SMALL TEAMS FOR BIG MATTERS
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REGULATORY FRAMEWORK FOR PETROLEUM ACTIVITIES ON THE NORWEGIAN CONTINENTAL SHELF

The Norwegian Petroleum Act of 1996 (the Petroleum Act) sets out the main regulatory framework for petroleum activities on the Norwegian Continental Shelf (the NCS). The Petroleum Act implements a system where all petroleum deposits on the NCS belong to the Norwegian State. Governmental approvals are required in all phases of petroleum activities, from the award of exploration and production licenses, gathering of seismic data and exploration drilling, to development, operation and decommissioning of oil installations. Revenue to the Norwegian State from the oil and gas activities is secured by taxation, direct participation by the Norwegian State in the production licenses (managed by Petoro), and through ownership in Statoil.

The Petroleum Act is supplemented by certain other legislation specifically relating to petroleum activities, such as the Petroleum Tax Act of 1975. In addition, there is a significant volume of secondary regulations concerning different aspects for petroleum activities. To some extent there are also special regulations and qualifications when general Norwegian laws and regulations are applied on the Norwegian Continental Shelf.

The main regulatory body is the Ministry of Petroleum and Energy, which has authority over most parts of the Petroleum Act including ownership regulations and licensing rounds. Some of these functions are delegated to the Petroleum Directorate. Major development projects and issues of fundamental importance must be approved by the Norwegian Parliament. The Ministry of Finance has authority for petroleum tax issues. The Ministry of Labour and Social Affairs and the Petroleum Safety Authority are responsible for safety and HSE matters.

According to the Petroleum Act, the intention is that the petroleum resources are managed in a long-term perspective for the benefit of the Norwegian society as a whole. In this regard the resource management shall provide revenues to the country and shall contribute to ensuring welfare, employment and an improved environment, as well as contributing to the strengthening of Norwegian trade and industry and industrial development, while at the same time taking due regard to regional and local policy considerations and other activities.

PETROLEUM ACTIVITY REQUIRES A PRODUCTION LICENSE

Companies wishing to engage in petroleum activities on the NCS must hold a production license. A production license gives a right to carry out petroleum activities within a defined geographical area.

Production licenses are only awarded to Norwegian limited liability companies that are either existing license holders or that demonstrate that they are qualified to hold such licenses. For new entrants a system of pre-qualification has been implemented. The general policy is that petroleum activities must be carried out by entities that are able to contribute to the Norwegian petroleum industry beyond just financial participation, and that the activities are carried out in an efficient, competent and responsible manner. Therefore, license awards and prequalification requires that the company can demonstrate sufficient technical, financial and HSE resources. The prequalification procedure for new entrants typically takes up to half a year. Guidelines for pre-qualification are found on the web page of the Petroleum Directorate.

LICENSING ROUNDS

New production licenses are awarded through two different kinds of licensing rounds. There is a system of numbered ordinary licensing rounds, which are normally held every second year. These rounds focus on frontier areas on the NCS. The deadline for applications to the 24th licensing round was 30 November 2017, with awards expected in the second quarter of 2018. In addition, there is an annual system of Awards in Predefined Areas (APA) that focuses on mature areas of the NCS. The APA system ensures that areas close to existing and planned infrastructure are available to the industry.

The Ministry of Petroleum and Energy awards production licenses based on the applications submitted. Relevant,
objective, non-discriminatory and announced criteria form the basis for these awards. Applicants can apply individually or as a group.

It is the policy of the Ministry of Petroleum and Energy that there should always be more than one company participating in each license. New production licenses are therefore awarded to a group of companies, that each will hold a participating interest in the license. The license grants the participants exclusive rights to carry out surveys, exploration drilling and production of petroleum within the geographical area covered by the license. The licensees become the owners of petroleum that is produced.

A production license is valid for an initial period (exploration period) that can last for up to ten years. During this period, a work programme must be carried out in the form of e.g. geological/geophysical preliminary work and/or exploration drilling. If all the licensees agree, the production license can be relinquished when the work programme has been fulfilled. If the licensees wish to continue to hold the license, the license will enter the extension period, which is the period for development and operation.

**JOINT OPERATING AGREEMENTS**

The license participants form a joint venture that is responsible for the petroleum activities within the license area. The license group will enter into a Joint Operating Agreement (JOA) which regulates the rights and obligations for the joint venture within the specific license. The JOA’s are based on a standard format that the Ministry requires all new licenses to use.

The Ministry nominates one of the participants in the license as the operator. The operator is responsible for the operational activities authorised by the license. The operator carries out this function on a no gain no loss basis. Major decisions are made by the management committee where all licensees are represented, and have voting rights according to the specific voting rules set out in the license terms. The participants in the license have joint and several liability for the obligations and liabilities arising out of the license.

**PARENT COMPANY GUARANTEES**

The Petroleum Act section 10-7 gives the Ministry of Petroleum and Energy the right, at any time, to demand security from licensees on the NCS. The authority pursuant to section 10-7 is quite wide with regard to timing and the nature of the security that can be required. However, in practice the Ministry of Petroleum and Energy requires licensees to post an unlimited parent company guarantee for the benefit of the Norwegian State to secure all obligations in relation to the petroleum activities. The format and wording of the parent company guarantee follows a standard template.

The main policy is that the parent company guarantee is posted by the ultimate parent company of the licensee. A company is considered a parent company if the company, directly or indirectly, owns more than 50 per cent of the capital and voting shares in the licensee. However, there are some examples where the parent company guarantee has been issued by entities within a group that is not the ultimate parent company.

There have so far not been instances where the guarantee has been used in practice, and there are several questions of interpretation that remain uncertain. For instance, it is debated whether other participants in a license can draw on the guarantee if another partner in the license defaults on its obligations.

In November 2017, Oslo District Court rendered its judgement in a case where the question was whether or not the guarantee covers tax claims against the licensee. The tax authorities had made a claim against a former licensee that was unable to pay. The tax office therefore filed a claim against the parent company under the parent company guarantee. The court found that the parent company guarantee did not cover tax claims, as this was only indirectly a part of the petroleum activities. The judgement has been appealed.

**PLANS FOR DEVELOPMENT AND OPERATION (PDO)**

If the licensees decide that a discovery is economically recoverable and wish to develop the field for production,
the license must submit a Plan for Development and Operation (PDO) to the Ministry of Petroleum and Energy for approval. An important part of the PDO is an impact assessment which is submitted for consultation to various parties that could be affected by the plan. The impact assessment shows how the development is expected to impact the environment, fisheries, and society in general. The processing of this assessment and the PDO itself aims to ensure that the projects are prudent in terms of resource management, and that the consequences for other general public interests are acceptable.

THE OPERATIONAL PHASE

During the operational phase the license is obliged to follow applicable laws and regulations, with the aim of achieving safe and efficient production of petroleum deposits. Each license holder will become the owner of its share of the produced petroleum, and will enter into separate sales and transportation agreements. Significant changes to the production plan, and significant new investments, will require regulatory approval.

DECOMMISSIONING

As a main rule, the Petroleum Act requires licensees to submit a decommissioning plan to the Ministry of Petroleum and Energy two to five years before the licence expires or is relinquished, or before the use of a facility ceases. The cessation plan must have two main parts; an impact assessment and a disposal plan. The impact assessment provides an overview of the expected consequences of the disposal for the environment and other factors. The disposal plan must include proposals for how cessation of petroleum activities on a field can be accomplished.

The Petroleum Act does not contain detailed regulation about how the disposal shall be carried out. However, the main rule is that all wells shall be plugged and abandoned, and the facilities shall be removed. Norway is a party to the OSPAR convention (Oslo Paris Convention for the protection of the marine environment of the North-East Atlantic), and in practice the Ministry of Petroleum of Energy will require that the disposal plan meets the requirements of the OSPAR convention.

It follows from the Petroleum Act that a seller of a participating interest in a production license will remain secondary liable for decommissioning costs. The secondary liability applies to the seller’s share of installations existing at the time of the transaction, and is only a financial obligation to contribute to the license if the buyer of the participating license fails. In order to protect the seller from such liability it is not uncommon to enter into decommissioning security agreements between the buyer and the seller, depending on the financial solidity of the parties and the amount of decommissioning obligations. There is currently no practice or requirement for general decommissioning security arrangements internally between the partners in a license, other than those being entered into in connection with transactions.

THE NORWEGIAN PETROLEUM TAX SYSTEM

For companies participating in production and transportation of petroleum products on the NCS, there are two, partially overlapping income tax regimes: ordinary income tax imposed by the general rules in the Norwegian General Tax Act of 1999 (the GTA) and the special petroleum tax on income imposed by the Petroleum Tax Act (the PTA) due to the extraordinary profit associated with recovering the petroleum resources. As a result, the total marginal income tax rate for companies engaged in E&P activities on the NCS is 78 per cent, consisting of a 23 per cent general income tax and a 55 per cent special petroleum tax to the State levied on income generated by exploitation, treatment or transportation of petroleum, ref. the PTA section 5. The petroleum tax applies on a corporation net profit level, not on a ring-fenced basis. Losses generated by other activities may as a general rule not be set off against assessed income for special tax (55 per cent) purposes and there are limitations on the right to set of other losses against the general tax base (23 per cent).

For general income tax purposes, depreciation deductions are permitted under a reducing balance system. For petroleum tax purposes depreciaction of production installations and offshore pipelines are permitted under
a straight-line basis at a rate of 16 2/3 per cent annually from the year in which the investments takes place, i.e. a deprecation over 6 years. In addition to the depreciation allowance offered, an extra deduction (uplift) is allowed in the basis for special tax to shield normal return from special tax. An uplift of 5.3 per cent pr. year is thus granted in the special tax basis for a four-year period (form an including the investment year) for investments in production and pipeline facilities. Hence, a licensee on the NCS that is subject to Norwegian taxation will be entitled to tax deductions with regard to exploration and production costs (running expenses, net financial items, deprecations and uplift) and transportation costs (tariff payments). Losses for tax purposes may be carried forward indefinitely. Interest is added for losses incurred in 2002 and subsequent years. The calculated interest is added to loss carry forward at the end of each year.

Companies that are not in a tax position can carry forward deficits and uplift with interest. These rights follow the participating interest and can be transferred. Companies can also apply for a refund of the tax value of exploration expenses in connection with the tax assessment. Also, there is a system of repayment of accumulated tax losses carried forward upon cessation of petroleum activities. In August 2017, the environmental organization Bellona filed a complaint about the Norwegian state to the European Surveillance Authority (ESA). The complaint concerned the up-front cash flow reimbursement of fossil exploration activities, which Bellona deems to be illegal state aid, and thus in breach of Article 61 of the EEA Agreement. As a consequence, ESA has started to look into the legality of Norwegian state subsidies towards oil and gas exploration companies.

Petroleum produced from the NCS is largely sold to affiliated companies. To assess whether the prices set between affiliated companies are comparable to what would have been agreed between two independent parties, norm prices can be stipulated for use when calculating taxable income for the purpose of the tax assessment. The Petroleum Price Council (PPR) sets the norm price. The Council receives information from and meets with companies before setting the final norm price. This system applies to certain grades of crude oil and NGL. For gas, the actual sales price is used as the basis.

**TRANSACTIONS AND CHANGE OF OWNERSHIP**

Participating interests in Norwegian petroleum licenses are transferrable, and there is a market for buying and selling such participating interests.

As a general rule, the participating interests can be sold without the consent of the other license partners, as long as the compulsory work obligation set out in the license has been fulfilled. Prior to fulfilment of the work obligation the management committee of the license must give its consent to an assignment. There are normally no pre-emption rights for the other license partners pursuant to the JOAs, except for in some of the older licenses. The Norwegian State has a right of pre-emption, but so far this has never been used in practice.

Direct transfer of participating interests is subject to approval by the Ministry of Petroleum and Energy pursuant to the Petroleum Act. The same applies for share transactions where the buyer passes thresholds of 1/3, 50 per cent, 2/3 or 100 per cent. Approval by the Ministry of Finance is also required for tax purposes. The main principle is that transactions should be tax natural, so that they do not trigger capital gains taxes but also give no increased basis of tax depreciation or other tax benefits. For corporate transactions, the policy of the Ministry of Petroleum and Energy is to return parent company guarantees if a shareholder ceased to have more than 50 per cent of the shares in the target company.

Transactions can also trigger other regulatory approvals, such as approval from the Ministry of Oil and Energy for change of operatorship or approval to create pledges over the license interests. The Petroleum Safety Authority can also require that new applications are made with regard to HSE related permits of the transaction changes the basis for existing permits. It is a general principle that all petroleum activities within a group are conducted through one single legal entity. Therefore, if an existing company buys the shares of another company, the Ministry of Petroleum and Energy will require that the businesses are merged into one single
legal entity. If the two companies are participants in the same licenses, the Ministry will also require that the voting rules are amended.

If a contemplated transaction leads to a company acquiring 100 per cent ownership in a production license, the Ministry of Petroleum and Energy has in recent transactions set as a requirement for its approval that the acquiring company divests a part of its participating interest in the relevant license. The deadline for selling down varies from up to a year for exploration assets, to having to sell down immediately for some producing assets. Further, the management committee’s leeway will be restricted until the divestment is completed.

REMAINING LIABILITY FOR COMPANIES WISHING TO EXIT THE NCS

Up until late 2017 it was possible to achieve a clean exit from the NCS by selling shares in a subsidiary that holds production licenses. For share transactions there was no secondary liability for decommissioning, since a share transaction does not imply a change of the legal entity holding the production license. It was also the government’s policy to return the parent company guarantee when the shares were sold. Examples of companies previously having achieved a clean exit from the NCS by selling the shares in the subsidiary, includes RWE, E.ON, Marathon, Svenska Petroleum, Premier Oil and BP.

In light of the latest market environment with many of the larger companies looking to sell down in the North Sea, a concern for the government has been whether the new entrants will be able to meet future decommissioning costs. This prompted the government to revisit the policy of granting companies a clean exit, and in November 2016 the Ministry of Petroleum and Energy sent a letter to the companies to address its new approach to such matters. The Ministry stated that for all future share transactions it would consider to impose as a new condition to approve the new owner that the selling shareholder undertakes to issue a new parent company guarantee where the seller remains secondary liable for existing decommissioning obligations.

As of late 2017, the Ministry has implemented this as a requirement for approval of share transactions and has developed a standard template for the new guarantee that the seller must issue. As a result of this approach share transactions and asset transactions are now treated more equally in terms of decommissioning obligations.

Several questions arise relating to this new approach. One question is whether the guarantee requirement only applies to transaction where 100 per cent of the shares are sold, or if it also applies where smaller shareholdings are being transferred. So far, the secondary liability requirement has only been imposed on transactions where 100 per cent of the shares in a company have been sold. Another question is whether a payment under the new guarantee should be calculated as an amount pre- or post-tax. It is also likely that the new approach will raise debate about the tax treatment in general, including the availability of tax refunds upon cessation of petroleum activities and the risk that lower tax rates can increase the post-tax cost of decommissioning for the companies.

ENVIRONMENTAL CONSIDERATIONS

Environmental and climate considerations around the oil and gas industry are increasingly becoming an important political focus. The industry is both facing new regulatory requirements and a need to adapt to public expectations to maintain its political legitimacy and support.

In the political platform for the newly formed conservative Government it is agreed not to open up for petroleum activity, or environmental impact assessments, in the areas outside Lofoten, Vesteålen and Senja until the next general election in 2021. It is also agreed not to initiate petroleum activity at Jan Mayen, the ice front, Skagerak or the Møre fields. The definition of the ice front will be determined in connection with the revision of the management plan for the Barents Sea and the areas outside Lofoten.

On October 18, 2016, the environmental organizations Greenpeace Norden and Natur og Ungdom (Nature & Youth) submitted a writ of summons to the Oslo District Court claiming that the 23rd licensing round was inva-
lid, because the resulting petroleum activities would be contrary to the Paris climate accord and the constitutional obligation to protect the environment. The case was heard between 14 and 22 November 2017, and the Government won the case. However, the case sparked significant public attention and debate.
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OUR SERVICES

BAHR's legal team has vast experience of working closely with a number of major players on the Norwegian continental shelf and follows developments. We have a thorough understanding of the legal framework governing the industry. We advise in large transactions and represent companies in legal disputes. We also assist in connection with major development projects. Furthermore, we have comprehensive experience within the regulatory field including extensive government relations. BAHR also has firm expertise in energy taxation, appeals and litigation of tax disputes. We represent several large oil companies in complex tax disputes before the tax assessment administration and the court.

RECENT CASES WITHIN THE OIL & GAS SECTOR:

- Advising Point Resources in its acquisition of Exxon Mobile’s participating interest in the Balder and Ringhorne fields.
- Advising Aker BP in its acquisition of Hess Norge AS including the participating interests in the Valhall and Hod fields, and the subsequent sale of participating interests in Valhall and Hod to Pandion Energy.
- Advising CapeOmega in connection with investments in Gassled.
- Advising Engie in connection with the sale of its E&P business to Neptune.
- Advising Aker BP in connection with new alliance agreements with key suppliers
- Advising INEOS in connection with the financing of the DONG Energy transaction.
- Advising Statoil, ExxonMobile and Shell in court cases concerning Petroleum Tax
- Advising E&P companies in connection with RBL facilities
- Advising investors in Gassled in litigation against the Norwegian state concerning tariffing