

On the Petroleum Activity

Unofficial translation from Norwegian

1 Main goals and actions to realise the long-term scenario

1.1 Main challenges

The oil and gas industry is Norway's largest and most important industry. Since the start-up of the activities on the Norwegian Continental Shelf, the industry has been characterised by growth and increased production. The situation today is different; the oil production decreases every year and few discoveries are ready for development. At the same time, there are large resources on the Norwegian Continental Shelf which remain to be proven. It is a central challenge to secure profitable exploration activity in order to prove these resources. On existing fields, it is important to recover the largest possible share of the economic resources in place.

The government's goal is to provide for profitable production of oil and gas in the long term. The parliamentary debate on the previous Report to the Storting on the Oil and Gas Activities (Report no. 38 to the Storting (2001-2002)) gained widespread support to work for realisation of the long-term scenario of the petroleum industry. The realisation of the long-term scenario requires i.a. that all profitable petroleum resources on the continental shelf are produced. This is an ambitious goal which will result in oil production from the Norwegian Continental Shelf for more than 50 years and gas production in a longer perspective.

The long-term scenario is based on the Norwegian Petroleum Directorate's estimate for recoverable petroleum resources on the Norwegian Continental Shelf, cf. chapter 3.1. The remaining petroleum resources include proven resources and expected, undiscovered resources. The long-term scenario represents a production path of these resources.

Proven resources decided for development are characterised by the fact that the main part of the investments related to the development of the resources already is, or will be, implemented in the near future.

Proven resources which are not decided for development consist of resources in concrete fields and resources in discoveries. There can be several reasons why these resources are not decided for development, for instance uncertainty concerning the resource potential and availability of infrastructure or missing technological solutions. Hence, there will be uncertainty as to the extent of the resources and, not least, the timing of decisions about development and production.

Estimates for the undiscovered resources are based on geological assessments of the resource potential in different regions. Major uncertainty is associated with this estimate and with respect to when the resources will be discovered and produced.

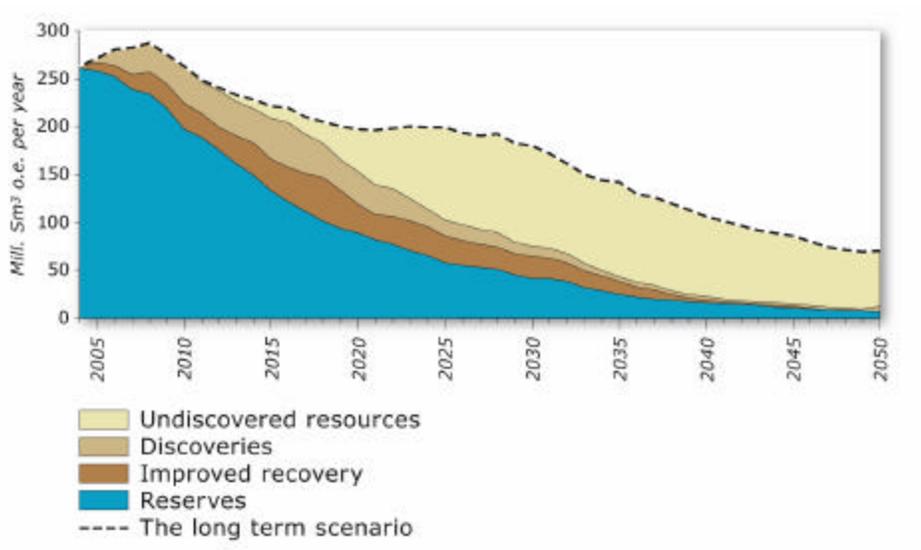


Fig. 1.1 The long-term scenario

Source: The Ministry of Petroleum and Energy / The Norwegian Petroleum Directorate

The future production development which forms the basis of the long-term scenario, is based on expectations of market development, information from the operator companies and estimates from the Norwegian Petroleum Directorate. The expected production presumes that the authorities and the industry are able to implement the necessary actions in order to achieve profitable development of the resources on the Norwegian Continental Shelf.

If the long-term scenario is not realised, major values are at stake. A large number of jobs will disappear and valuable skill may be lost. At the same time, the potential is large if we succeed.

Measures must be adapted to the changed reality and no single action alone can solve the challenges. A broad set of actions is necessary. Action must be taken within area management, the number and types of companies, cost reductions, efficient regulation and research and development. The actions must be effective both in the short and long term, and they must remedy the situation in different parts of the industry; existing and new oil companies, small and large suppliers.

The industry has been given access to new acreage. For instance, large areas in the Barents Sea are again made available to the oil industry. Requirements to ensure a more speedy exploration in awarded areas have been introduced. The large oil companies' interest and willingness to invest in Norway is very important for the future development of the Norwegian Continental Shelf. New awards of production licences will only influence the activity level in a few years at the earliest. It takes time from award until possible discoveries are developed.

New, smaller players will be an important supplement to present players. Therefore, more work is being done to market the Norwegian Continental Shelf to new qualified oil companies which can contribute to value creation.

The cost-level on the Norwegian Continental Shelf is very high. This contributes to too low exploration activity and insufficient efforts for increased recovery. The costs must be reduced to make activities more profitable. The main responsibility for this demanding task rests with the various parties of the industry.

The responsibility of the authorities is to establish framework conditions that promote cost effective activities. When it comes to Government regulations, it is important to maintain our strict requirements relating to environment and health, safety and work environment (HSE). At the same time, it has become even more important to make sure that the strict requirements are met in a cost effective manner, i.e. obtain the greatest possible benefit from the resources invested to safeguard HSE and environmental concerns.

Research and development is essential in order to reduce costs of exploration, development and operation as well as to increase the rate of recovery. The industry's importance to Norway and the state's share of the revenues from the petroleum activities, necessitate increased public contribution. The public grant for petroleum research is at a low level, but has had a continuous increase over the last years. It is important to continue this progress.

The main challenges to reach the long-term scenario are:

- *to increase recovery from existing fields*
- *to increase exploration activity*
- *to reduce the cost level on the Norwegian Continental Shelf*
- *to further develop the competence of the Norwegian Petroleum Industry Cluster*

while maintaining a high standard relating to safeguarding the environment and HSE. In preparing this Report, the Ministry of Petroleum and Energy has made the basic assumption that maintenance and further development of a secure level of health, environment and safety in the petroleum industry, is essential assumptions for a continued sustainable development of the petroleum industry. Moreover, a satisfactory safety level is an essential precondition for petroleum activities in environmentally vulnerable areas. Therefore, the Government wants the petroleum industry to be leading in the HSE-area.

A summary of the Government's actions to meet the challenges related to the realisation of the long-term scenario is given in chapter 1.2.

1.2 The Government's actions to realise the long-term scenario

This chapter gives an overall summary of the Government's actions to realise the long-term scenario. The actions are given comprehensive coverage in chapter 3.

A flexible and efficient exploration policy

It is necessary to discover new resources to realise the Government's goal of a long-term scenario for the petroleum activities on the Norwegian Continental Shelf. As the continental

shelf is maturing, new challenges arise as regards to the exploration and licensing policy. Therefore, it is important that this policy is flexible enough to adapt to the new challenges at all times. It is equally important that the Government through its exploration and licensing policy, gives the industry access to the right areas on the continental shelf at the right time.

Therefore, the Government will:

- Conduct annual licensing rounds which include all of the mature area on the Norwegian Continental Shelf, as well as conducting licensing rounds in frontier areas with a comprehensiveness and a frequency that satisfy the need for resource growth.
- Secure rapid and efficient exploration for and exploitation of the petroleum resources in awarded areas through active use of work obligations and the area fee.
- Inform new competent players about the opportunities on the Norwegian Continental Shelf.
- Make sure that the high level of ambition with regard to the environment is maintained as well as securing a continued positive co-existence with the fishing industry.
- Re-open the Barents Sea South for all-year petroleum activity, except for the areas near the coast and the especially valuable areas: the Bear Island, Tromsøflaket, the ice edge and the polar front. In connection with the re-opening of the Barents Sea, the following will be implemented:
 - the oil spill contingency and the work to reduce the risk related to export of petroleum by ship in the Lofoten / Barents Sea area should be strengthened
 - a committee to evaluate compensation arrangements for the fishing and fish-farming industry in the case of major oil spills from Norwegian petroleum industry in the Lofoten-Barents Sea area will be appointed
 - programmes will be implemented to fill the knowledge gap related to the petroleum activities in the Lofoten-Barents Sea area
 - measures will be taken to secure that the petroleum activities in the Lofoten-Barents Sea area are conducted so as to contribute to the value creation and employment in onshore activities in the region

Making the most of the large values in mature fields

Mature fields on the Norwegian Continental Shelf are characterised by declining production and high operating costs. This leads to increased cost per unit produced. The unit cost is important for the timing of the shut-down of a field. There are significant remaining resources in mature fields. Furthermore, it is assumed that about half of the undiscovered resources on the Norwegian Continental Shelf are in mature areas. In addition, the infrastructure in mature fields has a limited lifetime. Consequently, if actions are not taken soon to reduce operating costs, increase the recovery factor and produce additional resources in nearby fields, major values will remain in the ground and jobs will be lost.

Therefore, the Government will:

- In co-operation with industry, see to that they implement the necessary measures in mature fields in order to create value through more efficient operation and increased production
- Seek to adjust activities at the onshore supply facilities to changes that take place at the production facilities/installations they serve. License requirements must be respected, but changes in the kind of work and functions that are carried out at the individual supply facility or operation organisation must be opened up for.
- Complete the frame agreement between Norway and United Kingdom and work to simplify procedures for development of small petroleum resources which straddle the delimitation line between the two countries.

Reduce the high cost level in the petroleum industry

The cost level is essential for the profitability of the resource base on the Norwegian Continental Shelf. The high cost level influence the exploration and development in a negative way. In order to maintain the Norwegian Continental Shelf as an attractive area for new investments, it is essential to control the cost level.

Therefore, the Government will:

- Support the efforts of the industry to reduce the costs on the continental shelf.
- Review the regulation of the petroleum industry.

More effective use of infrastructure

A mature continental shelf implies, inter alia, an increasing degree of spare capacity in existing infrastructure. It is important to make use of such capacity, inter alia by the owners of infrastructure opening for increased third party use. Reasonable terms for third party use will ensure that new and established players have incentives to explore for smaller resources which can be processed on existing installations. In order to secure new activity through the development of smaller resources close to existing infrastructure, it is important to find good transport solutions and to secure good arrangements for third party access to infrastructure.

Therefore, the Government will:

- Consider changes in the framework for use of existing offshore installations.
- Follow the industry's work to secure sufficient gas transport capacity via Gassco's annual transport plan and follow up the study which is carried out to develop gas transport capacity from Halten/Nordland.
- Work to maintain the competitiveness of Norwegian facilities for processing and export of rich gas.

Increased efforts in research and new technology

Research and development is important in order to reduce costs, increase recovery and secure sound environmental solutions. In addition to its contribution to increased profitable

production from Norwegian Continental Shelf, research and technology development is necessary in order to maintain a competitive oil and gas industry in Norway.

Therefore, the Government will:

- Contribute to strengthened efforts in research through the PETROMAKS programme under the Research Council of Norway.
- Stimulate increased co-operation for technology development across production licences on the Norwegian Continental Shelf.
- In order to strengthen the public financing of the petroleum research, the Government proposes to increase the capital of the Fund for Research and Innovation by NOK 1bn from 1 July, 2004. The increased earnings should be used for long-term, basic research towards the petroleum industry.

Strengthen the petroleum cluster

The Norwegian petroleum cluster is characterised by strong competence environments in both oil companies, the supply industry, research environments, shipping as well as within the bank and finance sectors. In order to secure a long-term profitable development of the resources on the Norwegian Continental Shelf, it is essential that we maintain a strong competence environment within this industry in Norway. To this effect, it is important that the industry maintain the ability to recruit a competent work force. This requires that the industry at all times has a positive reputation in the Norwegian society at all times. The industry must be internationally competitive. This will form the basis for long-term employment and value added, independent of the activity on the Norwegian Continental Shelf.

Therefore, the Government will:

- Co-operate with the industry and different competence environments to secure long-term profitable development of the petroleum resources.
- Support the internationalisation of the Norwegian petroleum industry, including further development of the Intsok and Petrad foundations, as well as work towards obtaining equal international market conditions for the industry.

Adjustments in the petroleum tax system

The oil industry has, under the direction of KonKraft, prepared the report "Proposals for tax amendments to stimulate greater activity and value added". The proposals contained in the report are as follows; (a) a lower special tax rate for new fields and (b) implementation of a volume allowance for increased production from existing fields. The Government has evaluated the oil industry's proposal; cf. the Revised National Budget for 2004.

In the Revised National Budget for 2004 the Government proposes some adjustments to the petroleum tax system. The adjustments will result in increased predictability for new companies, improved profitability of investments inter alia in tail-end production and increased recovery and simplified trade of licences.

The proposals include:

- The uplift will be accelerated to 7.5 per cent over 4 years.
- The Government will reimburse the tax value of exploration deficits in connection with the tax assessment.
- The Government will reimburse the tax value of deficits at termination of activity.
- Simplification of the tax treatment in connection with transfer of licences.
- Changes in the tax rules for depreciation of investments with a shorter economic life than six years.
- Larger flexibility in contracts between oil companies and contractors (so-called incentive contracts).