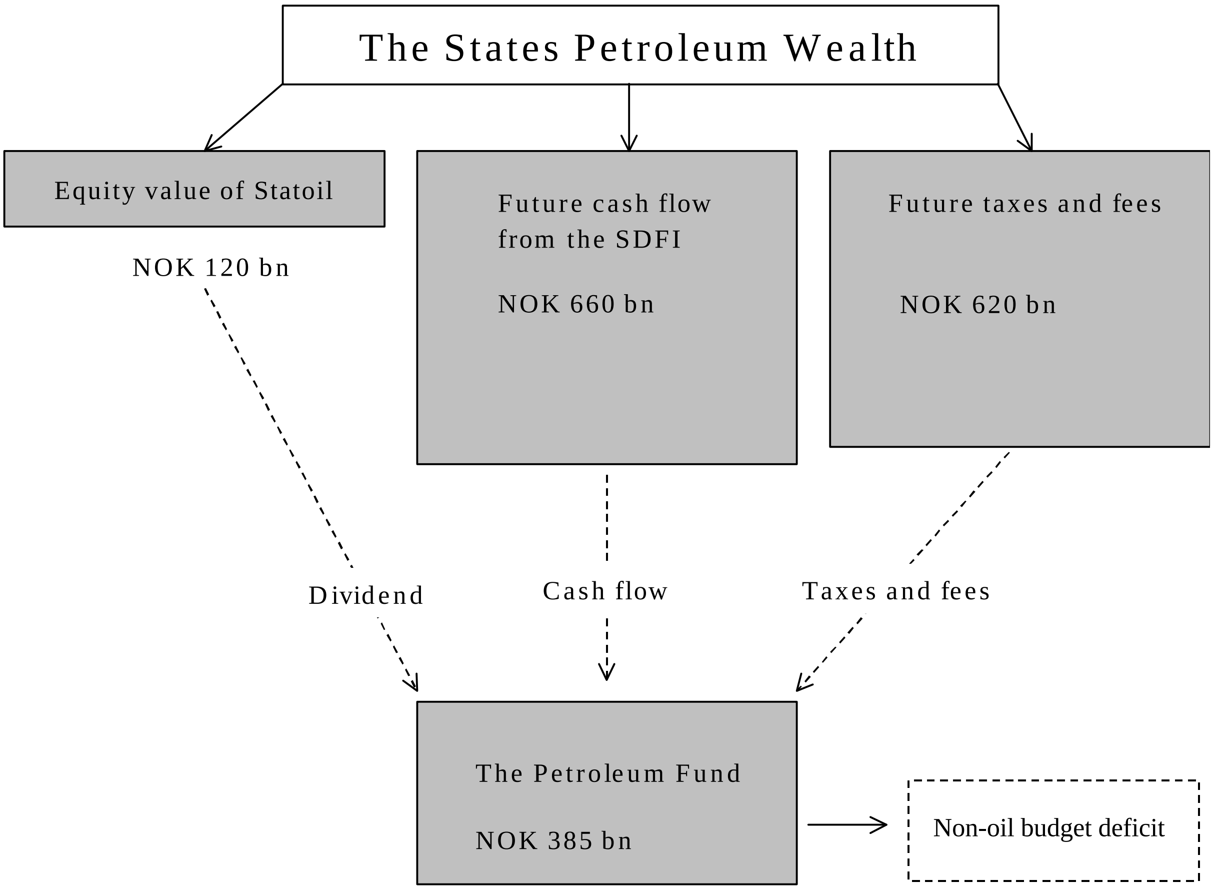

Figure 7.1: The state's petroleum wealth[11]

Sources: Ministry of Petroleum and Energy and UBS Warburg.

Ownership of Statoil represents a very important part of the state's involvement. Statoil is a highly qualified company, which creates value through the well-organised application of knowledge, technology and capital. The capital has largely been provided by the state in the form of equity contributions and by self-financing from the company's profits. The state receives value back in the form of dividend. The owner must have very ambitious goals for Statoil's future development.

The SDFI is a purely financial involvement, with no operational organisation. Value created by companies in production licences flow directly to the state in proportion to the share of investment contributed by the SDFI.

Exploration for oil and gas, field development and market sales are handled by the oil companies. The individual companies on the NCS and the interaction between these companies and the supplies industry are accordingly crucial for the efficiency of the offshore sector.

Statoil and Norsk Hydro occupy a key place in this perspective. On their own, however, they cannot safeguard government financial requirements while also maintaining and developing the competitiveness required to ensure the highest possible value creation.

Good wealth management is dependent on Norwegian offshore operations being pursued as efficiently as possible. This will strengthen the companies, the tax base and revenues from the SDFI.

[11] Note that the estimated market value of Statoil dates from June 1999, and is assumed to have risen since then. See section 3.2.

7.2.2 Assessment of the Statoil board's recommendation

The report of 13 August 1999 from the Statoil board proposes that "the company is strengthened with all or a significant part of the resources currently held by the SDFI".

Statoil presents a number of arguments to support its recommendation. The principal justification is that this will increase the value of the state's revenues *and* create a robust and powerful Norwegian-based player in international markets. In particular, the board points to the opportunity of "building up a position for Statoil as a central gas company in Europe".

Great weight is placed by Statoil on the necessity of an SDFI sale and the introduction of other owners to Statoil in order to meet the challenges facing us.

Although market changes and developments among competitors are happening quickly, the Ministry believes that a balanced attitude must be taken on modifying the ownership of the country's overall oil and gas resources. A long and successful history for oil policy, with constructive state ownership, should not simply be altered and privatised at a high tempo. As a nation, we must adopt a perspective on this issue which extends beyond the desires of a single company.

The task we face involves more than privatising a state-owned company. It also extends beyond merging two entities. Improved management of Norway's overall oil and gas resources is the aim.

Opportunities for achieving changes in value creation must be put into perspective. We cannot ignore the fact that extensive modifications to the structure and the adoption of new instruments will involve *risk*. However, we must accept that failing to act when circumstances and framework conditions change also poses a risk.

Size is a key consideration in Statoil's argument. The company maintains that size confers strength and contributes to enhanced value creation.

Statoil's argument is that size will be significant both for the market's assessment of financial robustness and for the company's competitiveness. However, Statoil maintains that size alone will be no guarantee of good results. It emphasises that the crucial considerations for all players are that available resources get well utilised, that the commercial strategies on which the business builds are credible and well adapted to the markets served, and that results and profitability grow in line with these parameters for competitors.

Quality, expertise, management, strategy and the ability to deliver results are more important than size, and essential for sustainable growth. Size achieved without the presence of the basic requirements would rest on an insecure foundation and could mean unnecessary risk.

A company based on merging Statoil and the SDFI would have a very large cash flow to invest profitably. Much of this cash flow will probably be invested abroad. That calls for strategy, expertise and the ability to implement projects. The fact that these qualities have been well documented over a lengthy period will be a source of reassurance to and a requirement for the owner.

The Ministry of Petroleum and Energy's financial and strategic advisers, and other analysts, believe it is important to strengthen Statoil. But they have warned against giving Statoil too large a share of the SDFI.

One of the most important considerations for achieving good resource management and value creation is to avoid a *one-sided approach* to operations on the NCS. Competition and interaction are extremely important. We must not weaken the potential for participation by the best qualified foreign companies. Nor ought we to weaken the potential and competitiveness of other Norwegian players in this process. A balance between different companies and industrial communities provides the best basis for value creation. In this area, our experience is unambiguous. Merging Statoil and the SDFI would give the company a disproportionately strong position on the NCS.

After an overall assessment, the government believes that the recommendation from the Statoil board cannot be implemented in full. In the government's view, this proposal would not provide the highest possible value creation and revenues for the community when risk is taken into account.

Not would it yield the best industrial development or competitiveness for the NCS. Factors in this assessment are:

- uncertainty over the valuation of Statoil and the SDFI;
- consequences for the competitiveness and attractiveness of the NCS;
- the industrial and value-related consequences of giving Statoil a very large cash flow;
- gas management considerations are not fully safeguarded by excessive restructuring and privatisation;
- gradual development provides time for strategic focusing, building expertise and documenting results.

Both singly and collectively, these considerations mean that the state as owner is not served by transferring all or a significant part of the SDFI to Statoil. A balanced, gradual approach, which is also large enough to generate the most important positive aspects of a restructuring, appears more attractive.

In its report (appendix 7), Pareto Securities has illustrated this assessment diagrammatically as follows:

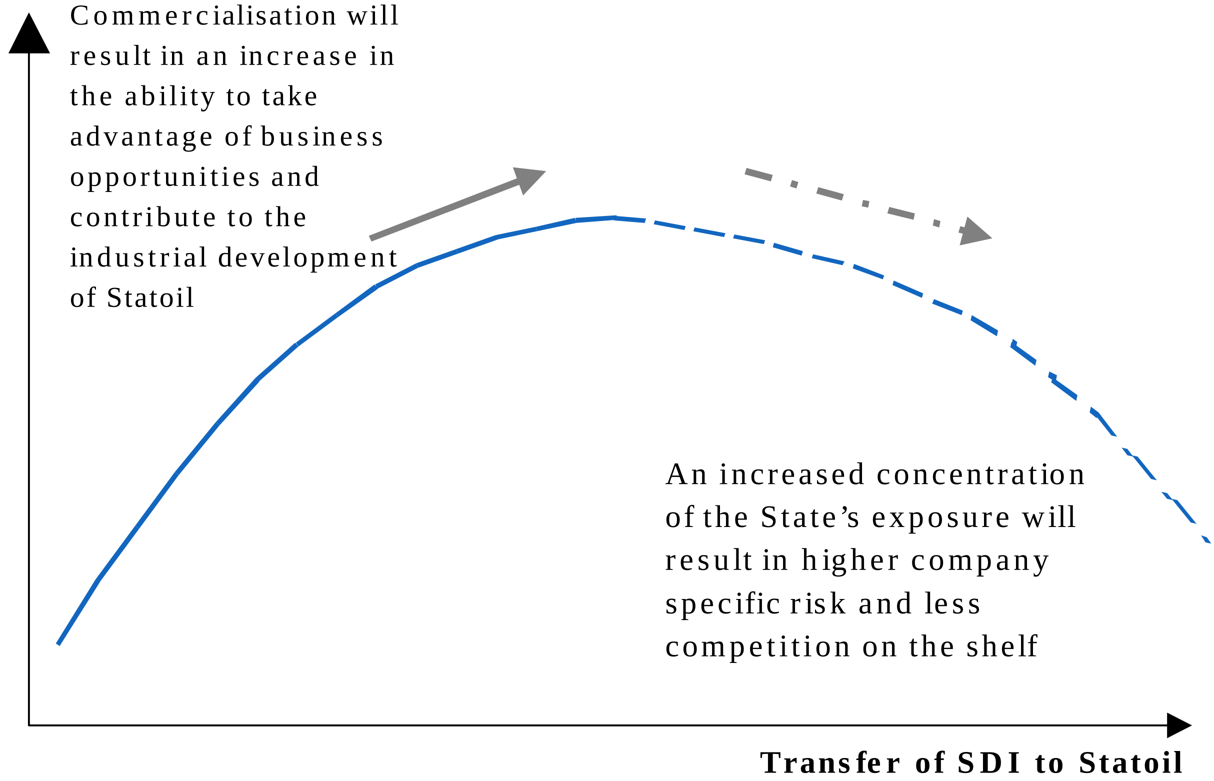

Figure 7.2: Pareto Securities ASA — optimal transfer of SDFI assets

Source: Pareto Securities ASA.

7.2.3 Concerns emphasised by the government

On this basis, the government would give particular emphasis to three concerns underlying its assessment:

- *government finances*: ensure the highest possible value for the state, when risk is taken into account;
- *industrial*: strengthen the industrial players on the NCS;
- *competitiveness of the NCS*: improve efficiency on the NCS in order to achieve the highest possible value creation.

These principal concerns are closely related. The aim is for a restructuring to help satisfy all of them in a good way.

Ensuring good long-term gas management represents a challenge which is integrated with all three of the above-mentioned concerns. Within the framework set by these concerns, the basis will be laid for the best possible gas management. Once again, we must adopt a broad perspective on gas management. State ownership will be essential for ensuring long-term management of these resources. This will also be very important in future, particularly given the market and regulatory challenges presented in Europe.

Government financial concerns

Key considerations when restructuring state involvement must be value creation and revenues for the community.

Together with the tax system, the SDFI contributes to substantial government revenues from the oil sector. Revenues from petroleum activities are expected to account for 25 per cent of government income in 2000.

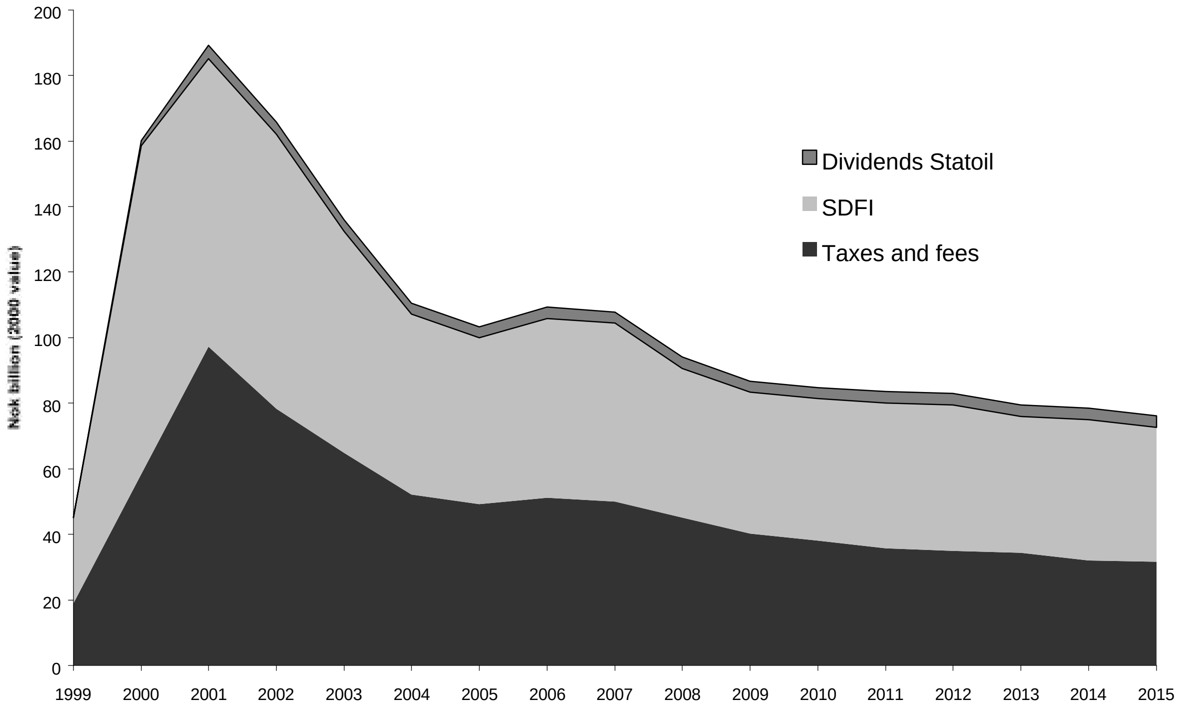

Figure 7.3: Government revenues

Source: Ministry of Petroleum and Energy.

Cash flow from the biggest fields represents the largest source of value. This emerges from figure 7.4, which shows the net present value of SDFI assets in the various fields. A large part of the SDFI’s value is concentrated in relatively few big fields. The value of Troll is greater than the combined value of Gullfaks, Åsgard and Heidrun.

Many of these fields also play a key role in our overall gas management.

The breadth of the SDFI’s portfolio and the addition of new interests can help to maintain cash flow from the SDFI in a longer-term perspective.

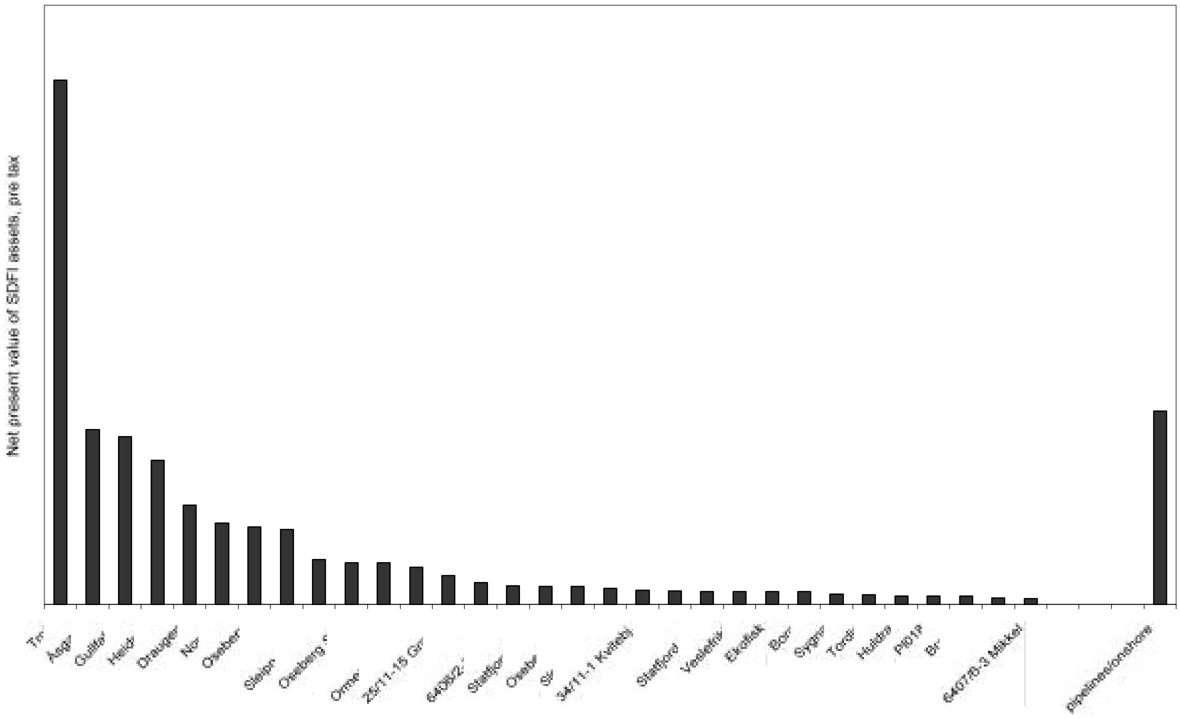

Figure 7.4: Net present value of SDFI assets before tax

Source: Ministry of Petroleum and Energy

Industrial concerns

The oil and gas industry attracts expertise, investment and company formation from both Norway and abroad. This sector has had major industrial spin-offs, which have also affected the regions.

Norway’s petroleum industry has its basis on the NCS. The national oil companies — Statoil, Norsk Hydro and formerly Saga Petroleum — have been key players in the development of this sector.

An important role has been played by our expertise and competitive supplies industry, represented by the large turnkey contractors and a number of sub-contractors, engineering specialists, service companies and so forth.

Interaction with petroleum-related research communities has been very significant.

Similarly, leading foreign oil companies and suppliers with a presence in Norway have made a substantial contribution to developing the petroleum industry community.

The government wants to develop *Statoil* in a long-term perspective on the basis of the company’s leading position as an operator in core areas of the NCS. The company must also be dimensioned so that it can create value beyond the lifetime of operations in Norway. A solid resource base and a strong financial position are important for further progress in Statoil’s international involvement and to exploit the potential for creating a strong European gas company.

The government accordingly envisages selling selected SDFI assets to Statoil, but not on the scale proposed by the company’s board.

Norsk Hydro is also an important player on the NCS. Its continued progress will be important for value creation and employment.

In its report of 1 September 1999, Norsk Hydro states that the company is “interested in acquiring possible SDFI assets which the authorities might choose to make available...on commercial market-related terms”.

The government envisages selling selected SDFI assets to Norsk Hydro, since this company is a key player in core areas of the NCS.

Concern for the competitiveness of the NCS

To identify remaining resources, develop these cost-effectively and achieve good operation, we *must* have competition and interaction between the world's leading companies. Their experience from other parts of the globe and from the NCS is important in this context.

The balance between industrial communities and diversity in company participation is crucial — *and the most important factor* — for ensuring good long-term resource management. We must apply this perspective not only to our licensing policy, but also to a restructuring of state involvement.

Resources operated by Statoil accounted at 1 January 2000 for roughly 70 per cent of remaining proven resources on the NCS. At the same time, fields operated by Statoil accounted for about 60 per cent of current production. Resources operated by Statoil and Norsk Hydro accounted for roughly 85 per cent of remaining proven resources, while fields operated by these two companies represented some 80 per cent of current production.

At the same time, licensee composition and decision-making structures in many production licences on the NCS are very complex, with large numbers of partners and small shares for both operators and partners. Apart from TotalFinaElf, ExxonMobil and BP, which have their main holdings in the southern part of Norway's North Sea sector, operators on the NCS have an average licence interest of 20 per cent. Between them, the two largest partners have an average holding of 25 per cent.

Table 7.1: Average shares held by operators and partners per field and the average share of the two largest partners.

Operator	Number of operated fields *	Operator's average share in %	Mean number of partners **	Average share of the two largest partners in %
Statoil	31	19.6	3.5	23.2
Hydro	23	20.3	3.4	27.5
Shell	3	17.5	2.3	28.1
TotalFinaElf	6	44.6	1.8	27.2
ExxonMobil	4	76.4	1.5	18.0
BP	6	34.1	2.7	43.4

* Fields are defined here as independent and satellite fields in production, under development or being considered for development.

** Arithmetic mean of the number of partners per field. The SDFI is not included as a separate company in the calculations.

Source: Statoil.

Relatively large differences in ownership composition exist in geographically limited areas, which makes it particularly demanding to reach decisions involving several production licences — on coordinated use of infrastructure, for instance.

Licence shares on the NCS are small by comparison with the UK continental shelf (UKCS). This relates not only to operator shares but also to partner interests, and is illustrated in the figure below.

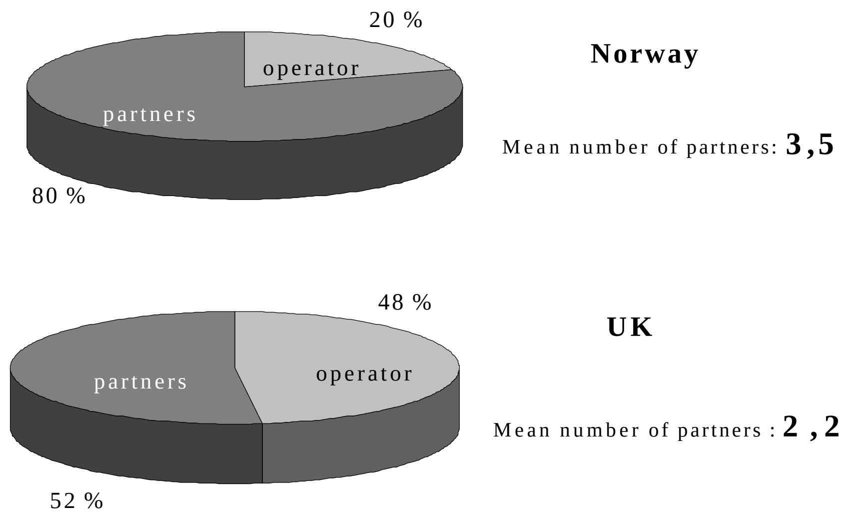

Figure 7.5: Licence interests on the NCS and UKCS in fields operated by the two largest operators.

See notes to table 7.1.

Source: Statoil

The consolidation of licence interests which occurred on the UKCS in the late 1980s has very probably yielded synergies across licence boundaries. This view is supported by work carried out by McKinsey for Statoil, for instance.

It is important that companies on the NCS, particularly the operators, have good incentives to maximise value creation. This is not least important when the fields become more mature and the remaining resources are to be recovered.

A restructuring of state involvement could give companies increased licence interests on the NCS. Larger holdings will provide companies with stronger incentives, allow them to take better advantage of economies of scale and coordination benefits in and between production licences, and strengthen decision-making processes. This will enhance exploration, development and operational efficiency as well as extending production.

Substantial additional value could be realised through a reorganisation of interests on the NCS. The Tampen area can serve as an example. Statoil has identified a number of measures which will contribute to increased value creation there in coming years. The probability of implementing these measures increases substantially if the structure of interests in the area is reorganised. This can be implemented in a way which creates greater harmony in licensee composition between different production licences, and thereby a more harmonised structure of incentives.

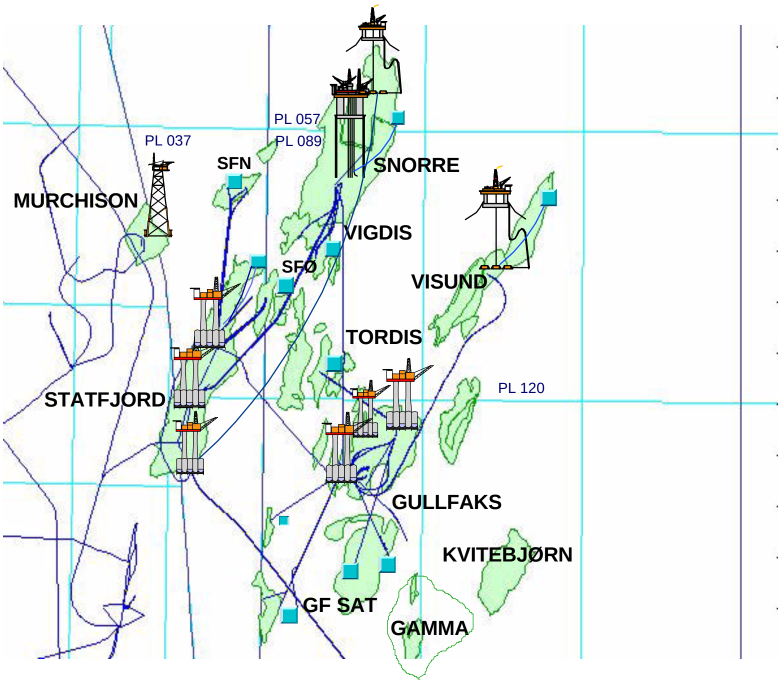

Figure 7.6: The Tampen area of the North Sea

Measures which can be implemented with a more harmonised licensee structure could include:

- reduced operating costs, in part through coordinated use of key services and infrastructure, which could in turn lead to extended production horizons;
- increased output as a result of improved production processes and reservoir management;
- more effective use of capital owing to improved project management and economies of scale in procurement;
- improved systems for finding and developing new fields.

Opportunities for implementing such measures and for securing a larger share of the gains achieved would make the NCS more attractive. In this way, diversity and competition could be enhanced in the offshore sector and overall value creation would increase.

Long-term gas management

Safeguarding value creation from our gas resources is viewed by the government as a major and important challenge.

Gas plays an important role in resource management through its extensive use as a means of improving oil recovery. Injection gas will amount to almost 50 billion scm in 2000. Gas is expensive to transport and store compared with oil. That makes gas sales less flexible, since gas must normally be sold in nearby markets and flow through existing pipeline systems. High storage costs also mean that gas production must be matched to current consumption in the regional gas market. Viewed in isolation, the above-mentioned framework for gas — with heavy investment in transport systems and extended production profiles — means that gas is less profitable to produce than oil.

In order to offset these factors to some extent, it is important to optimise gas production from several fields and exploit possible gains from coordinating their operation. The largest fields play a particularly important role in good management of overall gas resources. This picture is very clear in the Netherlands, where the large Groningen field plays an essential role in optimising production from smaller discoveries. The trend is moving in the same direction on the NCS, where Troll already plays a similar role towards other fields. This development will be extended as total production rises, the number of fields increases and the size of fields declines. Fields with large reserves and big production capacity will play a key future role in exploiting Norwegian gas resources. This makes it important for the authorities to retain control of and influence over production from the largest gas fields. A central ownership position for the state in these fields represents an important factor in securing such influence — also from a gas management perspective.

In order to lay the basis for good overall future gas management, the state should retain substantial interests in the Troll, Oseberg and Ormen Lange fields. At the same time, strengthening Statoil as a gas company is important since it will be the key gas player on the NCS. Achieving a balance between these two considerations accordingly represents best way to safeguard the value of the state's gas assets.

7.3 The government's proposal for restructuring the SDFI

A better-organised and more active management of the resources will create more value and contribute to improved progress for the Norwegian oil and gas industry. To meet the objectives set by the government, a partial restructuring of the SDFI is recommended. The government has sought to strike a balance between government financial concerns, industrial concerns, concern for the competitiveness of the NCS and — as an integrated part of all these considerations — concern for long-term gas management.

Much of the value of the SDFI is concentrated in a few large fields. The most important of these are Troll, Åsgard, Gullfaks, Heidrun, Draugen, Norne and Oseberg. See figure 7.4.

Gas management considerations make it important that the state has a substantial interest in Ormen Lange. Troll, Oseberg and Ormen Lange are important fields for future gas management.

It is proposed that SDFI assets corresponding to 20 per cent of the asset value of the SDFI are included in a restructuring of state involvement, providing the state achieves satisfactory terms. The state will retain direct interests corresponding to 80 per cent of the SDFI's asset value. The interests which the government envisages selling to Statoil will account for about 15 per cent, while those it envisages selling to Norsk Hydro and other companies will account for roughly five per cent. The government would emphasise that all transactions will be implemented at market value.

In addition to taking care of government financial and gas management concerns, this proposal involves a strengthening of industrial players on the NCS and further development of the Norwegian petroleum industry. The foundation will be laid for continued value creation and employment in Norway.

Increased holdings for the companies — particularly the operators — will strengthen the competitiveness of the NCS.

When selecting specific SDFI assets for sale, the aim is to combine these factors in such a way that total value creation from the NCS becomes as large as possible.

To secure possible efficiency gains on the NCS, it will be important to restructure the SDFI in such a way that additional value can be realised through ownership restructuring. Correspondingly, it will be important to sell SDFI assets in fields, discoveries and exploration acreage with a low resource potential and poor projected profitability. In order to lay the basis for good overall future gas management, the state should retain substantial interests in the largest gas fields. At the same time, strengthening Statoil as a gas company is important. To ensure good management of those parts of the SDFI which the state decides to retain, it is important that this portfolio is concentrated on a limited number of fields and licences in order to make the caretaker function simpler and more straightforward.

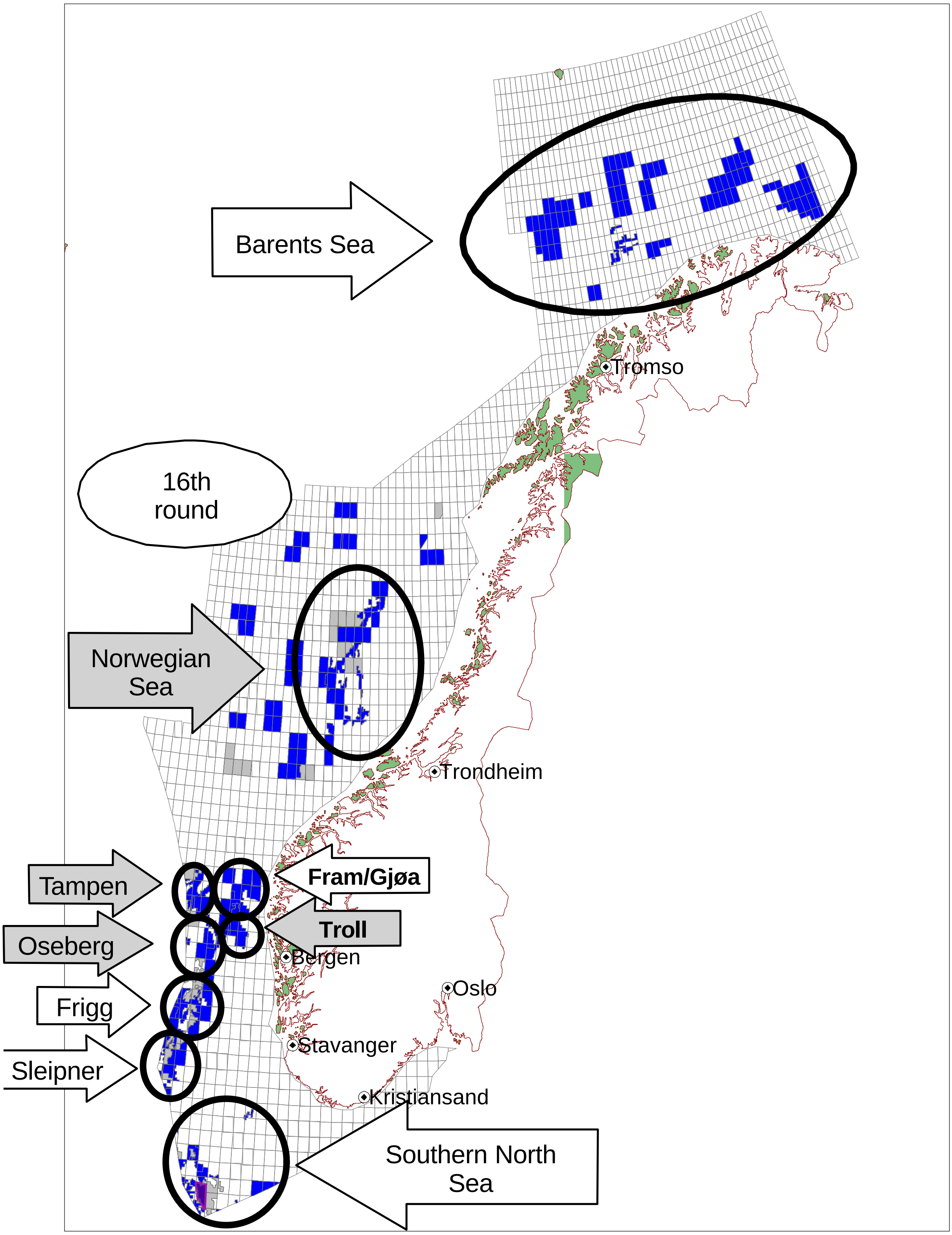

Figure 7.7: SDFI assets on the NCS

- The southern part of Norway's North Sea sector contains one field with large remaining resources. This is Ekofisk. Remaining resources and projected value in other fields with SDFI participation are small. The government envisages selling most or all of the SDFI assets in this area.
- The Sleipner area contains only one field with relatively large remaining resources and a relatively high projected value. This is Sleipner West. Remaining resources and projected value in other fields with SDFI participation are small. A restructuring potential has been identified in this area. The government envisages selling most or all of the SDFI assets in the Sleipner area.

- The Frigg area contains only one field with relatively large remaining resources and a relatively high projected value. This is Grane. The government envisages selling most or all of the SDFI assets in this area.
- The Oseberg area contains several fields with large remaining resources and a high projected value. A restructuring potential is felt to exist in this area. The Oseberg field is important for future gas management. The government envisages only a limited sale of SDFI assets in the large fields in this area.
- Troll is a very large field. It is important for future gas management. It is accordingly regarded as crucial for the state to retain a substantial part of the SDFI in this field. A limited sale is envisaged for Troll. A condition of a government sale of an SDFI share in Troll to Statoil will be that the company does not sell all or part of its share in this field after the restructuring without prior approval from the authorities. It could be appropriate to consider similar terms for the sale of other gas interests.
- The Fram/Gjøa area contains no fields with large remaining resources or high projected value. It is felt that some restructuring potential could exist in this area. The government envisages selling most or all of the SDFI assets in this area.
- The Tampen area contains a number of fields with large remaining resources and a high projected value. A restructuring potential has been identified. The government envisages only a limited sale of SDFI assets in the large fields.
- The Norwegian Sea contains many fields with large remaining resources and a high projected value. A restructuring potential has been identified. The smaller fields and much of the exploration acreage should be sold. However, it is considered important to retain a substantial part of the SDFI in gas fields in this area. The government envisages only a limited sale of SDFI assets in the large fields in the area.
- In the 16th offshore licensing round, which covered the Norwegian Sea, six licences were awarded with SDFI participation. SDFI participation in this exploration acreage will be assessed in more detail.
- Projected profitability in the Barents Sea is low, even though resources have been proven on a certain scale. The value of the SDFI assets in the Hammerfest Basin, including Snøhvit, is limited. The government envisages selling most or all of the SDFI assets in this area.

With a restructuring corresponding to 20 per cent of the SDFI's asset values, the government envisages that the bulk of the restructuring will take place in:

- the Oseberg area
- Troll
- the Sleipner area
- the Tampen area
- the Norwegian Sea

Relatively little value is associated with the SDFI assets in the southern part of the Norwegian North Sea, the Frigg area, the Fram/Gjøa area and the Barents Sea. Although the government envisages selling most or all the SDFI assets in these area, these nevertheless represent a small part of the overall restructuring in value terms.

On this basis, the SDFI caretaker company (see chapter 8) will have a portfolio in the order of 20-25 larger fields. Most of these lie in the Oseberg and Tampen areas and on the Halten Bank, along with the Ormen Lange and Troll gas fields. In addition, SDFI participation will remain in a number of smaller fields and finds in the neighbourhood of existing large fields, as well as in some exploration acreage — particularly close to the large fields.

This portfolio can be handled well by the new company established to manage the SDFI. See chapter 8.

As part of the restructuring, moreover, the government proposes that the state and Den norske stats oljeselskap a.s (Statoil) undertake a swap which reduces the state's interest in Europipe II and selected fields in exchange for increased holdings in Norpipe and Statpipe.

The government also proposes that the ownership structure for the Mongstad crude oil terminal is amended as part of the restructuring in order to give the state a holding.

In the government's view, a restructuring of the SDFI portfolio along the lines proposed can be undertaken within the framework of existing EU/EEA legal regulations.

The government takes the view that the proposed outline strikes a good balance between government financial concerns, industrial concerns, concern for the competitiveness of the NCS and — as an integrated element of these considerations — concern for long-term gas management.

Statoil and state interests in gas transport systems

The transport systems represent an extremely important element in exploiting gas resources on the NCS, and must be seen in a long-term perspective. Pipeline transport of gas offers such substantial economies of scale that this business forms a natural monopoly. It is essential for ownership and other organisation to take account of this in order to achieve efficient development and operation of the transport systems. See chapter 9 for a more detailed discussion of this topic.

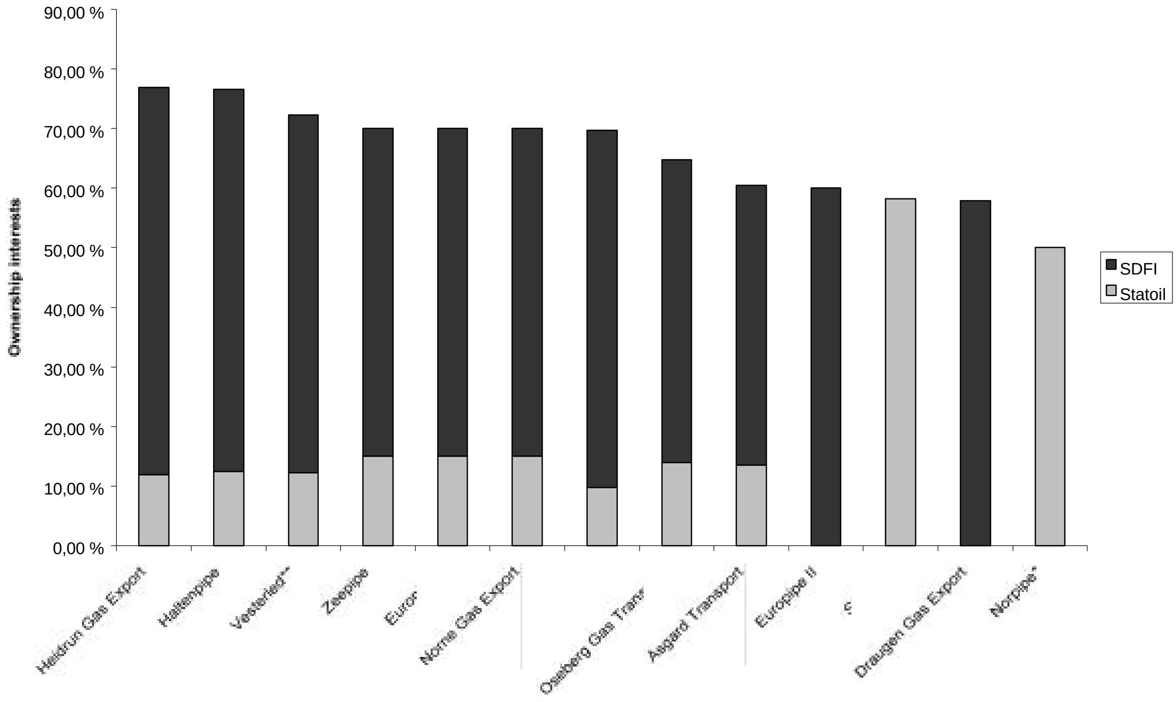

Figure 7.8: Today’s division of interests between Statoil and the SDFI in the infrastructure

* The holding in Norpipe will be changed in 2005 (Statoil 40 per cent, SDFI 20 per cent) and 2007 (Statoil 30 per cent, SDFI 40 per cent).

** The permit for installation and operation of Vesterled specifies that the Ministry will determine a new distribution of interests before this system begins operation, based on proposals from the licensees.

On the basis of the above considerations, the state has taken a substantial ownership interest when new transport systems have been established and licences for existing transport systems extended. The state has taken an interest in the order of 50-60 per cent in the latest transport systems to be developed. A large interest should be maintained by the state regardless of its holdings in the fields. The Ministry accordingly takes the view that the state should seek an interest of at least 50 per cent in the gas infrastructure, and that this should ultimately be achieved in all the transport systems.

Such a high state interest will mean that the companies receive a smaller share in the infrastructure than they have in the gas flow. Viewed in isolation, this will exert pressure for low tariffs and more efficient utilisation of the infrastructure.

Within such a framework, it is desirable that the difference between each company’s interest in the transport systems and in the gas flow does not become too large.

On that basis, the Ministry believes that the interests held by Statoil and the state in three transport systems — Statpipe, Norpipe (gas) and Europipe II — are particularly distorted. The state does not have direct interests in either Statpipe or Norpipe, while Statoil holds only 0.01 per cent in Europipe II. The government envisages a swap of SDFI interests between the state and Den norske stats oljeselskap a.s such that the state reduces its holding in Europipe II and selected fields, and increases its interest in Norpipe and Statpipe.

Mongstad crude oil terminal

The facilities at Mongstad consist primarily of a refinery and a crude oil terminal. Only the crude oil terminal is referred to here.

This terminal was built to safeguard marketing of offshore-loaded crude in general, and the combined volumes of Statoil and SDFI crude in particular. The sailing range of shuttle tankers is limited to north-western Europe. By storing and transshipping at Mongstad, however, Statoil has been able to sell its own and the SDFI crude to more distant areas.

The proposed model for restructuring the SDFI would leave the state with a direct interest in a number of crudes which are currently loaded offshore. Oil for use as feedstock by the refinery is also landed via the terminal and piped from there to the refinery. Some direct transshipment from shuttle tankers to conventional crude carriers also takes place in the Port of Mongstad.

In its present form, the Mongstad terminal is wholly owned by Statoil. Sole ownership of these facilities gives the company control over an important part of logistical system used in selling a large proportion of Norway's oil.

Through the SDFI, the state will be a substantial future shipper via the Mongstad terminal. Since this facility is favourably located in relation to several of the large oil fields, and the state through the SDFI will need access to a terminal, using the installations at Mongstad would be a possible solution.

For those fields and services where tariffs have already been determined, the question of whether the state should own or lease terminal capacity focuses on when the costs are incurred. With an equity interest, the bulk of the costs are incurred once, while leasing means that costs are charged on a continuing basis. For new fields and services, it will be important to ensure that the Mongstad terminal represents an attractive option. It is necessary to secure access to the terminal for the SDFI's volumes. An equity interest provides an influence which can be utilised to handle this requirement.

These considerations make it important to harmonise state and Statoil interests in the Mongstad crude oil terminal. In this context, the crude oil terminal must be established as a separate legal entity.

A change in the ownership structure for the Mongstad terminal which gives the state an equity interest is proposed as part of the restructuring.

It could be necessary to consider a long-term leasing agreement as an alternative to an equity interest.

The new Statoil

Statoil will be significantly strengthened by the government's proposal.

A sale of SDFI assets to Statoil corresponding to 15 per cent of the SDFI's value will substantially increase the company's reserves and production. Depending on the specific SDFI assets acquired by Statoil, its overall petroleum production could rise by about 40 per cent over the next few years. Gas output could show the strongest growth, with an increase of some 60 per cent, while oil production could increase by about 35 per cent over the next few years.

The company's additional size will give it greater strength to pursue its responsibilities on the NCS and to hold its own internationally.

Developing petroleum resources on the NCS makes special demands on the organisation and implementation of *gas* sales. Buyers of Norwegian gas today consist almost exclusively of large national gas companies with a dominant position in their respective markets. This position has made big demands on the strength and expertise of Norwegian gas sellers, but has also contributed to stable and predictable terms for Norwegian gas sales.

However, the liberalisation of gas and electricity markets currently under way in continental Europe could prompt major changes in the organisation of the gas industry. This development could provide both opportunities and challenges for Norwegian gas. Competition in the gas market could intensify, while new commercial opportunities could open.

The proposed strengthening of Statoil, with a substantial transfer of additional gas resources to the company, will lay the basis for meeting new market challenges and contribute to better management of Norwegian gas resources.

The government's proposal to strengthen Statoil as a gas company also means a considerable increase in the company's oil resources. On the NCS, oil and gas usually occur in the same reservoirs subject to integrated licensee regimes.

A purposeful strengthening of Statoil with gas resources and through increased interests in the company's core areas of the NCS would contribute to better management of the state's overall interests in petroleum activities.

Moreover, such a strengthening would be very significant for the company's value. Its portfolio composition, image and role can be tailored in a way which will confer greater strength and opportunities for enhanced value creation.

Value

The market value of the new Statoil will first be clarified when the company is partially privatised and listed on the stock market. Several factors will affect this valuation, such as the company's progress and most recent results, the strategy it communicates externally, oil market trends and developments in Norwegian and international financial markets. Most of these factors can change significantly over a short period.

In addition, the valuation of and mode of payment for SDFI assets will be of great significance. See below for more details.

The government's proposal means that the strengthening of Statoil will have a substantial positive impact in any event on the company's value.

Increased cash flow will put the company in a position to finance growth on the NCS, in selected international core assets upstream and in other business areas to which the company's decision-making bodies resolve to allocate resources.

Share prices will normally reflect expectations for future profitability. In the oil industry, it is natural to emphasise the net present value of the future cash flows likely to be generated by company reserve bases.

Much of this cash flow will be reinvested through company efforts to replace produced reserves and to pursue growth. Future profitability, and thereby company value, is therefore likely to be a combination of market and regional presences by the companies, their management and corporate cultures, and their established reserve bases.

Looking at the relationship between company market value and earnings or cash flow, the position is that the stock market puts a far higher value on the large integrated oil companies than on small independent upstream enterprises. This reflects investor expectations that companies such as BP, ExxonMobil, TotalFinaElf and Royal Dutch/Shell will achieve higher returns on future investment. These companies have demonstrated over a long period that they have the ability to create profitable growth.

7.4. The SDFI in future production licences

State participation in Norwegian petroleum activities has varied over time in both form and scope. The state has participated through Statoil since 1973 and also directly through the SDFI since 1985.

The average SDFI share has been reduced in the most recent offshore licensing rounds. In the 16th round, which was completed in the spring of 2000, the average SDFI share was 15 per cent. This proportion was 22.9 per cent in the Barents Sea project of 1997. It came to 27.2 per cent in the 15th round, completed in 1996, compared with 37.6 per cent in the 14th round of 1994. This reflects the resource potential and projected profitability of the respective rounds at the time these awards were made.

The size of SDFI share is matched to the profitability and resource potential of each production licence. The size of SDFI participation, the tax system and the allocation of commercial interests among participating companies determine the real financial exposure of players in a licence. Ensuring a sufficient real financial exposure for the players in each licence is important.

The SDFI represents an important instrument for the state which, combined with the tax system, secures it a high proportion of value creation from petroleum activities. State investment in petroleum activities through the SDFI have been very profitable.

The government envisages that the state will continue to be able to take SDFI shares in future offshore licensing rounds.

7.5 Effects on state revenues and risk

By selling parts of the SDFI, the state will convert an annual net cash flow from this arrangement to:

- a cash settlement for the interests sold;
- tax payments from the companies on the interests sold;
- dividend from companies in which the state has an equity interest (Statoil and Norsk Hydro);
- the increase in value on retained profits (equity) in these two companies.

In addition, the state will receive:

- revenues from a possible sale of shares in Statoil;
- increased revenues from the enhancement in value creation generated by improved efficiency.

These aspects are reviewed below.

Net cash flow from the SDFI

Since the state is retaining SDFI assets corresponding to 80 per cent of the SDFI's value, cash flow from the SDFI will remain substantial in future.

Revenues from Troll and the transport systems will represent an important and stable source of income for the SDFI. Over time, these two income sources will account for a growing proportion of the cash flow from the SDFI.

Settlement for sale of SDFI assets

The government proposes in this proposition that Statoil will partly pay cash for SDFI assets and could partly receive such holdings as an equity contribution. A final decision on the most appropriate form of payment will be taken on the basis of the most suitable capital structure for the oil company.

In assessing what would be the most appropriate capital structure, emphasis should be given to finding a relationship between liabilities and equity which gives the lowest possible capital costs. At the same time, the capital structure should bear a reasonable relationship to the company's requirements. The equity ratio should not be too high.

One of the Ministry's advisers, UBS Warburg, has recommended that Statoil should have debt-equity ratio in the order of 20 per cent.[12] This is in line with Statoil's own assessments.

It is envisaged that SDFI assets will be sold to other companies for cash.

All transactions will be implemented at *market value*. Experience indicates that this could be higher than the net present value. That is because:

[12] The debt-equity ratio is defined here as **net debt divided by company value**. Net debt is defined as long-term liabilities plus short-term interest-bearing liabilities less market-based current financial assets less liquid assets. Company value is defined as the market value of the equity plus net debt.

- different evaluations are made of technical and financial conditions, including assumptions about cost reductions, opportunities for more efficient operation, improved recovery and so forth;
- buyers are seeking to strengthen their position in geographical areas or in particular business areas.¨

Taxation of SDFI assets sold

A sale of SDFI assets would convert a substantial proportion of the value of today's SDFI into future tax revenues. Income from petroleum production on the NCS is subject to a special tax of 50 per cent in addition to ordinary corporation tax of 28 per cent. A company fully liable to tax will pay a rate of about 78 per cent. The effective tax rate will normally be lower than this.

The proportion paid by Statoil in tax will be important for overall tax revenues. Over the past 10 years, the company's annual tax rate has averaged about 70 per cent.

When interests in Norwegian offshore production licences are sold or transferred, the Ministry of Finance must give its approval and regulate the tax consequences as specified in section 10 of the Act on Petroleum Taxation. This provision aims in part to ensure that overall projected future tax payments by the companies are not significantly reduced by the transfer. Given increased value creation as a result of the transfer, tax revenues will in principle not be changed but would rise instead in line with the growth in value creation.

For the sale of SDFI assets, the way this provision is practised must be adapted to the fact that the SDFI is not liable to tax. One possibility is to specify that the buyer will not be able to deduct the purchase price from taxable income. The buyer will then pay a smaller purchase price but higher future taxes by comparison with a tax-deductible purchase price. The tax-adjustment solution adopted will accordingly be very significant for whether state revenues from the sale should take the form of a one-off cash payment or continuing taxes.

The sale of SDFI assets to the companies will moreover result in rather higher royalty payments. With royalty being phased out, however, this increase will be modest.

Future dividend

The state will receive revenues in the form of increased dividend from Statoil for that part of the SDFI which may be transferred to the company as an equity contribution, and which is not later sold once other owners are introduced to Statoil.

The size of this dividend will depend on the return on future investment. Improved efficiency will increase the size of the payment.

Enhanced value creation from improved efficiency

Chapter 1 outlined the principal challenges and key trends of significance from an ownership and resource management perspective:

- the NCS is changing character and gradually maturing as a resource area;
- licensee composition and decision-making structures in many production licences are complex, with a number of participants and small holdings;
- new petroleum provinces have been opened to private commercial interests;
- structural changes in the international oil industry are creating stronger entities with increased competitiveness and ability to carry risk;
- the EU electricity and gas directives open the way to greater competition, and markets for gas and electricity are converging.

These conditions create major challenges for the Norwegian companies, the state as owner and the NCS as a resource area. At the same time, the commercial and energy policy opportunities are substantial.

In response to these challenges, the government has proposed in this proposition to open up for other owners in Statoil and to restructure the SDFI.

The government's proposal will have a number of positive effects:

- increased interests will give operators stronger incentives to act efficiently in each production licence, while opportunities for achieving area-wide gains will improve;
- diversity and competition on the NCS will increase, and the competitiveness of Norway's offshore sector will improve;
- opportunities for Norwegian companies to succeed against ever more demanding competition will be strengthened;
- owner supervision of Statoil as a partially-privatised and listed company will improve;
- the basis is laid for good long-term gas management.

All in all, this will contribute to improved efficiency and higher value creation on the NCS. The tax base and revenues from the SDFI will be better safeguarded than at present.

Even small improvements in efficiency will represent substantial value. Through direct interests, the tax system and equity holdings in Statoil and Norsk Hydro, a substantial share of the efficiency improvements on the NCS will accrue to the state.

The Norwegian Petroleum Directorate sees a value creation potential on the NCS as a consequence of restructuring the SDFI. On that basis, the NPD recommends using SDFI assets in such a way that licence interests in the various areas of the NCS lay the foundation for an optimisation. This would be achieved by harmonising interests between the players and an operator with sufficient incentive to pursue further development.

The NPD has considered restructuring gains in isolation and not in connection with the effect of a partially privatised Statoil.

Other assessments carried out to calculate efficiency gains with the aid of various methodological approaches are outlined below. These all conclude that a restructuring of the SDFI and the introduction of other owners to Statoil offer a substantial potential for enhanced value creation.

According to *Pareto Securities ASA*, a restructuring in the form of privatising Statoil and selling SDFI assets would substantially increase the value of the state's wealth. Its calculations indicate that a partial privatisation of Statoil and a very extensive restructuring of the SDFI (considerably larger than the government proposes) could create close to NOK 280 billion in additional value before tax. The state's share of this enhanced value creation is expected to be about NOK 240 billion.

Pareto Securities attributes the increase in value to three factors:

i. improved efficiency in exploration, development and operation could create up to NOK 170 billion in increased value;
ii. improved profitability through better commercial utilisation of gas is expected to total almost NOK 90 billion;
iii. additional return on applying the cash flow from the NCS internationally is expected to come to about NOK 20 million.

Several explanations are advanced by Pareto Securities for why changes in state ownership will have such consequences:

- commercialisation and privatisation of decision-making processes on the NCS;
- continuous monitoring of decisions through stock market supervision of Statoil;
- improved ownership flexibility for gas;
- stronger operators;
- a better structure of incentives;
- increased diversity and genuine competition because certain other players are given opportunities to increase their exposure to selected fields.

See appendix 7 to this proposition for a more detailed overview of the Pareto Securities calculations, assumptions and methods.

UBS Warburg basis its calculations on the total value creation potential of the NCS (before tax), which it assesses as follows:

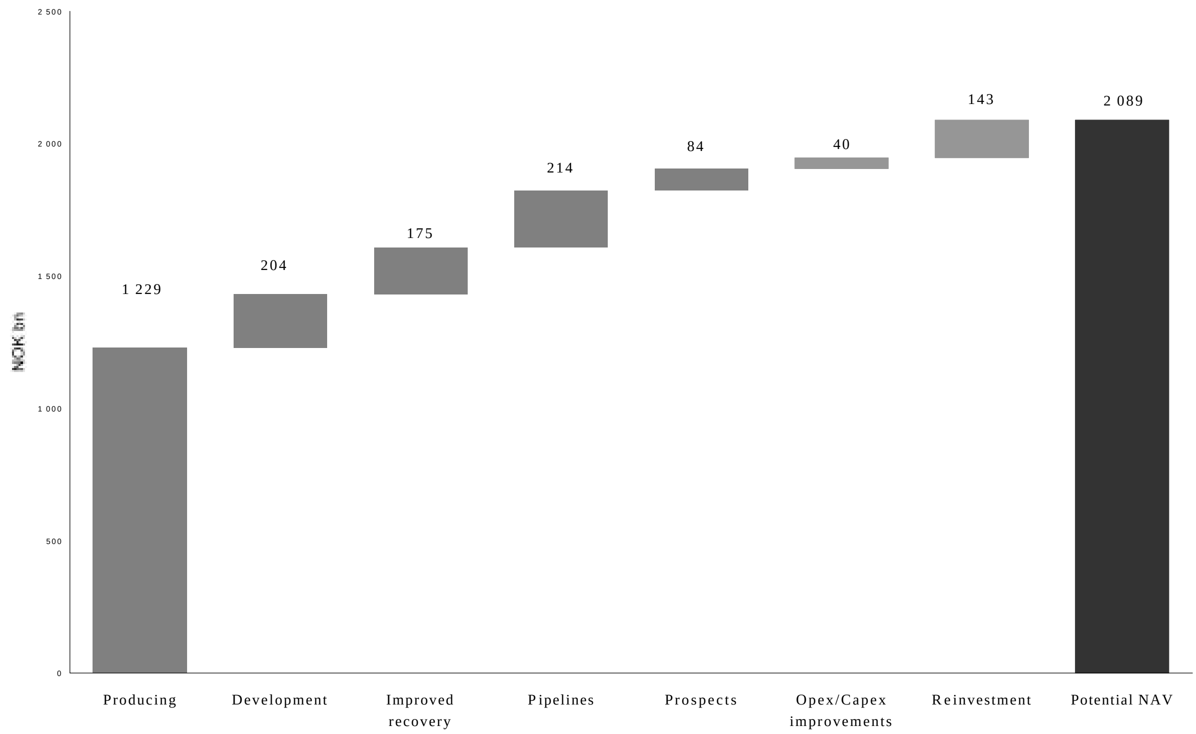

Figure 7.9: Total value creation potential on the NCS — value before tax

Source: UBS Warburg.

According to the UBS Warburg calculations, in other words, the potential net present value of the NCS is in the order of NOK 2 100 billion before tax. The company states that:

" Overall, it is possible that achievement of between a third and a half of the value from improved recovery, reduction in costs and reinvestment on the NCS requires changes to the structure of ownership on the NCS. The range of pre-tax values at stake on this basis might be between NOK120 billion and NOK180 billion, the majority of which accrues directly to the State through the SDFI and tax."

UBS Warburg notes that operator performance must be enhanced and field coordination benefits realised if cost savings and improved recovery are to be achieved. The following considerations are highlighted in this context:

- privatisation is expected to make Statoil a more efficient company, which will be positive for its performance as the most important operator on the NCS;
- through a sale of SDFI assets, the authorities can contribute to strengthening incentives for the companies to reduce costs and ensure a better decision-making structure between production licences, and to giving the companies more harmonised interests.

Moreover, UBS Warburg believes that a large part of the value associated with future investment depends on existing operators becoming more efficient and on strengthening the position of foreign operators on the NCS.

See appendix 6 to this proposition for a more detailed overview of the UBS Warburg calculations, assumptions and methods.

McKinsey has been commissioned by Statoil to estimate the value creation potential associated with a change in the ownership structure on the NCS. This assessment is based on a comparison between the NCS and other regions, with particular emphasis on the UKCS at the end of the 1980s when a consolidation process took place which must be attributed partly to the oil price slump in 1986 but which also reflected the fact that the UKCS at that time had reached a mature phase with expectations of declining production. From that perspective, the position was not entirely unlike the one we face on the NCS today.

The comparison has been carried out as follows. First, the value creation potential realised by leading companies on other continental shelves through economies of scale and synergies between production licences is estimated. This is done by dividing the improvement measures initiated by the companies into licence-specific and generalised, and then calculating the effect of the generalised measures on exploration, development and operating costs as well as supervision expenses for partners. It is then assumed that the generalised measures implemented on the UKCS and in other areas can also be implemented on the NCS, and that their effect would be same on the NCS as on the UKCS and in other areas.

In addition, McKinsey has estimated an increase in tail production as a result of reduced unit costs.

The overall value creation potential is put at roughly NOK 135 billion. McKinsey regards this estimate as conservative. It points to experience on the UKCS, where cost reductions in themselves have contributed to more discoveries and additional production. The effects of this are not included in the estimate.

No separate report has been submitted by McKinsey. Its work is presented in a report prepared by Statoil.

Statoil has also carried out an analysis of the value creation potential associated with a change in ownership structure for the company's core areas on the NCS — Tampen, the Halten Bank, Sleipner and Troll.

This analysis is based on a licensee restructuring of a size which means that both the operator and certain supporting partners are strengthened in order to achieve a licensee composition which makes it possible to identify and bring forward for decision those measures which enhance value creation in an area perspective, and which gives key companies in the area sufficient financial incentives and voting influence to take the necessary decisions.

Realising the value creation potential requires measures which can coordinate the use of installations between partnerships in each core area. Typically, measures in each core area comprise:

- coordination of maintenance, drilling and logistical functions;
- concentrating oil and gas processing on a limited number of platforms in order to reduce operating costs;
- extended economic production life, and thereby increased overall recovery of oil and gas;
- use of existing production facilities and infrastructure to realise new projects.

The fragmented licensee structure on the NCS currently makes it a demanding process to reach decisions on implementing such measures because the licensee composition and company financial interests differ greatly between the various production licences. The small shares held by operators also weaken the basis for maximum value creation.

Statoil estimates that the value creation potential in its core areas is in the order of NOK 110-130 billion. This assumes that it proves possible to implement all the measures identified. In practice, it must be anticipated that some proportion of the potential cannot be realised. Statoil's assessment is that the value of specified and unspecified measures will have a weighted probability of just over NOK 100 billion with a licensee restructuring and a strengthening of the operators. The corresponding estimate without licensee restructuring is about NOK 55 billion. In other words, Statoil's estimate of the increase in value creation from a licensee restructuring and a strengthening of the operators is in the order of NOK 45 billion.

This means that about 40 per cent of the estimated value creation potential is likely to be realised with the present licensee structure, while about 80 per cent is likely to be realised after a licensee restructuring.

Statoil concludes that SDFI assets should be used to increase the interests of operators and key partners in their respective core areas in order to improve both incentives and opportunities for reaching decisions which realise value creation gains between licences and areas.

The NPD sees a value creation potential associated with the transfer of SDFI assets to Statoil in the company's core areas. After an assessment of Statoil's analysis, the NPD arrives at a lower estimate than Statoil of the increase in value creation which would follow from a restructuring.

The government accepts the overall assessments that the NCS offers a large potential for improvement. Opportunities for realising this potential will be influenced by the structure we select for the industry. The proposal for a changed structure will improve system properties. In the government's view, the proposals in this proposition will contribute to increased efficiency and enhanced value creation on the NCS.

However, the government would emphasise that the kind of calculations and estimates outlined above are subject to considerable uncertainty and must be interpreted with great caution. Interactions between the different factors which affect the companies and their relationships, and which create dynamism and value on the NCS, are characterised by complexity.

It must also be emphasised that several of the analyses offer different assessments of which factors would make the greatest contribution to generating possible additional value, and most of the analyses are based on a more extensive restructuring than the government is proposing. Moreover, the effects result partly from a partial privatisation, a restructuring, and a combination of these two approaches.

However, the analyses cited and other suggestions received by the Ministry unanimously conclude that the NCS has a substantial value creation potential. They also indicate that changes in the state's ownership involvement are important and necessary if this value creation potential is to be fully exploited.

Risk assessments

The government's proposal involve a limited change in the composition of the state's petroleum wealth and in the timing for realising its value. However, a change of this nature in wealth composition also has implications for risk.

As a rule, a possibility will exist when transactions are implemented that the value realised might be lower than the value of the resources would suggest, because of asymmetric information and the timing of the transaction.

This also applies to a sale of SDFI interests and of shares in Statoil.

The valuation of a field or a production licence will be based on a number of assumptions relating to recoverable reserves, production properties, prices, costs, development solutions and so forth. Such figures are subject to uncertainty, and buyer and seller could have different access to relevant information on some of them. In principle, the operator of a production licence must be assumed to possess better information than the state.

To ensure that the state has the best possible information on the value of SDFI assets before the transactions take place, a thorough review has been undertaken for all production licences on the NCS in which the state has a direct financial interest.

The NPD has carried out an evaluation of the SDFI portfolio with support from Gaffney, Cline and Associates, a leading international technical/geological consultant for oil and gas. The Ministry of Petroleum and Energy's advisers, UBS Warburg and Pareto Securities, are carrying out a valuation of the SDFI based in part on this background and on commercial and market conditions.

A sale of Statoil shares also involves a transaction risk, since the timing of a stock market listing could be significant for the share price. Developments in the oil price and the stock market — particularly for the international oil companies — could have a considerable effect on the valuation of Statoil.

One important requirement for reducing this type of transaction risk is to be flexible about the proportion of Statoil shares to be included in the initial public offering, and about the timing of a listing.

Cash payments from the sale of SDFI assets and a possible sale of state shares in Statoil will lead to a faster build-up of the Government Petroleum Fund because part of the future net cash flow from the SDFI is converted to financial wealth in the Fund, which has a broad and diversified portfolio. Such a conversion of petroleum wealth to financial wealth contributes to reducing the state's oil price risk.

The system change could in itself alter the risk position. It is difficult to draw an unambiguous conclusion about how far the proposals in this proposition would increase or decrease system risk compared with the present position. There are factors which could point in both directions. Some of these are discussed below.

The government's proposals mean that part of the cash flow from the SDFI is transformed into future tax revenues. Part of the cash flow which now goes directly to the Treasury will thereby be reinvested by the companies, which are then taxed. A larger proportion of the state's wealth will thereby become dependent on the dispositions made by the companies. Viewed in isolation, this could increase the risk to the state's revenues.

On the other hand, owner supervision of Statoil is expected to improve. This would increase the probability that the company's dispositions will result in improved profitability. The risk of bad decisions by the company, and thereby the risk to the state's revenues, would be reduced.

One question relating to the evaluation of system risk is whether the dependence on dispositions made by Statoil will increase.

The state's dependence on Statoil is already very high. As shown in figure 3.1, Statoil's asset value represents an important part of the state's overall petroleum wealth. As operator and business manager, the company also has a big influence on the value of the SDFI, which accounts for about 45 per cent of the state's overall petroleum wealth. In addition, Statoil is the largest taxpayer on the NCS and that part of the petroleum wealth associated with future taxes will accordingly be influenced to a considerable extent by the company's performance. Tax receipts from other players will also be influenced by Statoil in that the company is operator for about 70 per cent of the reserves on the NCS.

Viewed in isolation, a sale of SDFI assets to Statoil will increase the state's exposure to the company. This can be countered to some extent if the state sells part of its holding in Statoil.

In the government's view, there is no basis for asserting that overall system risk will increase as a result of the proposals in this proposition. On the other hand, the risk of failing to respond to the challenges we face by making system changes could be even higher.

Throughout our petroleum history, we have made amendments to tax policy, exploration policy, gas organisation, Statoil and the SDFI, and so forth in response to new challenges in order to safeguard value creation and state revenues. The government believes that the time is now ripe for new modifications. In the government's view, a purposeful restructuring of the SDFI and the introduction of other owners to Statoil will increase state revenues and wealth.

7.6 Conclusion

The government proposes that holdings corresponding to 20 per cent of the asset value of the SDFI are included in a restructuring of state involvement, providing the state achieves satisfactory terms. The state will retain direct interests corresponding to 80 per cent of the SDFI's asset value. The interests which the government envisages selling to Statoil will account for about 15 per cent, while those it envisages selling to Norsk Hydro and other companies will account for roughly five per cent.

As part of the restructuring, the government also proposes a swap between the state and Den norske stats oljeselskap a.s which involves a reduction in the state's ownership interests in Europipe II and selected fields, and an increase in its ownership interests in Norpipe and Statpipe.

Furthermore, the government proposes that the reorganisation should include a change in the ownership structure of the crude oil terminal at Mongstad to give the state a holding.

All transactions will be implemented at market value.

Statoil will pay cash for part of the SDFI assets transferred to it, and receive the remainder as an equity contribution. A final decision on the most appropriate form of payment will be taken on the basis of the most suitable capital structure for the oil company.

The government envisages that the state will continue to be able to take SDFI assets in future licensing rounds.

8. Future management of the SDFI

8.1 Introduction and summary

The purpose of the state's direct financial interest (SDFI) in petroleum activities is to secure the best possible management of the resources and the highest possible value creation for the state.

In the Ministry's view, today's management model for the SDFI has functioned satisfactorily since it was established in 1985. If Statoil is partially privatised, the present management arrangements cannot continue unchanged.

The Ministry believes that the present management model contains a number of positive features which should be retained.

A number of options for discharging the SDFI caretaker function have been considered. To achieve the purpose of the SDFI, the basic requirement is that this function must continue to be pursued on a commercial basis.

This means that it must be possible to have regard to which interests are represented by the overall SDFI portfolio. As a result, overall responsibility for this portfolio must be gathered in one place.

The government cannot directly undertake commercial operation of a scope and character required to manage the SDFI. A new company should therefore be established for the purpose of managing the portfolio of interests held by the state in production licences, pipelines and land-based plants. This company will manage the SDFI assets at the state's own risk. The most appropriate form of organisation would be a state-owned limited company. To allow the company to act externally in its own name, the state must guarantee the obligations of the company which derive from the SDFI caretaker function. It would be appropriate to exempt the company from taxation. It is proposed to establish special regulations for the company in a new chapter in Act no 72 of 29 November 1996 pertaining to petroleum activities (the Petroleum Act). The government will present an Odelsting proposition with such a proposal.

The new company will fulfil its purpose without possessing the same expertise as traditional oil companies. New state participation interests will be managed by the company, but it will not apply for new licences on its own account and will not be awarded operatorships. Its activities will be functionally related to petroleum activities on the NCS. What resources are required to discharge the caretaker function will depend on the scope and composition of the portfolio of participation interests to be managed, and on how far the company will assign work to business managers.

8.2 Considerations in shaping a future management arrangement

Great emphasis is placed on retaining and developing the positive elements in today's management arrangement, in order to ensure that the state's financial interests in petroleum activities will continue to be managed as efficiently as possible.

The objective of the company established to administer the SDFI will be to ensure the best possible management of the resources and the highest possible value creation.

SDFI assets will be managed on a commercial basis. This means that it must be possible to decide, when managing state interests in the individual partnerships, what would be the best option for the partnership and for the SDFI portfolio as a whole.

Where the sale of produced petroleum is concerned, the management arrangement must ensure that the objective of the highest possible value creation for the state is achieved.

The management arrangement must also comply with the relevant legal requirements outlined in section 8.3 below.

8.2.1 Retaining important qualities

In the Ministry's view, today's management arrangement for the SDFI has functioned satisfactorily since it was established in 1985. One strength of this arrangement is that it has functioned over a number of years and has accordingly become well known to and established with other players in the petroleum sector, buyers of Norwegian petroleum and various suppliers to the industry.

Today's management arrangement incorporates some core elements which have been crucial in concluding that it has functioned satisfactorily:

- Firstly, it has contributed to value creation in that SDFI assets are managed on a commercial basis through a commercial company. Through the arrangement, the state has been able to participate in the commercial partnerships which create value on the NCS.
- Secondly, all decisions and dispositions involved in the caretaker function for the SDFI are taken by the governing bodies in a state-owned limited company. Statoil acts in relation to the outside world as the holder of the participation interests, and is thereby legitimised in managing these. The board of the company has a duty to submit to the general meeting "all matters which must be presumed to be of political importance and/or which may have essential effects on the nation and its economy". This entails a clear division of labour and responsibility, while giving the state the necessary management and control of the administration of its assets.
- The cash flow generated by the SDFI does not pass into Statoil's operations, but is transferred to the Treasury after deducting the share of investment and operating costs which relate to the SDFI's holdings. This allows the Storting to utilise the net cash flow which the SDFI assets generate through the central government budget, including transfers to the Petroleum Fund which thereby convert oil wealth into financial assets. In accordance with this system, the SDFI is not included in Statoil's accounts. Separate accounts are kept for the state's ownership interests. For reporting to the central government accounts, Statoil also prepares accounts on the cash basis applied for the central government budget and accounts. The SDFI's holdings are registered in the Petroleum Register.
- The management arrangement also draws a distinction of principle between commercial operations pertaining to the SDFI and the normal regulatory authority exercised pursuant to the petroleum legislation. This helps to avoid an undesirable confusion of the state's roles as a participant in operations and as the administrative authority.

The objective which underlies these core elements should be retained in the new management arrangement established for the SDFI.

8.3 The legal framework for constructing a new arrangement

A new management arrangement for the SDFI must be constructed within the relevant legal frameworks.

8.3.1 Constitutional framework

The new arrangement must be established in accordance with the constitutional provisions pertaining to commercial operations by the state and the administration of state property.

Responsibility for managing state commercial operations lies with the government. This follows from the vesting of the executive power in the King (government), see article 3 of the Constitution.

Article 19 of the Constitution authorises the government to appoint, instruct and watch over those responsible for managing the state's property, and gives it the right to amend their decisions.

The government's pursuit of state commercial operations is constrained by the authority vested in the Storting to fix annual appropriations and to open loans on the credit of the Kingdom. See articles 75 b and d of the Constitution.

The Office of the Auditor General acts on behalf of the Storting to supervise the executive, and has the authority to audit the management of the SDFI. See article 75 k of the Constitution.

8.3.2 Petroleum legislation

The state has sovereign rights in accordance with the general principles of international law over petroleum resources on the NCS. In national legislation, section 1-1 of the Petroleum Act specifies that the right to petroleum resources is vested in the state. The state itself can participate in petroleum activities without a licence. See section 1-3 of the Petroleum Act. According to section 3-6 of the Act, state participation in accordance with the Act can be determined by the King. Section 12 of the petroleum regulations authorise a business manager arrangement.

Petroleum legislation imposes no special restrictions on the mode of organisation for a management arrangement covering the state's own participation interests.

8.3.3 The licensing directive

Directive 94/22/EC from the European Parliament and the Council of Ministers on the conditions for granting and using authorisations for the prospection, exploration and production of hydrocarbons (the licensing directive) has been incorporated into Norwegian law and regulates the award of production licences from 1 September 1995 (from the 15th offshore licensing round).

The directive is intended to lay the basis for competition in order to achieve efficient exploration for and production of petroleum resources. To implement this, the directive specifies certain minimum requirements for the individual country's regulations concerning the procedure for awarding production licences.

Direct state participation in licences conforms with the directive. This participation is not subject to the same procedures as awards to other participants. It can be administered by the state itself or by a legal person. Awards to Statoil as a commercial company comply with the general procedures specified in the licensing directive.

The proposed management arrangement complies with the directive's provisions on direct state participation.

8.3.4 Voting rules in joint operating agreements

The award of a production licence is conditional on all the companies given a share in the licence concluding a joint operating agreement. This incorporates rules on how resolutions will be adopted in the partnership which is established by the joint operating agreement. A management committee must be established for each partnership, which will adopt resolutions on the basis of specified voting rules. Voting rules in joint operating agreements build on a combination of requirements for the number of partners voting in favour and for what percentage of the total vote they must represent in order for a resolution to be valid.

In the event of amendments to the partnership through a change either in the number of participants or in their shares of the licence, the partnership must propose new voting rules. These are subject to approval by the Ministry. If no proposals are made, the Ministry can determine new voting rules for the partnership. The joint operating agreements provide that new voting rules must be formulated in such a way that the individual participant suffers as little change as possible to its voting weight. This provision imposes a restriction on the way new voting rules can be formulated.

8.3.5 Relationship with other existing agreements

On the basis of the existing management arrangement, Statoil has concluded agreements on behalf of the SDFI but in its own name. Externally, Statoil thereby appears as the contractual party. In the event of a restructuring of the SDFI which involves the transfer of management responsibility from Statoil, a review of these agreements and the parties to them will be required. If the restructuring involves a transfer of contractual responsibilities, this will call in part for sufficient capitalisation of the SDFI arrangement which is established.

8.4 Various arrangements considered

8.4.1 Discharging the caretaker function without establishing a separate management unit

Consideration has been given to whether the caretaker function for the SDFI could be assigned directly to one or more private players, such as one or more of the other participants in the partnerships, for instance, without establishing a separate entity with responsibility for this function. This assessment has covered arrangements in which the state cannot intervene in the caretaker function as well as ones in which the state has such a right.

Management by private players without a right of state intervention

Consideration has been given to whether the caretaker function for the SDFI can be assigned to private players without a right of state intervention in the exercise of this function. The state would then have no right to vote in the partnerships. Particular consideration has been given to whether each SDFI share could be administered by the operator or proportionately by the other members of the partnership.

If the individual partnerships are viewed in isolation, their members will largely have concurrent interests. The operator, who normally has a large share in the licence, will have a particular interest in maximising the profit it yields. Oil companies have complex portfolios of holdings and participations, however, and their interests accordingly differ. When a company must decide between alternatives in a partnership, it will also pay regard to the company’s interests as a whole. For this reason, it cannot be taken for granted that such a model will secure the best possible caretaking of the resources and the highest possible value creation from the state’s portfolio of interests in production licences and infrastructure.

In such a model, the state would be completely passive in relation to the management of SDFI assets. That would preclude the government from discharging its responsibility to monitor and supervise the administration of state property, and the Storting from exercising its right to give the government instructions in this respect.

This model cannot be recommended, since it fails to fulfil fundamental objectives of the arrangement — in other words, the best possible management of the resources and the highest possible value creation for the state from the SDFI. Nor does the model provide the government with opportunities to discharge its responsibilities for monitoring and supervising the administration of SDFI assets, and accordingly fails to comply with the constitutional provisions on state commercial management and the administration of state property.

Direct management by private players with opportunities for state intervention

For the government to discharge its responsibilities to monitor and supervise the management of the state’s participation interests, the state must have an opportunity to intervene in the caretaker function.

If private players are to be assigned the task of managing the SDFI, agreements will be needed which include guidelines for discharging the caretaker function, provisions stipulating the state’s right to intervene and a specification of fees to be paid for business management. Administering such agreements will in itself represent a form of activity which the state is not well qualified to perform on its own account.

Particular consideration has been given to the question of whether the other members of the partnerships, or possibly the operators, could manage the SDFI. As mentioned above, participants in an individual partnership will by and large have concurrent interests, but the individual company will also have regard to its overall interests in deciding between different options.

A model which assigns the caretaker function for the SDFI to private players must contain mechanisms for handling conflicts of interest between the state, as the owner of the SDFI, and the individual business manager. Which issues are to be submitted by the manager to be state must be defined. For its part, the state must decide which position to adopt on the issues submitted. These questions will be of a scope and character that the state is not qualified to decide directly.

The model outlined here can accordingly not be recommended.

8.4.2 Converting SDFI assets to a tax arrangement

Consideration has also been given to the possibility of converting SDFI assets to a tax arrangement. The state has different participation interests in the various licences, and a tax arrangement must accordingly be based on the individual licences. This is not in line with today’s company-based tax system, and would present major technical challenges of a taxation and administrative nature.

Converting the state’s interests to taxation would mean that the state no longer enjoyed the right to direct ownership of produced petroleum which its interests provide today. This production would be divided between a number of smaller petroleum sellers. In particular, an arrangement of this kind would substantially weaken our opportunity to undertake optimal resource management in the gas business. It has accordingly been rejected as a realistic option.

8.5 Proposal for a new business manager arrangement

8.5.1 Introduction

The conclusion is that the objective of achieving the best possible management of the resources and the highest possible value creation is incompatible with the arrangements discussed under section 8.4 above.

Another conclusion is that the participation interests which the state elects to retain in production licences, pipelines and land-based plants will remain as they are today, in the sense that the state retains the rights vested in the participation interests. A further conclusion is that, in the event of a privatisation of Statoil, the caretaker function for the state’s own interests must be detached from Statoil. See section 6.4.

It is accordingly necessary to establish a new caretaker arrangement for the state’s own interests. It is envisaged that this arrangement will not involve the establishment of a new company which possesses all the expertise found in a traditional oil company.

When formulating proposals for a future business manager arrangement for the state’s interests and the sale of the state’s petroleum, great emphasis has been placed on retaining the positive elements in the existing arrangement, as mentioned in section 8.2.1 above.

According to the government’s proposals, the state’s equity in Statoil and the business manager arrangement for the SDFI can be presented schematically as follows:

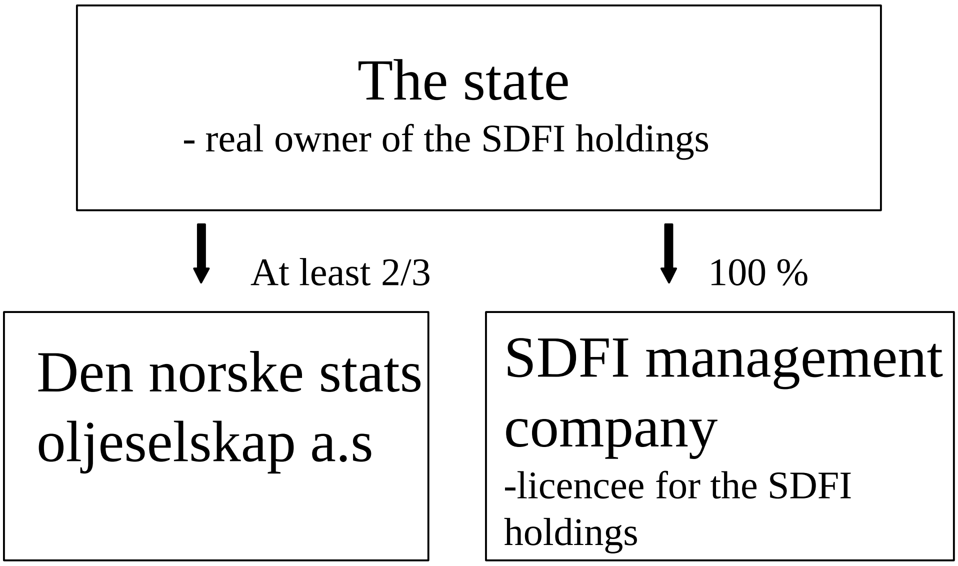

Figure 8.1: State ownership of Statoil and SDFI management arrangement

8.5.2 Summary of the principal structure

The state cannot engage on its own account in commercial business operations of the scope and character involved in the management of large participation interests in oil and gas fields, pipelines and land-based plants. It is envisaged that responsibility for the caretaker function should therefore be assigned to a separate entity outside the public administration. This makes demands both on the choice of organisational form and on the way the organisation is equipped and functions.

It is proposed to establish a state-owned limited company, which will be charged with managing SDFI assets for the state. It will basically be subject to the Companies Act, including the special provisions on state-owned limited companies, but certain specific rules which depart from the provisions of the Act will need to be established by statute. Articles of association will be adopted for the company in the normal way.

All decisions and dispositions involving the caretaker function will be taken by the governing bodies of the company, including the Minister as general meeting for the company. The board of the management company will have the same duty to submit certain types of issue to the general meeting as the Statoil board has today. The new company will manage state participation interests at the state’s risk. It will be legitimated in relation to third parties to manage the state’s interests on the basis of the legal authority conferred by company law. The management company will have the rights and duties of a partner in relation to the joint operating agreements and as a licensee in accordance with the rules laid down in or issued pursuant to the Petroleum Act with associated regulations. As is the case today, however, the state will retain the real ownership of SDFI assets.

The cash flow generated by SDFI assets will be transferred directly to the Treasury, in that revenues and expenditure pertaining to these holdings are excluded from the management company and kept separate from its own operation. This corresponds to the present financial relationship between the SDFI and Statoil.

The new management company can elect to be represented by business managers in the partnerships. Sale of the state’s petroleum will be organised in a way which retains important aspects of the present systems.

Today’s management arrangement draws, as mentioned earlier, a distinction in principle between commercial operations pertaining to the SDFI and the normal regulatory authority exercised pursuant to petroleum legislation. The Ministry believes it will be appropriate to retain this principle, which entails an orderly structure of objectives. The company managing the state’s own interests will work to secure the best possible management of the resources which these interests represent, and the highest possible value creation from these.

8.5.3 Key elements in the organisation of the management entity

Reasons for the choice of organisational mode

Consideration has been given to which mode of organisation should be adopted for the entity to be given responsibility for managing the state's own participation interests. The crucial requirement has been to find the mode of organisation which offers the best prospects for achieving the objective: securing the best possible management of the resources and the highest possible value creation from the state's participation interests.

In order to equip the organisation to be able to discharge commercial operations in the best possible manner, and to create the greatest possible clarity in the division of labour and responsibility between the Ministry and the entity, it has been decided that the latter should be organised as a separate legal person.

The conclusion is that this entity must be wholly owned by the state in order for the state to have sufficient authority to issue instructions and exercise supervision.

More detailed consideration has been given to whether the new SDFI entity, on this basis, should be organised as a state-owned enterprise, a hybrid company established by law or a state-owned limited company.

The purpose of the Act on State-Owned Enterprises was to provide an appropriate mode of organisation for state commercial operation in areas where the state also needs to safeguard sectoral considerations. Through statutes and regulations, petroleum activities are subject to considerable government regulation. Moreover, unfortunate opportunities would be created for confusing different roles if a management company for the state's interests were not only to act commercially but also be intended to safeguard sectoral considerations. The Ministry accordingly recommends that the company should not be organised as state enterprise.

A hybrid company established by law has the advantage that it can be tailored to the specific requirement. On the other hand, this requires the establishment of special regulations. It would be an advantage if an existing mode of organisation, with an associated established, tested and known body of regulations, could provide the organisational basis.

The state-owned limited company is the mode which builds directly on experience gained with the caretaker function for the SDFI over the past 15 years, and which most clearly reflects the intention that management of the state's interests will be commercially based. A tried and tested body of regulations exists for state-owned limited companies, and this mode of organisation is well known to the business community both in Norway and outside the country. It is also the mode which provides the clearest division of responsibility and labour between the company's board and the Minister as the company's general meeting.

On this basis, it has been concluded that the state's interests should be managed by a state-owned limited company. However, certain special legal amendments will be required if the new management arrangement is to retain important characteristics of the present arrangement. See section 8.5.8 below.

Within this framework, this government has considered variations to the state-owned limited company form. Consideration has been given, for instance, to whether the state-owned limited company should both manage the SDFI and own the state's shares in Statoil. The government has nevertheless opted to propose a solution as set out schematically in figure 8.1, and which forms the basis for the discussion below.

The company's area of activity

It is envisaged that the management company's activities will be functionally related to petroleum activities on the NCS. The company will not apply for licences or be awarded operatorships.

External relations — the company's legitimacy

State participation interests will be managed by the company at the state's risk. The company will act as the licensee and participant in the partnerships. Necessary dispositions in relation to third parties can be made within the legal authority conferred on the board and management by company legislation.

Financial relationship between the state and the company

In order for the state, as the owner of participation interests in petroleum activities, to continue to be assured of an annual net cash flow which can be incorporated in and utilised through the central government budget each year, it is assumed that the ownership right to SDFI assets will remain vested in the state and not in the new management company. All revenues and expenditures related to the state's ownership interests will be excluded from the management company's own accounts.

The state will make funding available to the company to cover expenditures pertaining both to the SDFI assets directly and to the company's own operation. Revenues and expenditures pertaining to the SDFI assets will be incorporated wholly in the state's appropriations system.

Revenues from the SDFI assets pass to the state and are not liable to taxation. The management company will be operated on the basis of appropriations from the state, and it is proposed to give the company statutory exemption from tax.

In practice, the framework for the company's overall operations will be defined through decisions taken in the central government budget. One part of the financial relationship between state and company will be to ensure that the company does not develop in an undesirable direction. An important principle of the relationship between the state and the management company must be that the latter, in discharging the caretaker function, does not incur costs over and above the limits specified in the central government budget.

The management company will be required to compile two separate sets of accounts, as Statoil does today. Accounts will be kept for the company's operations in the normal manner. In addition, the company must keep separate accounts for revenues and expenditures which pertain to state participation interests. Reporting to the central government accounts will be on a cash basis, in line with Statoil's existing practice.

The Office of the Auditor General will supervise the administration of the state's ownership interests in the normal way. Operation of the company will be subject to the rules in the Companies Act on the Auditor General's supervision of state-owned limited companies.

The company's capital base

The proposed management company will not be larger in terms of expertise and capacity than is necessary to discharge the actual management function. It must have sufficient competence to be able to take decisions and vote on behalf of the state's participation interests in the various partnerships, to ensure that the state's ownership interests are managed in an acceptable manner. These matters must also be viewed in relation to the company's power to engage business managers in discharging its management duties.

To make it possible for the company to act externally in its own name, the state must accept liability for those of the company's obligations which pertain to the SDFI caretaker function. This will give the company the financial weight it needs as a large player in petroleum activities. Since the principle in company legislation is that the liability of the owners of a limited company for the company's obligations does not extend beyond the paid-in capital, it will be necessary to define the state's liability for the company's obligations through special legislation. A proposal for such legislation will be presented later. See section 8.5.8 below.

A liability of this kind presents the state with a risk which must be taken into account when framing a Bill. Rules should therefore be adopted which impose certain limits on the company's freedom of action, and which will give the state acceptable opportunities for management and control. Through an Act, for instance, it would be possible to introduce provisions concerning the board's duty to ensure that the company does not incur obligations beyond those covered by appropriations, on the board's duty to supervise the way business managers carry out their work, on a prohibition against raising loans and on the board's duty to submit specified issues to the general meeting.

The board's duty to submit issues

The state's ownership interest must be viewed in relation to its status as the general meeting of the management company. The state-owned limited company mode has been constructed in accordance with this. Since the company is to be charged with managing participation interests held by the state, it is recommended that a special duty be imposed on the board of the company to submit specific issues to the general meeting. This duty should be statutory.

The company can engage business managers to administer the state's participation in petroleum activities. It is the board's responsibility to ensure that these managers are required to report to the management company, which will allow the latter to discharge its duty to submit issues to the general meeting.

8.5.4 Implementation of the management function by the company

The caretaker function for the SDFI assets involves various types of work and responsibility. In order for the management company to discharge its responsibilities in the best possible manner, various types of player will need to be engaged. The company's principal function will be to supervise the state's participation interests in the individual partnerships and the overall portfolio, and supervise the sale of the state's oil and gas.

Various types of agreements and arrangements will need to be established in connection with the commercial caretaker function for the state's ownership interests. It may accordingly be appropriate for the management company to conclude business manager agreements for partnerships with state participation. There could also be a need to concluded agreements on advisory and other services. These agreements and arrangements must contribute to the best possible management of the resources and the highest possible value creation for the state. Because the management company will have limited capacity, the initial intention is that the company itself will not undertake sales of the state's petroleum. However, the management company will be responsible and will accordingly supervise the sales arrangements.

It is envisaged that any use of private business managers will comply with article 9 of the Constitution, providing that adequate management and control of the business are ensured by the state and the management company. Moreover, the management company must ensure that it can fulfil its duty to submit issues to the general meeting. The possible engagement of private business managers other than members of the partnerships are engaged must be done in accordance with prevailing procurement regulations.

Supervising participation interests in partnerships

To start with, the management job involves a responsibility for managing the commercial interests represented by the state's licence interests. The management company will have rights and duties as a participant in the partnerships as specified in the joint operating agreements and as a licensee in accordance with rules laid down in or issued pursuant to the Petroleum Act with its associated regulations. The company will fundamentally be placed on a equal footing with the other licensees. It can undertake supervision of the partnerships and exercise its voting rights itself, or engage business managers to do this. In any event, the company will be responsible for the way voting rights are exercised. However, certain special rules will apply with regard to voting rights for the company which manages the state's participation interests. See section 8.5.5 below.

Sales of oil and gas

As part of its business manager duties, Statoil is responsible for managing the sale of the oil and gas generated by the SDFI assets. In addition, Statoil sells the state's royalty oil. In the Ministry's view, the present arrangement with Statoil has functioned well.

As mentioned above, the aim is not to build up extensive technical and commercial expertise in the management company. This entails that the most appropriate course would be to exclude the sale of oil and gas generated by the SDFI and the state's royalty oil from the management company's duties. In formal terms, this assumes that the task of making such sales is assigned to others.

Supervision of the sale of these volumes will be performed by the management company, and will in itself make heavy demands on the latter.

The Ministry envisages that important aspects of the present organisation of oil sales will be retained. This arrangement must ensure that sales revenues from the state's oil are maximised and are adapted to structural conditions in the oil market. In that connection, consideration will be given over time to the question of whether sales through more than one company would best serve this purpose. Initially, Statoil will undertake the sale of all the oil generated by the SDFI assets.

No change is planned to the organisation for selling the state's gas. Statoil will accordingly continue to undertake these sales.In the individual field, Statoil will thereby retain responsibility for supervising and implementing existing sales contracts for the state's gas. Responsibility for and supervision of this arrangement will rest with the management company, and will in itself make heavy demands on the latter.

The government's basis is that the sales arrangement for oil and gas can be continued within the existing EU/EEA legal framework.

Net profit agreements

In some production licences awarded in 1969-71, the state has no active participation rights but only an agreement which secures the state a share of the net profit accruing to the licensees from the operation. In addition to the financial interest, these agreements give the state the right to information concerning operations in the relevant blocks.

Statoil currently administers these net profit agreements on behalf of the state. In the event of a partial privatisation of Statoil, it would no longer be appropriate for this function to be vested in the company. The new management company will therefore take over the function discharged by Statoil today in respect of the net profit agreements.

8.5.5 Voting rules in the partnerships

Before a new management arrangement for the state's participation interests with associated voting rights is implemented, or before SDFI assets are sold, a formal division must be made between Statoil's own participant interest and the state's participant interest in licences where the state participates directly. This will raise certain issues pertaining to voting rights.

Ordinary voting rules

The ordinary voting rule in joint operating agreements is based today on a combination of the percentage of shares and the number of participants voting in order for resolutions to be adopted.

In the event of a change in the number of participants or in the individual participant's share of the licence, the partnership is required to propose new voting rules. These are subject to approval by the Ministry. If no proposals are made, the Ministry can determine new voting rules for the partnership. The joint operating agreements provide that new voting rules must be framed in such a way that the individual participant suffers as little change as possible to its voting weight.

At present, Statoil casts one combined vote for itself and SDFI in those licences where both the company and the SDFI have interests. In those licences where the SDFI but not Statoil has interests, the company votes for the SDFI as part of its business manager function.

When the state's own interests are separated from Statoil and assigned to a separate management company, new voting rules must be established which give the new company an independent vote. This means that the rules must amended in terms of both the number of participants required to adopt a valid resolution and how large an overall percentage of the shares these must represent.

Report no 26 to the Storting (1993-1994) states:

"The decision-making model which was established [in Report no 73 to the Storting (1983-1984) — our note] has created a broad basis for decisions, but has also produced a decision-making system in which little correspondence exists on many occasions between voting strength and financial exposure. On that basis, the Ministry would recommend that authorities give greater emphasis than before when determining voting rules to a majority of shares. This will also apply to SDFI shares."

In line with these signals, one objective will be to frame new voting rules with greater emphasis than before on a majority of shares

The state's special voting rights, the general meeting clause and the right of veto

Most joint operating agreements in licences awarded before 1 September 1995 and in the ownership agreements for most licences and land-based plants incorporate special voting rules for the state's participant interest in particular cases. This general meeting clause provides that "in matters considered to have political or other major aspects of importance and/or which might have major consequences for society or its economy, a management committee resolution is adopted when Den norske stats oljeselskap a.s votes in accordance with a decision made by its general meeting".

In other words, Statoil has authority to pass resolutions on its own. The general meeting clause also incorporates special regulations for certain important issues, such as approving the budget and work programme, and decisions on development and unitisation. When Statoil votes on such issues in accordance with a decision made by its general meeting, the main rule is that at least two members representing more than 50 per cent of the participation interests are required to have voted in favour of the proposal.

The general meeting clause has been replaced with a right of veto in production licences awarded after the licensing directive came into force in Norway. The right of veto is sanctioned in Norwegian law by section 12 of the petroleum regulations and by the individual joint operating agreements.

While the general meeting clause implies a positive decision-making authority, the right of veto implies a right to review a resolution which has been adopted.

Although Statoil exercises these rights today, they are exercised on behalf of the SDFI and not on behalf of Statoil as a commercial company.

These rights will be retained in those licences where the state continues to have participation interests, and be exercised by the new management company.

In those licences which no longer have any direct state participation, no basis exists for a right of veto or general meeting clause.

8.5.6 Relationship with the Petroleum Insurance Fund

As a general principle, the state is its own insurer. Following the reorganisation of state participation in petroleum activities and the establishment of the SDFI in 1985, the Storting passed a new Act on the State Petroleum Insurance Fund in 1986. This fund serves as a reserve for payments to cover claims and liabilities affecting the state in its capacity as direct financial participant in petroleum activities. The fund meets the state's share of payments in respect of claims valid under normal insurance conditions. Statoil is not regarded as part of the public administration, and insures its risk in the ordinary insurance market.

The arrangement with the State Petroleum Insurance Fund can continue after the state's interests have been transferred to the new management company. Statoil's present duties in respect of this arrangement can be transferred to the management company.

8.5.7 Organisation and location of the management company

Organisation

The scope and complexity of the caretaker function for the state's own interests will be determined in part by the size and composition of the portfolio of interests to be managed. This must be reflected in the organisation established to manage the future SDFI portfolio.

The operator does the work in the individual partnership. Before resolutions are adopted in the partnerships, their members must individually asses the financial and strategic significance of the resolution. On the same basis as the other participants, the management company must consider the need to perform its own studies as the basis for its decision and vote in the partnerships. As mentioned above, the management company will be able to conclude business manager agreements for the partnerships. It will also be able to engage other advisers, and in this way secure access to the necessary leading-edge expertise.

Activities in the individual licences can be divided into various phases: exploration, development, production and abandonment. Supervisory requirements will differ from phase to phase. In particular, the development phase, which extends from the time a discovery is made until the start of production, will often present complex issues of technical, financial and strategic significance where the individual participant must make their own decisions.

As mentioned above, it would not be appropriate for the management company to sell of the state’s oil and gas. However, the management company will supervise the arrangement established for this purpose.

The management company can take over the duties discharged by Statoil today in connection with the State Petroleum Insurance Fund.

In order to discharge its management duties and to achieve the objectives of the best possible management of the resources and the highest possible value creation, the management company will need technical, financial and legal expertise. Since the management company will not itself undertake the sale of oil and gas, and since it can engage business managers and other advisers, its organisation will be limited.

Location of the management company

In addressing the question of the company’s location, a very important consideration must be to emphasise closeness to the oil industry community in Stavanger. Weight could also have been given to other considerations, such as geographical closeness to the owner and the authorities in Oslo.

The government takes the view that closeness to the industry community in Stavanger is of overriding importance, and will therefore propose that the company is located in that city.

8.5.8 Giving statutory effect to the main elements

The present management arrangement was established with the reorganisation of state participation through Statoil in 1985. An important aspect of this reorganisation was that Statoil’s administrative duties were abolished, with the consequence that important provisions in the joint operating agreements were amended.

The external impact was modest with respect to the actual caretaker function for the participation interests transferred from Statoil to the state. The key element was the underlying financial division of the holdings, which continued formally to be awarded to Statoil. Statoil continued as before to manage the state’s overall participation interests. Formally, therefore, the changes only found expression in Statoil’s articles of association. The principles for the reorganisation were presented to the Storting, which approved the arrangement.

The reorganisation of state participation which is now proposed means that the present underlying division of interests into an SDFI share and a Statoil share will be formalised and made manifest. In establishing a new management arrangement for these resources, therefore, giving it a clear construction will be important both for the state as owner and for those external interests which must relate to this new player. For both practical and legal reasons, it is accordingly necessary to provide a special statutory basis for the management arrangement. The intention is to give statutory sanction to the central elements in the arrangement through a separate chapter in the Petroleum Act.

As mentioned above, the intention is to exempt the management company from tax and for the state to guarantee the company’s obligations. These aspects must be given statutory effect.

The government will shortly present an Odelsting proposition to the Storting containing proposals for a new chapter to the Petroleum Act which enacts the main features of the management arrangement.

8.6 Conclusion

The government proposes that a new state-owned limited company be established to manage the SDFI portfolio of interests in production licences, pipelines and land-based plants retained by the state.

This new company will fulfil its purpose without possessing the same expertise as traditional oil companies. New state participation interests will be managed by the company at the state's risk. The company will not apply for new licences on its own account. It will not be awarded operatorships. Activities in the company will be functionally related to petroleum activities on the NCS. The company will manage the SDFI assets at the state's risk. Expenditures and revenues pertaining to the SDFI assets will continue to be channelled through the central government budget.

The government will proposes that the company is located in Stavanger.

A separate Odelsting proposition proposing legislation to regulate the company will be presented in the near future.

9. Transport company for the natural gas infrastructure

9.1 Establishment of a new company to manage the natural gas infrastructure

Neutral and efficient utilisation and development of natural gas transport and processing facilities are very significant for realising the value of Norway's natural gas, and must be viewed in a long-term perspective.

The natural gas infrastructure comprises rich and lean gas pipelines with associated treatment plants and terminals. These are owned by separate partnerships, and built and managed in accordance with special permits from the Ministry of Petroleum and Energy. The natural gas infrastructure forms an integrated transport system.

Preserving the coordination benefits offered by this integrated system through joint development and management is important. This is achieved today partly because much of the infrastructure has the same operator, Statoil.

An independent and neutral transport company

The government proposes that an independent company be established for gas transport on the NCS. This builds on the following considerations:

- Transport and treatment facilities must serve all gas producers, and contribute to efficient overall utilisation of resources on the NCS.
- The company responsible for managing the gas transport systems must be neutral in relation to all users of the transport system.
- The company responsible for management has a key role in further development of the system.

It is proposed to establish this undertaking as a limited company.

It is envisaged that technical operations will be pursued by the organisations which discharge them today under contract with the newly-established transport company. This means that the new company will concentrate on system management, licence administration and overall supervision of the gas transport infrastructure on the NCS.

This company will take over responsibility for pipelines and transport-related treatment facilities. These are facilities integrated in resource management and safety terms in the management of the gas transport system.

The company will be owned for the time being by the state, until a permanent form of ownership has been found for the pipeline systems on the NCS.

It is envisaged that all companies with responsibility for gas pipelines and transport-related facilities will be treated in the same way.

On that basis, the Ministry envisages that the new transport company will not engage in processing of natural gas or other industrial operations beyond those required by the actual transport function. Responsibility for such operations must continue to rest with the oil companies and other commercial players.

Establishment of the transport company will not involve any changes to the ownership of pipelines or treatment plants. Nor will tariffs for using the infrastructure be affected.

9.2 Review of the existing system

9.2.1 Description of the natural gas infrastructure

Figure 9.1 shows an overview of existing and planned pipelines for gas transport.

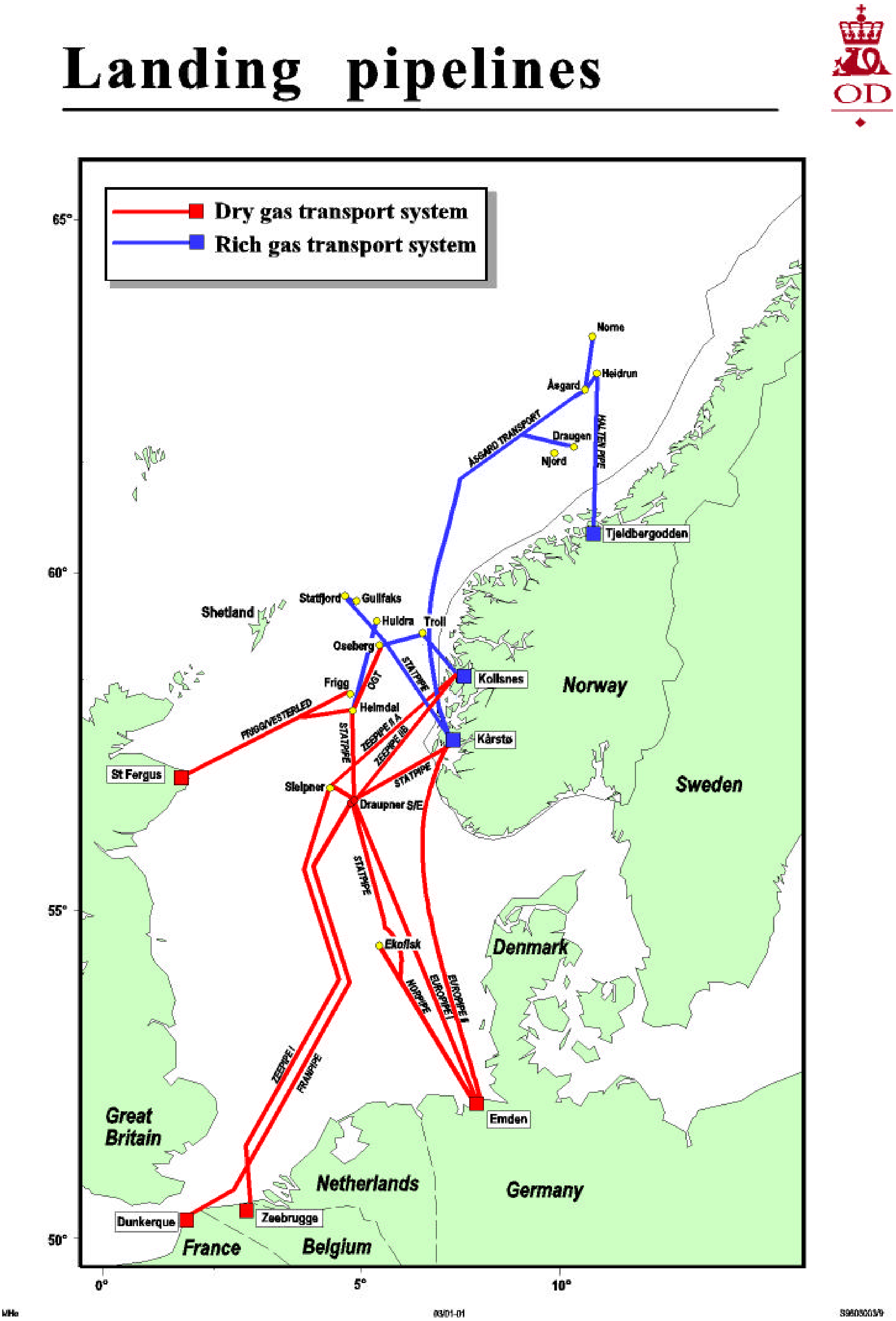

Figure 9.1: Transport systems

Source: Norwegian Petroleum Directorate.

This infrastructure can be roughly divided into two components: 1) rich gas transport and treatment facilities, and 2) lean gas transport.

Rich gas consists of lean gas and natural gas liquids (NGLs). To convert the rich gas into saleable products — lean gas and NGLs — the NGLs must be extracted and fractionated into various NGL products. Rich gas is carried in the Statfjord-Kårstø leg of Statpipe, Åsgard Transport and tie-ins to this line from the Draugen, Heidrun and Norne fields, and Haltenpipe. Gas from Troll is transported in multiphase pipelines to Kollsnes. Treatment plants are established today at Kårstø, Kollsnes and Tjeldbergodden, as well as offshore at the Heimdal gas centre.

Lean gas for continental Europe is carried in the Zeepipe, Franpipe, Statpipe (lower section), Norpipe and Europipe I and II pipelines. These connect with receiving/treatment plants on land in Belgium, France and Germany respectively.

The Norwegian Frigg pipeline carries lean gas to the UK, where it is treated in the associated terminal at St Fergus. Gas production from Frigg will be phased out over the next few years. Laying a new pipeline link between Heimdal and the Frigg line will permit the transport of gas from other parts of the NCS to St Fergus. The decision has been taken to establish a new transport system, Vesterled, which will embrace the new pipeline, the Norwegian Frigg pipeline and Norway's share of the terminal in St Fergus. Plans call for Vesterled to begin operating on 1 October 2002, but the licensees are also considering the possibility of a start-up in 2001. A lean gas pipeline from Oseberg to Heimdal — Oseberg Gas Transport (OGT) — became operational in October 2000.

Gas infrastructure forms an integrated transport system

The infrastructure for natural gas comprises rich and dry gas pipelines with associated treatment plants and terminals, and forms an integrated transport system. One result of integrating the pipelines to land is that individual fields can send gas to several delivery points — both to Germany and Belgium, for instance.

Operationally, the integrated gas transport system lays the basis for a considerable degree of flexibility in coordinating deliveries from different fields. Gas flows from various sources can be optimised to offer the right quality of Norwegian gas. This is accomplished by coordinating transport in the rich and lean gas pipelines as well as treatment plants and terminals. At the same time, gas transport is closely integrated with operation of the individual fields. The flexibility of this infrastructure means that gas production can be varied to optimise oil recovery.

In operational terms, the high degree of interdependence between the various parts of the infrastructure also creates a high level of complexity. The various pipelines are mutually dependent on each other in capacity terms, for instance, because of relationships between pressure and operating conditions in the lines. Ensuring efficient and rational management of the infrastructure is important for achieving the best possible utilisation of overall transport capacity.

The control centre at Bygnes in Karmøy local authority coordinates gas deliveries and transport through the infrastructure from producers on the NCS to gas buyers in continental Europe. This centre controls — and will continue to control — gas flows through 5 500 kilometres of pipelines, which collectively transport about 90 per cent of Norwegian gas exports to the continent.

Organisation

The owners of pipelines and treatment plants are organised as a rule in separate partnerships. Pipelines and treatment plants are built and managed under special permits issued by the Ministry of Petroleum and Energy, which also approves the manager for the partnership. Relations between the owners are regulated by a participant agreement. The management committee, in which all the owners are represented, is the decision-making body for the partnership.

As gas producers, the owners are also users of the infrastructure. An infrastructure in which the producers also have equity interests has been an important instrument in achieving cost-effective development and management. New capacity has been developed gradually, in line with expectations of future capacity requirements.

Statoil manages most of the pipelines and treatment plants, including the control centre at Bygnes. Some pipelines and treatment facilities are managed by other companies. Phillips Petroleum is manager for Norpipe. Statoil can take over this management role under certain conditions. See

Storting proposition no 41 (1994-95). Norsk Hydro manages Oseberg Gas Transport and the Heimdal gas centre, and is operator for Vesterled during the development phase. According to the permit for installation and management of Vesterled, the Ministry is due to appoint the manager for this system in the operational phase in good time before it starts up. TotalFinaElf is technical operator for the Frigg pipeline. Shell is manager for Draugen Gas Export, which became operational in October 2000, but the permit for installation and operation specifies that a transfer of this management function to a separate company can be required.

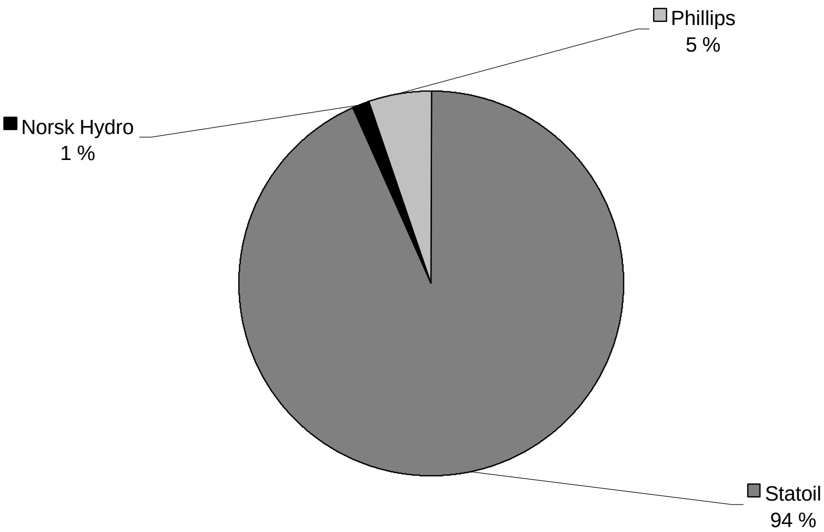

Figure 9.2: The share of gas pipeline capacity for which the various companies have management responsibility

Source: Ministry of Petroleum and Energy

Figure 9.2 illustrates the share of total capacity in the gas pipelines for which the various companies have management responsibility. These management shares are calculated on the length and capacity of the lines. The figure does not include gas treatment plants and terminals. Statoil is manager for six out of nine treatments plants and terminals for Norwegian gas.

Natural monopoly — government regulation

The cost structure for gas transport is characterised by high initial expenditures and low operating costs. Constructing gas pipelines is capital intensive.

Pipeline transport of gas offers such substantial economies of scale that this business forms a natural monopoly. Such natural monopolies cannot be permitted to exploit their strong position in relation to users, but must be managed with a view to providing a regulated return on capital invested.

The return on pipelines is accordingly regulated by the government. Tariffs in newer lines are set on the basis of a required real return on total capital of roughly seven per cent before tax, with opportunities for small supplementary revenues in order to stimulate increased utilisation and cost-effective management.

Purchase of transport and treatment services, and the terms governing this, are subject to negotiations between the pipeline partnerships and users. Agreements on using pipelines and treatment facilities must be submitted to the Ministry for approval. The Ministry can determine tariffs and other conditions.

The Ministry can decide which fields will deliver under the various gas sales contracts. These decisions also determine to a great extent which parts of the infrastructure will be used by the various fields. The Ministry’s influence relates to overall usage, not the day-to-day management of the transport system.

9.2.2 Division of duties

Relationship between the players

The relationship between the company responsible for managing gas transport and the owners is regulated by participant agreements in the various partnerships. The company has usually been a member of the relevant partnership.

Participant agreements are largely standardised, and include a description of the rights and duties of the company responsible for management in relation to the owners. Among its responsibilities, the company will:

- Carry out all activities on behalf of the partnership and its owners in accordance with the participant agreement and the decisions taken by the owners. The transport system will be managed in close cooperation with those responsible for operating fields and other transport systems.
- Present the annual budget for approval by the owners. Rules specify how financial outlays and possible budget overruns should be handled.
- Provide gas transport services on behalf of the pipeline owners. This includes an overview of spare capacity.

A basic principle in the participant agreements is that the company responsible for management will neither lose nor gain financially from this work.

Liability for possible financial losses in the partnerships will be divided between the owners (including the manager) in proportion to their share of the relevant pipeline. If a loss results from gross negligence or imprudence on the part of senior personnel at the company responsible for management, the latter will have to cover the loss.

The company responsible for management can resign or be dismissed at six month’s notice. Such a decision requires a unanimous vote by the management committee, with the exception of the management company’s own vote.

Management

Management functions relate to two principal tasks: 1) system and administrative management, and 2) technical operation.

- System management embraces work relating to planning, supervising, coordinating and managing transport from fields to terminals. This amounts to an estimated 50 work-years for the gas pipelines managed by Statoil. Administrative management covers accounting, invoicing and budgeting.
- Technical operation involves planning and implementing maintenance and repairs as well as external and internal inspection.

According to Statoil, technical operation and processing activities at the Kårstø and Kollsnes plants and the terminals in Germany, Belgium and France require 380, 210 and 85 work-years respectively. In addition come a few work-years relating to management of Haltenpipe and its terminal at Tjeldbergodden. In the following, technical operation will also include processing activities.

Development of gas transport systems

Both field and pipeline owners make proposals for developing new pipelines and for tie-ins with existing transport systems.

The developer of a new field draws up new pipeline development plans, unless an alternative approach is agreed. The management role confers no decision-making authority in such cases. That lies with the partnership for the field, or possibly with the partnership for the new pipeline.

An operator for the installation phase is proposed by the companies responsible for a development in the plan for installation and operation (PIO). The Ministry authorises installation and operation, and its powers include the right to approve or impose requirements on the operator in the installation and operational phases.

9.3 Purpose of the management function for gas transport

Achieving effective management of the resources on the NCS is important. This makes it necessary to ensure that management of the infrastructure serves the overall activity. Gas operations, and thereby gas transport, have a long-term perspective. Government control must also be robust in relation to future changes in Norwegian offshore operations.

Responsibility for the most important parts of the natural gas infrastructure must rest with a neutral and independent transport company, particularly in view of the dimensions acquired by the natural gas infrastructure. A neutral and independent transport company is one which does not have commercial interests on the production and marketing sides, with consequent interests of its own in the management and development of the infrastructure, and which is not connected with a particular owner company. This is important not least for the competitiveness of the NCS.

Ensuring efficient resource management is one of the principal arguments for assigning responsibility to a neutral and independent company. By making this company independent, the possibility that it could obtain advantages in terms of information which could be exploited commercially would be avoided. Nor would a company dedicated solely to managing gas pipelines have incentives to cross-subsidise other operations.

The need for efficient resource management

The company responsible for management has a particular influence on the infrastructure by determining the assumptions which underpin new decisions about individual pipeline systems falling within its responsibility. Being responsible for large parts of the infrastructure provides insights into development requirements for the whole transport system. This role and closeness to the transport system confer great influence on and power to affect further development.

Eliminating any conflict between the company responsible for management and efficient resource management is important. This responsibility should accordingly be held by a player who can contribute to an integrated development of the infrastructure on the basis of the correct financial priorities.

Through its responsibility for the most important sections of the infrastructure, as well as interests in all parts of this infrastructure and in most production licences, Statoil currently has greater opportunities than other companies to influence the development of the infrastructure. It will not be the purpose of a partially privatised Statoil to take socio-economic considerations into account when presenting alternative development proposals for the infrastructure. Nor can the company be required to accept such responsibility. Statoil is also likely to concentrate its operations to a greater extent on a few selected areas of the NCS. It would be desirable for the authorities that the key source of assumptions underpinning strategic decisions on the infrastructure is neutral and independent. This player should not be a company with interests on the production side.

Efficient resource management can be more easily achieved if management responsibility for the infrastructure lies with a neutral player.

Information advantages

The solution chosen must be organised in such a way that individual companies do not obtain information advantages relating to transport conditions and opportunities which could be exploited commercially. Various measures can be adopted to counter such information advantages. The Ministry takes the view that the best way of ensuring that individual owners in the natural gas infrastructure are not given information advantages is to assign management of the infrastructure to a neutral and independent company.

The company responsible for the integrated transport system has a role to play in coordinating deliveries from the fields tied to this system. That calls for close cooperation between the operators of the individual fields and the company responsible for gas transport. Decisions need to be taken continuously in this context with regard to operating conditions on the fields and in the transport system, optimising liquids production from each field, and coordinating maintenance and inspection of fields, pipelines and treatment plants. The Ministry believes that all these decisions can also best be taken in a system with a neutral company responsible for gas transport.

Cross-subsidisation

Provisions in participant agreements on the manager's rights and obligations include the principle that this company will neither lose nor gain financially from discharging its role. In addition to the cost of managing the pipeline, the company will have its administrative, training and other expenditures met. A company which is also active on the NCS has a substantial interest in seeing that the infrastructure is managed in the most efficient possible way. Nevertheless, questions could arise if this company requires that costs from other parts of its operations are met via the transport business (cross-subsidisation). This possibility will be avoided if transport responsibility is held by an independent company with the transport system as its only business.

A company not integrated in other offshore operations will have more appropriate incentives for presenting the actual costs of transport management, and will not need to take account of its own commercial interests as a gas producer and seller.

9.4 Establishment of a new transport company

The Ministry recommends that an independent company be established to manage gas pipelines and transport-related gas treatment plants.

This company is intended to take over the responsibilities currently held by Statoil and other companies relating to management in infrastructure partnerships and companies relating to the gas infrastructure. The owners will have the same determining influence as before through management committees and company bodies, within the frameworks of participant and company agreements as well as government regulations. As a result, the proposal for a new company involves no significant changes to the present systems for and legal organisation of the infrastructure.

The new company will take over responsibility for pipelines and transport-related gas treatment facilities. It is crucially important that facilities integrated in of resource management and safety terms in the management of the gas transport system are subject to unified responsibility. That will in turn provide a clear and unambiguous structure of incentives for the company and a natural demarcation with operations by the commercial players.

Accordingly, the Ministry envisages that the new company will not engage in processing of natural gas or other industrial operations beyond those required by the actual transport function. Responsibility for such operations must continue to rest with the oil companies and other commercial players.

9.4.1 Transport company functions and area of activity

A review must be carried out into which functions are to be discharged by the new company, and for which partnerships. At the same time, an assessment must be made of which functions will be performed by the company itself and which will be carried out under contract by other suitable players.

System and administrative management

The transport company should have sole responsibility for system and administrative management of the gas transport system. It is important that a single company is responsible for daily optimisation of the integrated transport system.

These functions are particularly important for exploiting the coordination benefits offered by managing the infrastructure as an integrated system. They are also important for maintaining neutrality in relation to users, and in relation to day-to-day operating conditions on the supply fields.

The necessary manuals for system management have to be adapted and transferred to the new company. The company must be given an adequate legal basis for discharging its functions. This includes the collaboration between fields over their production.

Technical operation

It is important that the company takes a holistic approach to managing the infrastructure, partly for its understanding of the infrastructure’s technical condition at all times. This suggests that the independent transport company should have formal responsibility for all types of operational functions in each partnership covered by the company’s area of activity.

However, the Ministry’s proposal implies that technical operations should continue to be handled by the organisation which currently performs them. Economies of scale are achieved by an integrated approach to planning and implementing maintenance and inspection. A company which is also responsible for maintaining infield flowlines and other subsea operations, for instance, would achieve such economies of scale.

The Ministry believes that a clear division of responsibility between the new company and these companies is important. The new company must have overall responsibility.

Maintenance and inspection planning relates to system management, for example. This is partly because maintenance and inspection could require pipelines or plants to be shut down or operated at reduced capacity for periods.

Development and extension of gas transport systems

When developing new or existing gas transport systems, cooperation must be established between the owners concerned and the new company. This is because the company will have an overall perspective in order to ensure that total transport capacity is well adapted and that new and existing infrastructure are in conformity.

As at present, development decisions will be taken by the individual partnership with subsequent consideration by the authorities. The transport company will accordingly have no decision-making authority in such cases.

The development operator for new transport systems will be appointed as before by the individual partnership responsible for the new project. This operator must be approved by the Ministry.

The transport company’s area of activity

The new company will take over functions relating to system management, as outlined above. The coordination gains offered by joint management of the natural gas infrastructure, including the opportunity to secure the best possible management of gas flows in terms of achieving the right quality requirements at the lowest possible cost, and in responding to operating problems on fields or in parts of the infrastructure, indicate that as many pipelines and gas treatment facilities as possible should be included in the new company’s area of activity.

As a result, all parts of the gas infrastructure in which a mutual dependence exists between individual pipelines or transport-related treatment plants and the rest of infrastructure should in principle be included in the company’s area of activity. Similarly, pipelines or transport-related treatment plants should be included in the company’s area of activity if they have, or might have, several fields as their user.

The Ministry accordingly recommends that the Zeepipe (including Europipe I), Europipe II, Franpipe, Statpipe, Åsgard Transport, Heidrun Gas Export, Norne Gas Export and Draugen Gas Export pipelines, together with the terminals in continental Europe and the Kårstø treatment plant, are included in the transport company’s area of activity.

It is also desirable in principle that other pipelines and plants are brought within the company's area of responsibility, but certain special considerations apply to these:

- Troll Gas is managed from *Kollsnes*. At the same time, the Kollsnes facility could develop into a substantial treatment centre for gas from other fields. The Ministry envisages that Statoil will retain its manager responsibility at Kollsnes, but that the opportunity will be provided for the new company to take over functions relating to gas transport management when a significant increase in their use by other fields occurs.
- Tjeldbergodden currently receives gas through Haltenpipe from Heidrun. This field is currently the only supplier of gas to Tjeldbergodden. But possibilities will also exist for other fields to conclude contracts to deliver to Tjeldbergodden. The Ministry accordingly considers it important that the manager function for gas transport at Tjeldbergodden and in Haltenpipe is included in the new company's area of responsibility.
- The aim is to include pipelines and treatment plants currently managed by companies other than Statoil, such as Heimdal and Oseberg Gas Transport, in the transport company's area of activity.
- Management responsibility for Vesterled, including the terminal at St Fergus, will be taken over by the new company after this system has been completed and brought into operation. This is expected to be in October 2002. TotalFinaElf will remain responsible for technical operation is accordance with the requirements of the Frigg treaty that a single company should be responsible for operating both Norwegian and British pipelines.
- The new company will take over responsibility for managing Norpipe at the latest on the date that this can be transferred to Statoil under the existing agreement with Norpipe's owners.

Management of new rich gas, lean gas and multiphase flow pipelines and transport-related treatment plants should in principle form part of the transport company's area of activity. Responsibility for managing new plants and pipelines will be assessed in each case by the Ministry.

Summary

Table 9.1 summarises which pipelines, transport-related treatment plants and terminals should come within the transport company's area of activity.

Table 9.1: Overview of facilities which will be embraced by the transport company's area of activity

Lean gas pipelines	Rich gas pipelines	Terminals/transport-related plants
Zeepipe (incl. Europipe I)	Statpipe zones 1 & 5	Zeebrugge
Europipe II	Åsgard Transport	Emden/Dornum
Franpipe	Heidrun Gas Export	Dunkerque
Statpipe zone 4	Norne Gas Export	St. Fergus
Vesterled (Frigg Transport)	Draugen Gas Export	Kårstø
Oseberg Gas Transport	Haltenpipe	Tjeldbergodden
Norpipe		Heimdal

9.4.2 Establishment and ownership

Ownership

The infrastructure is owned by the users — in other words, gas producers on the NCS. An infrastructure in which the producers also have ownership interests has been an important instrument in achieving cost-effective development and management.

The company responsible for managing the transport systems must be neutral in relation to the players. This means that gas producers should have limited influence over day-to-day operations by the new company.

Efficient management of the pipelines is also very important. The new company and partnership members will evaluate appropriate mechanisms which satisfy this requirement. Members of partnerships for the various pipelines could be allowed to second employees on fixed-term contracts to the transport company, for instance, and to compare management of the pipeline system with other pipeline systems — through a benchmarking process, for example. Many oil companies commission this form of comparative analysis in order to measure their performance against that of their competitors.

The changes to management responsibilities will not involve any modifications to the fundamental financial relationship between the participating companies. Some redistribution of ownership interests in pipelines will be made between Statoil and the SDFI. But this redistribution is not related to the modifications proposed for gas transport management. No changes will otherwise be made to the ownership structure of the individual pipeline partnerships. The owners will have the same rights and duties as before, and will be able as before to exercise their ownership in relation to the company responsible for management. The new company cannot make investments or conclude agreements beyond those relevant to the functions and obligations defined in the agreements with partnerships. Revenues to the pipeline owners will not be affected by the change.

The company responsible for management is appointed by the partnership. When transferring responsibility from Statoil and others to the new company, the rules which apply in the individual partnerships will be observed.

As owners and users of the infrastructure, gas producers have a financial interest in the most efficient possible management of the infrastructure. They will be able to influence this through their membership of the individual partnerships.

Management costs for the transport company will be shared in accordance with a formula negotiated by the owners.

State ownership interest

Since neutrality is a principal objective in establishing the new company, the state's role should be to secure neutrality through an ownership interest in the company. The state must accordingly have a majority holding in the company. Since neutrality is the objective, it will be necessary to seek an ownership structure where no companies feel disadvantaged in relation to the company. This applies to ownership, board composition or other influence in relation to the new company. The ownership structure must not come into conflict with later changes in the ownership structure of the partnerships, and must ensure the requirement for neutrality. Maintaining flexibility in the ownership structure is important. This indicates that the state alone should own the new company until a permanent form of ownership has been found for the pipeline systems on the NCS. Nevertheless, further consideration will be given to whether it would appropriate for other reasons to establish an ownership composition for the transport company in which the producer companies are represented.

Management of the company

The company must act neutrally, and the most appropriate way of achieving this will be to organise it as an ordinary limited company.

Consideration has been given to whether the state should exercise its ownership of the transport company directly or through a new management company for the SDFI. Since the justification for state ownership is primarily the concern to achieve neutrality, it is necessary to ensure that no connection exists between the SDFI management company and the transport company. The state must accordingly exercise its ownership of the transport company directly.

The board of directors will have the principal responsibility for setting further management objectives for the company.

Starting up the company

In principle, each partnership owns all the assets and facilities required by the new company to discharge its management responsibilities. The company will not own facilities other than those which are additionally necessary to discharge these responsibilities.

The new company could need to own certain facilities which Statoil today makes available to the relevant organisational units. These include information technology services, for instance. Such facilities must be established by the new company itself.

An assessment of personnel requirements will be necessary before the company is established. The company will need about 150 people to discharge the functions it is intended to assume and which are described above. These tasks are currently performed by personnel employed by Statoil. These employees will accordingly be offered corresponding jobs in the new company. Personnel will be transferred in accordance with the provisions of the Working Environment Act. Employment terms for the other Statoil personnel who work on the operation of pipelines, terminals and treatment plants will not be affected by this division. These total an estimated 500 people.

Organisation of the infrastructure

A system which sets the level of tariffs for transporting and treating natural gas on the basis of a regulated return has been adopted for the NCS. The Ministry of Petroleum and Energy also approves all agreements on developing and utilising the infrastructure. Reorganising the management function will involve no changes to pipeline ownership, determination of tariffs or access to the infrastructure. No changes in the existing regulatory regime are envisaged as a result of establishing the transport company.

9.6 Conclusion

The government proposes that an independent company should be established for natural gas transport on the NCS. It is proposed to organise this undertaking as a limited company.

It is envisaged that all technical operating functions will continue to be discharged by the organisation responsible for them today, under contract with the newly-established transport company. This means that the new company will concentrate its activities on system management, licence administration and overall supervision of the combined transport infrastructure on the NCS.

This company will take over responsibility for pipelines and transport-related treatment facilities. These are facilities integrated in resource management and safety terms in the management of the gas transport system.

The company will be owned for the time being by the state, until a permanent form of ownership has been found for the pipeline systems on the NCS.

It is envisaged that all companies with responsibility for gas pipelines and transport-related facilities will be treated in the same way.

10. The process ahead

10.1 Sale of SDFI assets

In this proposition, the government proposes that SDFI assets corresponding to 20 per cent of the asset value of the SDFI are included in a restructuring of state involvement, providing the state achieves satisfactory terms.

The interests which the government envisages selling to Statoil will account for about 15 per cent, while those it envisages selling to Norsk Hydro and other companies will account for roughly five per cent.

To ensure the best possible basis for implementing the sales process, a comprehensive review has been conducted of all production licences and transport systems on the NCS in which the state has a direct financial interest. The NPD has carried out an evaluation of the SDFI portfolio with support from Gaffney, Cline and Associates, a leading international technical/geological consultant for oil and gas.

The Ministry of Petroleum and Energy’s advisers, UBS Warburg and Pareto Securities, are carrying out a valuation of the relevant parts of the SDFI portfolio on the basis of this background material as well as commercial and market considerations.

Discussions with Statoil on the sale of SDFI assets will continue in the time to come. Final agreements on the sale of holdings to Statoil or on a swap of holdings between the state and Statoil can first be concluded after the Storting has considered this proposition but before the company is partially privatised. The sale of SDFI assets to others can take place in parallel — or with some time lag — to the sales process covering Statoil.

10.2 Concerning a stock market listing

New owners corresponding to 10-25 per cent of the company’s value will be brought in through the listing. This will primarily be achieved by issuing new shares in the parent company, Den norske stats oljeselskap a.s, combined with the sale of part of the state’s shareholding. Shares will be placed in both Norwegian and international capital markets.

Statoil’s stock market value will be very substantial by Norwegian standards, and it is natural to assume that a significant proportion of the shares offered for sale will be owned by foreign investors. It would therefore be natural to consider applying to list Statoil on stock exchanges other than the Oslo Stock Exchange.

The share sale and stock market introduction demand extensive and time-consuming preparations in terms of both process and schedule. Adapting the timetable to the company’s reporting periods and other company-specific conditions will be important. The oil price and general stock market trends — particularly developments for the international oil companies — will be other important considerations.

To achieve the best possible price for the shares offered in Statoil, it is important that the interest on offer is sufficiently large to give investors confidence that the state as owner will give Statoil the freedom to develop its strategy on the basis of commercial goals. This requirement can be met by making an initial share offering in the order of 10-25 per cent of the company’s value, combined with a clarification that this can be increased to 33 per cent over time. Moreover, it must be made clear that Statoil will be operated on commercial principles in line with other listed companies. A share sale on this scale should match market demand and secure the necessary liquidity of the share.

Preparations will include the following:

- Statoil continues to develop its strategy in light of the plans for a changed ownership structure and a restructuring of state involvement. It must be made clear to investors that further development of the company will be based on commercial criteria in order to achieve the best possible return on capital employed over time.

- The SDFI restructuring is implemented.
- Statoil is converted to a public limited company (ASA).
- A legal, financial and commercial review of the company is carried out, and the necessary documentation prepared. During this period, auditors, lawyers and the global coordinators will carry out the necessary reviews of the company and draw up the prospectus and sales materials. Updated accounts for Statoil will need to be presented.

The share sale will be implemented by a syndicate of international and Norwegian securities houses which are authorised to implement this type of operation and which possess leading market positions and solid experience of similar transactions. These are often described as coordinators of the process.

In a privatisation process, the client usually selects a group of coordinators (bank syndicate) headed by two-three global coordinators. The Ministry wrote on 14 November 2000 to 16 banks, inviting them to apply for the role of global coordinator. The Ministry and Statoil have held preliminary discussions with all 16. A choice will be made and contracts awarded in the near future.

The coordinators will be supported by such specialists as legal advisers, auditors and possibly marketing advisers.

The global coordinators will head the syndicate, coordinate the work of its other members and play a leading role in marketing the share. They will also be responsible for preparing Statoil for a listing and for advising the Ministry of Petroleum and Energy and Statoil. Information on and analyses of Statoil by the global coordinators will be important for the level of interest among potential investors.

Company analyses carried out by the syndicate’s members are based in part on information from Statoil. They will cover a number of topics, such as company strategy, management, competitive position and ownership structure. Other subjects will include market and financial estimates, value parameters and assessments of risk and sensitivities relating to the analyses and valuations.

The analyses will be used by the analysts in cultivating the market to prepare investors for Statoil’s own presentations and for receiving the prospectus. This early market survey is important for focusing attention on core issues, helping to estimate an optimal price band for the privatisation, and stimulating price and demand.

In connection with the stock market introduction and issue/sale, Statoil’s board must draw up and sign a prospectus which describes all relevant conditions relating to Statoil. The company’s directors are responsible for the information provided in this prospectus.

Advice on pricing and allocation of the shares will be provided by the coordinators to the Ministry of Petroleum and Energy and to Statoil.

The price which can be achieved by selling part of the state’s shareholding will depend on a number of factors, such as the company’s development and trends in oil and financial markets. Relatively substantial changes in market conditions could be experienced over a short period.

Extensive work is planned to market the Statoil share. The focus internationally will be largely on institutional investors. In Norway, efforts will be made to attract demand from small shareholders as well as institutional investors. However, institutions will also represent the largest investment capacity in Norway.

Measured in terms of shares registered with owners through the Norwegian Registry of Securities (VPS), the total market value of the Oslo Stock Exchange at the end of October was about NOK 666 billion. Foreign investors owned 35 per cent of this, the public sector 17 per cent and private Norwegian investors 48 per cent. The last of these categories breaks down into private Norwegian limited companies (20.1 percentage points), institutions (18.9) and private individuals (8.8). The market value and number of companies registered on the Oslo Stock Exchange vary substantially over time.

Table 10.1: Market value of shares listed on the Oslo Stock Exchange, etc

	1997	1998	1999	Nov 2000
Market value of shares listed on the OSE (NOK bn)	490	353	512	638
Number of companies listed on the OSE	217	235	215	212
Share issues registered by the OSE (NOK bn)	21,5	11,4	14,4	27,6

Source: Pareto Securities/Oslo Stock Exchange

As the table indicates, the number of share issues registered by the Oslo Stock Exchange at November 2000 exceeded the level of activity for the whole of 1997, the previous record year.

The proportion of shares owned by foreigners on the Oslo Stock Exchange has been over 30 per cent since 1994, and reached its highest level in September 2000 at 35 per cent. Sectors traditionally attracting the greatest foreign interest have been shipping, oil and offshore, and IT/telecommunications. The position of the Oslo Stock Exchange as one of two exchanges in an international context with the strongest focus on oil- and offshore-related shares is particularly interesting for a stock market introduction of Statoil. International institutions are accustomed to investing in these segments on the Oslo Stock Exchange.

The USA is registered with the largest share of foreign share ownership, ahead of the UK. Together with the Netherlands, Sweden, Denmark and Luxembourg, these countries account for more than 80 per cent of foreign share ownership registered on the Oslo Stock Exchange. The largest number of direct foreign investors hail from Sweden and Denmark. This reflects the fact that investors from other nations largely invest in Norwegian shares through institutions or “nominee accounts”.[13]

About 40 000 private individuals are registered as shareholders in the VPS, or 11 per cent of the adult population. The corresponding proportion is more than 50 per cent in Sweden, 33 per cent in Denmark, 19 per cent in Finland, 25 per cent in the UK and 36 per cent in the USA.

The government has not finished assessing whether special measures should be adopted to stimulate demand from retail investors.

A recommendation on the question of adopting special measures in the sale of Statoil shares will be submitted by the government to the Storting at a later date.

All citizens of the European Economic Area have an equal right to buy Statoil shares.

It is difficult in advance to predict which groups of investors would wish to buy shares in Statoil. When evaluating the effects of a stock market listing, a natural approach is to draw a distinction between Norwegian and foreign funds because these use different indices as indicators.

The main list index is important for Norwegian institutions. This includes all shares — both Norwegian and foreign — listed on the Oslo Stock Exchange’s main list. All the shares are weighted by market capitalisation. In other words, shares in the index are weighted by their market value relative to the total market value of the index members. This means that a change in share price for a small company has less effect on the index than a corresponding change for a larger company. However, the weighting given to a share will also depend on how large a proportion of its share capital is listed on the stock exchange.

Only those shares which can be freely traded are taken into account for companies in which the state has a substantial shareholding. For Norsk Hydro, Telenor, DnB, Christiania Bank, Raufoss and Kongsberg Gruppen, this means that only the shares in private ownership are included in the index basis. The same is expected to apply to Statoil. How closely investors follow the weighting in the

[13] This means that the investor does not formally own the share, but is represented by another party.

index varies strongly from company to company and from fund to fund. Most Norwegian institutional investors do so relatively slavishly and to a growing extent.

A number of allocation strategies are available to foreign funds, including weighting by country, by industry sector and by selecting individual shares.

Historically, a number of funds have used an indicator based on weighting by country. The Oslo Stock Exchange's all-share index has had a limited weighting in the overall index base. Through the listing of Statoil (and Telenor), the Oslo Stock Exchange will weigh more heavily in Europe.

Most funds are no longer based on weighting by country but by industry sector. This development has accelerated following the introduction of the euro as the common European currency. These investors can freely choose which companies they want to own within specified industries, and would therefore assess an investment in Statoil against investments in other European oil companies.

A number of funds do not focus on weighting, but simply look for attractive investment opportunities independently of country or sector. The most important consideration for these investors is that the share has a liquidity which makes it simple to buy or sell relatively large holdings.

Forecasting an exact distribution of shares in Statoil is difficult at present.

During 2001, the government will decide on the timing for a stock market listing. Work is under way to lay the basis for a listing of Statoil during 2001.

10.3 Establishment of two new companies

Preparatory work for establishing the two new companies described in chapters 8 and 9 is well in hand. The companies will be established after the Storting has considered this proposition.

10.4 Conclusion

The government will work for a stock market listing which safeguards the financial interests in the best possible way.

A decision on the timing of a stock market listing will be taken by the government during the spring of 2001. Work is under way to lay the basis for a listing of Statoil during 2001. The sale of SDFI assets to Statoil will be implemented before the listing. A management company for the SDFI and a transport company for natural gas will also be established prior to the listing. Sales of SDFI assets to companies other than Statoil can be implemented in parallel — or with a time lag — with the sales process for Statoil.

11. Financial and administrative consequences of the proposal

The introduction of new owners to Statoil would involve changes to the procedures for selecting members of the company's board and corporate assembly. See chapter 5.

The provision in the articles of association which requires the company to submit an annual plan for its operations (the article 10 plan) to the general meeting will be abolished. A report on developments in the company could be included in future in the general Report to the Storting on companies in which the state has equity interests, and perhaps in a briefer form in the annual central government budget proposition.

Reducing the state's equity interest in Statoil does not of itself require any changes to the state's view of and attitude on issues relating to return on capital or dividend, but the state will no longer be able to take decisions alone on dividend policy or the required return. As mentioned above, the general meeting will no longer have the opportunity to set a dividend higher than that proposed by or acceptable to the board.

A proposal for partial privatisation of Statoil requires no legal amendments, but creates a requirement for statutory provisions in connection with the establishment of the management company for the SDFI.

In connection with a stock market listing, Statoil must be converted from a limited company to a public limited company. This follows from statutory regulations governing the stock exchange and limited companies. The conversion will be resolved by the general meeting. In itself, conversion to a public limited company will have no effect on state ownership of the company. Plans call for revenues from a possible sale of state-owned shares in Statoil to be transferred to the Government Petroleum Fund. This will require an amendment to the Act on the Government Petroleum Fund. Cash settlements from the sale of SDFI assets will be transferred in their entirety to the petroleum fund, in accordance with the Act. In connection with the establishment of a new state-owned limited company to manage the SDFI in the future, certain special legal amendments will be necessary so that the new management arrangement can retain important characteristics of the present arrangement. See section 8.5.8. The company will need to be provided with capital to meet establishment and operating costs.

Establishment of a state-owned company for natural gas transport requires no changes to the law. The company will need to be provided with capital to meet establishment and operating costs.

In connection with the change in ownership structure between the state and Statoil for the crude oil terminal at Mongstad, this facility must be converted to a separate legal entity.

See Chapter 7 for a discussion of the effects of the proposals in this proposition on the state's revenues and risks.

11.1 Budgetary considerations

NOK 15 million was appropriated in 1999 under chapter 1800, item 21 — see Proposition no 80 to the Storting (1998-99) and Storting recommendation no 218 (1998-99) — for special advice on shaping state involvement in petroleum activities. NOK 10 million was appropriated in 2000 to continue this work. See Proposition no 61 to the Storting and Storting recommendation no 220 (1999-2000).

Substantial costs will be incurred in implementing the measures proposed in this proposition. The largest item of expenditure will be fees to the coordinators for the Statoil privatisation. These costs must seen in relation to the revenues generated by the proposals.

Generally speaking, such contracts with coordinators contain an incentive element: their commission, and thereby the cost of the stock market listing, will depend on the proceeds secured from the sales transaction.

Costs will also be incurred for other advisers: legal, financial, marketing and so forth.

It is not possible at present to specify figures for costs and revenues. Part of the costs will be met by Statoil. This will be regulated by a separate agreement between the Ministry and Statoil.

The government will present a proposition to the Storting on the budgetary consequences of the measures once the expenditures and revenues have been clarified in more detail. The government aims to do this early next year.

The Ministry of Petroleum and Energy

recommends:

That Your Majesty approves and signs a proposal laid before you for a proposition to the Storting on the ownership of Statoil and the future management of the SDFI.

We HARALD, King of Norway,

confirm:

The Storting will be requested to decide on the ownership of Statoil and the future management of the SDFI in accordance with an attached proposal.

Proposal for a decision on ownership of Statoil and the future management of the SDFI

The Storting consents to the Ministry of Petroleum and Energy being authorised to:

1. sell SDFI assets corresponding to 20 per cent of the value of the SDFI to Den norske stats oljeselskap a.s, Norsk Hydro and others,
2. take payment from Den norske stats oljeselskap a.s partly in cash and partly by incorporating possible SDFI assets in the company as an equity contribution, and to adopt a final position on the most appropriate form of payment on the basis of the most suitable capital structure for the oil company,
3. swap SDFI assets between the state and Den norske stats oljeselskap a.s in order to reduce the state’s holding in Europipe II and selected fields, increase its holding in Norpipe and Statpipe, and give it an interest in the crude oil terminal at Mongstad,
4. bring new owners into Den norske stats oljeselskap, subject to the requirement that the state retains at least two-thirds of the shares in the company. New owners corresponding to 10-25 per cent of the company’s value will initially be brought in by issuing new shares and by selling part of the state’s shareholding,
5. establish a new state-owned limited company to exercise the caretaker function for the SDFI,
6. establish a new state-owned limited company for natural gas transport.

Propositions will be presented to the Storting with the necessary legal amendments and appropriations to implement the measures listed above.

List of appendices

Appendix no 1: Further development of Statoil and the SDFI — report from the Statoil board of 13 August 1999.

Appendix no 2: Caretaker arrangement for the SDFI — letter from Statoil of 1 September 1999.

Appendix no 3: Norsk Hydro's assessment of state involvement in the oil sector — letter from Norsk Hydro of 1 September 1999.

Appendix no 4: Statement from the international oil industry on the future disposition of the state's direct financial interest in production licences — letter from the Norwegian Oil Industry Association and the Norwegian Oil Licensees Association of 10 November 1999.

Appendix no 5: The state's direct financial interest (SDFI) and public/private ownership in the oil sector — letter from the Confederation of Norwegian Business and Industry (NHO) of 29 March 2000.

Appendix no 6: Report on the structure of the state's oil and gas interests — submission to the Norwegian Ministry of Petroleum and Energy from UBS Warburg of 8 December 2000.

Appendix no 7: Summary and recommendations to the Ministry of Petroleum and Energy concerning state involvement in petroleum activities — report from Pareto Securities ASA of 30 November 2000.

Appendix no 8: State involvement in petroleum activities — legal assessments — report from Thommessen Krefting Greve Lund and Arntzen Underland & Co of 5 December 2000.

Appendix no 9: Management model for the SDFI after the privatisation of Statoil — memo from Prof Erling Selvig of 22 November 2000.

Appendix no 10: Operator company for natural gas infrastructure — report from Arntzen, Underland & Co ANS of 5 December 2000.

Appendix no 11: Statoil's plan for its operations (article 10 plan) 1999.