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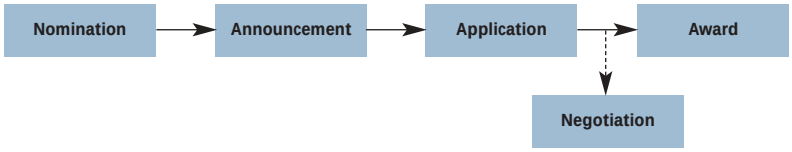

Figure 3.1 Licensing round.

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Regulatory framework

The regulatory framework for the petroleum industry refers to the conditions and requirements governing licensees when pursuing petroleum operations. This framework is established by the Storting and government, and enshrined in statutes, regulations and agreements. Parts of the framework will be same as the regulatory regime which applies to land-based industry. The following chapter reviews the main features of the framework specified for the petroleum industry.

Main features of the licensing system

Act no 72 of 29 November 1996 pertaining to petroleum activities (the Petroleum Act) provides the overall legal basis for the licensing system which regulates petroleum operations in Norway. Regulations under the Act were issued by Royal Decree of 27 June 1997. The Act and its regulations authorise the grant of permits and licences to explore for, produce and transport petroleum and so forth.

Legal authority to tax this business is conferred by Act no 35 of 13 June 1975 relating to taxation of subsea petroleum deposits (the Petroleum Taxation Act).

The Norwegian offshore licensing system comprises a number of documents which go into more detail on the rights and duties of the various parties in addition to those specified in the Petroleum Act with associated regulations. These documents are briefly outlined below.

It was resolved on 5 April 1995 to incorporate directive 94/22/EC from the European Parliament and Council of Ministers on granting and using licences to explore for and produce hydrocarbons (the licensing directive) into the European Economic Area (EEA) agreement. This decision came into effect on 1 September 1995, which means that the licensing directive applied to Norway as a member of the EEA from the same date. The Norwegian licensing system complies with the requirements of the directive.

The decision to incorporate directive 98/30/EC from the European Parliament and Council of Ministers (the gas directive) into the EEA agreement was taken on 26 October 2001 and came into effect for Norway on 1 August 2002. This directive's provisions on upstream activities are incorporated in the Petroleum Act and the associated regulations

Section 1-1 of the Petroleum Act specifies that the proprietary right to subsea petroleum deposits on the NCS is vested in the state.

Under section 2-1 of the Act, a company can apply for a reconnaissance licence to make geological, petrophysical, geophysical, geochemical and geotechnical surveys, including shallow drilling. This licence grants no exclusive rights in the areas covered and does not entitle the holder to conduct regular exploration drilling.

Before a production licence which permits drilling and production can be awarded, the area in question must have been opened for exploration (section 3-1 of the Act). In that connection, an impact assessment covering such aspects as the environmental, economic and social effects of

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such operations on other industries and adjacent regions must be carried out.

Production licences are normally awarded through licensing rounds. The government invites applications for a certain number of blocks (section 3-5 of the Act). Companies can apply individually or in groups.

Production licences are awarded on the basis of objective, non-discriminatory and published criteria.

The announcement specifies the terms and criteria on which awards will be based. On the basis of applications received, the MPE puts together a group of companies for each licence or can make adjustments to a group which has submitted a joint application. The MPE appoints an operator for this partnership (section 3-7 of the Act), who is responsible for the daily conduct of operations in accordance with the terms of the licence.

From the award of the licence covering the Statfjord field in 1973 to the 13th licensing round in 1991, state participation was a minimum of 50 per cent in each licence. The state's average direct financial participation has declined from the 13th to the 16th round.

The Storting added a new chapter 11 to the Petroleum Act in the spring of 2001, which specifies the main features of the management system for the SDFI. As a result, Petoro AS was established as a wholly state-owned limited company to manage the SDFI. It serves as the licensee for the SDFI in relevant production licences, pipelines and plants. The SDFI's assets belong to the state. Petoro's organisation, responsibilities and principal duties are described in Proposition no 36 (2000-2001) to the Storting, Recommendation no 198 (2000-2001) to the Storting, Proposition no 48 to (2000-2001) to the Odelsting and Recommendation no 70 (2000-2001) to the Odelsting.

See also chapter 2 on the state organisation of petroleum operations.

Key documents and legal provisions in the licensing system

Production licence

The production licence regulates the rights and duties of licensees in relation to the state. This document supplements the provisions of the Petroleum Act and specifies detailed terms for each licence. A production licence entails an exclusive right to explore for and produce petroleum within its specified geographical area (section 3-3 of the Act). Ownership of the petroleum produced rests with the licensees.

Each licence is awarded for an initial exploration period, which can last up to 10 years (section 3-9 of the Act). A specified work obligation must be met during this period, including seismic surveying and/or exploration drilling and so forth (section 3-8 of the Act).

Providing the work obligation has been completed by the end of the period, the licensees are generally entitled to retain up to half the acreage covered by the licence for a specified period, generally 30 years.

An area fee is charged per square kilometre, as specified in detailed regulations (section 4-9 of the Act). Providing all the licensees agree, a

licence can be relinquished once the work obligation has been fulfilled (section 3-15 of the Act).

Joint operating agreement

Section 3-3 of the Act makes the award of a production licence conditional on all the licensees concluding a joint operating agreement. Similar in many respects to company agreements made under civil law, this joint operating agreement regulates relations between the partners.

It forms the basis for day-to-day organisation and operation of the licence and for allocating any earnings, and requires the licensees to establish a management committee as their ultimate decision-making body. All licensees are represented on this committee. The agreement also regulates the operator's duties and obligations on behalf of the partnership, and specifies the group's voting rules.

Accounting agreement

As a condition of an award, the licensees are also required to conclude an accounting agreement with detailed provisions on the accounting and financial aspects of the partnership.

Offer letter

Before awarding production licences, the MPE will recommend to the government that specified companies receive interests in the acreage being offered. An offer letter is sent to each company with details of the interests being offered and of possible operatorships. It also specifies the terms which will apply to the licence on offer, and is accordingly regarded as a key document in the award process.

Various agreements

If a discovery extends across more than one production licence, the licensees are obliged to conclude a unitisation agreement which ensures appropriate utilisation of these resources (section 4-7 of the Act) and regulates rights to the discovery.

Interests in a unitised field are normally allocated in line with the way resources in the discovery divide between the production licences concerned. Licensee interests in a unitised field will thereby differ from their holdings in the separate production licences covering the field. A unitisation agreement requires the MPE's approval.

A licensee can also conclude a pass-through agreement with its foreign parent company which transfers rights and obligations in a licence to the Norwegian branch of the parent (section 10-5 of the Act). Such agreements require the consent of the MPE.

Other key legal provisions

Section 4-2 of the Act requires licensees to submit a plan for development and operation (PDO) to the MPE for approval before they can start developing a petroleum deposit.

Under section 4-3 of the Act, the MPE is also authorised to approve plans for installation and operation (PIO) of facilities for transport and utilisation of petroleum.

Section 4-8 of the Act requires the MPE to approve any use of such installations by others. To the extent that this relates to the most important pipelines for landing gas (the upstream gas transport network), however, section 4-8 of the Act

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specifies that natural gas companies and qualified customer have the right of access to these facilities.

At 1 January 2003, the most important pipelines for landing gas were integrated in a unified transport system (Gassled). A new chapter 9 in the petroleum regulations came into force at the same date. This establishes new rules about access to gas pipelines on the NCS. Where Gassled is concerned, the regulations specify that Gassco – established as a wholly state-owned limited company in May 2001 – as operator for Gassled will not only be responsible for operating the system but also for ensuring that the regulations concerning access to Gassled are observed. Tariffs in Gassled are governed by a special regulation issued by the MPE, which came into effect on 1 January 2003.

Under section 4-10 of the Act, the Crown decides where and how petroleum is to be brought ashore.

The Petroleum Act's section 5-1 also requires licensees, as a general rule, to submit a cessation plan two-five years before a licence expires or is relinquished, or the use of a facility is terminated. The MPE will then decide on the disposal of these facilities (section 5-3 of the Act).

Impact assessments

Norway's Petroleum Act calls for environmental impact assessments to be carried out as part of the input for decision-making at several stages in petroleum operations (see above). Such studies are required before an area is opened to exploration, in connection with field and transport system developments, and when disposing of abandoned installations.

The MPE is responsible for ensuring that environmental impact assessments are performed before an area is opened for the award of exploration licences. Because the issue of opening new areas ranks as very important in terms of an overall social evaluation and for local interests, it calls for comprehensive and detailed consideration. An impact assessment is intended to clarify the environmental consequences of petroleum operations and possible pollution threats as well as the economic and social effects which could follow from the exploitation of petroleum reserves in the area.

On the basis of such an assessment, the Storting undertakes an overall assessment of the advantages and disadvantages of pursuing petroleum operations in an area. Exploration will not be permitted where the disadvantages are greatest. Both Storting and government can also impose special conditions on an area, such as prohibiting drilling in certain periods.

An environmental impact assessment must have been carried out when an operator seeks official approval of development plans (PDO/PIO) for field installations, transport or landfall pipelines and other petroleum facilities. This assessment must include a description of the environmental effect of expected emissions from the project, and must review the cost-benefit of alternative measures for reducing this impact.

The assessment is circulated widely for comment to ensure that all consequences of a project

are identified as fully as possible. Measures to be implemented are determined as part of the final approval of a project by the Storting or the government.

Before a licence expires or an installation is abandoned, the licensees must submit a decommissioning plan. This has to be accompanied by an impact assessment covering relevant methods for disposing of the installations concerned. The authorities will consider the plan before reaching an abandonment decision.

Tax and royalty system

Petroleum taxation builds on the Norwegian rules for ordinary corporation tax, which is charged at 28 per cent both on land and offshore. Owing to the extraordinary profitability of petroleum production, a special tax of 50 per cent is also levied on this industry.

When calculating taxable income for both ordinary and special tax, investment is subject to depreciation on a straight-line basis over six years from the date it was made. Companies can also deduct their net financial costs allocated between land and offshore operations on the basis of the taxable assets held on land and offshore respectively. An uplift of five per cent of investment is deductible from the income base for determining special tax over a six-year period from the date of the investment.

The most important duties levied on petroleum operations are royalty on oil production, the area fee and the carbon dioxide tax.

Royalty is being phased out, and is paid today by two fields, Gullfaks and Oseberg.

All production licences must pay the area fee after the exploration period has expired. The annual fee for most licences increases from NOK 7 000 to a maximum of NOK 70 000 per square kilometre over the subsequent decade. If companies renounce the right of pre-emption in the production licence, they can apply for a 40 per cent reduction in the area fee. Special rules apply for the oldest licences, and for licences in the Barents Sea.

Carbon tax is levied at a rate per scm of gas burnt or directly released and per litre of oil burnt. The rate for 2003 is NOK 0.75 per litre of oil/scm of gas.

SDFI

The SDFI was established in 1985 by dividing Statoil's holding in most Norwegian offshore licences into an equity share for the company and a direct interest for the state. An SDFI interest is incorporated in most licences awarded after 1985. As a result, the state now has a direct interest in most petroleum fields and transport systems on the NCS. In connection with Statoil's partial privatisation, the government sold SDFI assets corresponding to 15 per cent of the portfolio's value to the company. A further 6.5 per cent was sold to other companies on the NCS in the spring of 2002.

Under the SDFI arrangement, the state pays a share of all investment and operating costs in a project corresponding to its direct interest. It also receives a corresponding proportion of produc-

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tion and other revenues on the same terms as other licensees. Petoro manages the SDFI portfolio on behalf of the government.

Norm price

The Act of 13 June 1975 on taxation of subsea petroleum deposits (the Petroleum Taxation Act) provides the legal basis for an administrative determination of petroleum prices – the norm price – for the purpose of calculating tax and royalty payments.

Authorisation to determine such norm prices for calculating royalty is provided by section 4-9, subsection 6 of the Petroleum Act. The norm price regulations of 25 June 1976, with subsequent amendments, specify guidelines for determining these prices, and are framed to have general validity for these three areas of application. For tax purposes, the norm price is applied to all petroleum transactions, whether traded between independent parties or transferred internally.

Authority to set provisional and final norm prices - and to decide whether such prices should not be determined for specified production areas - has been delegated to the Petroleum Price Board. The latter fixes norm prices in arrears - normally for each quarter. In recent years, with frequent oil price changes, the board has fixed monthly norm prices for crude oil.

The norm price must correspond to the price at which petroleum could have been traded between independent parties in a free market. «Independent parties» are defined as buyers and sellers with no common interests which might influence the price agreed. The norm price is fixed on a discretionary basis after an overall evaluation of market conditions, taking several types of transactions, reference markets and methods of evaluation into account.

Norway's norm price regulations are framed to cover all types of petroleum produced on the NCS. Contractual prices provide the basis of calculating liability to tax and royalty for dry gas, however, because markets for this commodity differ from the crude oil market.

The Petroleum Price Board has not set norm prices so far for NGL (ethane, propane, butanes and condensate). When no norm price is fixed, prices actually obtained provide the basis for calculating tax liability.

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