



# **OIL AND GAS IN NORWAY**

## **AN INTRODUCTION**

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## 1. Key facts and recent development

Norway is a small player in the global crude market with production covering about two per cent of the global demand. However, Norway is the second largest exporter of natural gas in the world and Norway supplies about 25 per cent of the EU gas demand. Nearly all oil and gas produced on the Norwegian shelf is exported, and combined, oil and gas equals about half of the total value of Norwegian exports of goods. For this reason, oil and gas represents the most important export commodities for the Norwegian economy. Government income is secured by taxation and direct participation in the petroleum activities.

Since production started in 1971, oil and gas have been produced from a total of 110 fields on the Norwegian Continental Shelf (NCS). At the end of 2019, 87 fields were in production: 66 in the North Sea, 19 in the Norwegian Sea and two in the Barents Sea. Thirteen fields are currently under development. Many of the producing fields are ageing, but some of them still have substantial remaining reserves. Petroleum resources on the NCS have been estimated to 15.6 billion standard cubic metres of oil equivalents. Only 48% of the total discovered and undiscovered petroleum resources have so far been produced and sold.

The exploration activity on the NCS was high in 2019 with a total of 57 exploration wells being drilled - an increase of four compared to 2018. The Petroleum Directorate expects 50 exploration wells to be drilled in 2020. In addition, a record 83 licences were awarded in 2019 under the APA 2018. In the 2019 APA round awarded in January 2020, 28 companies were awarded a total of 69 licenses, consisting of 33 in the North Sea, 23 in the Norwegian Sea and 13 in the Barents Sea.

Plans for Development and Operation (PDO) were delivered to the Ministry of Energy and Petroleum in 2019 for the Tor II and Solveig (formerly Luno II) fields, as well as amended PDO's for the Balder, Ringhorne and Fullfaks fields. In addition to this, the third largest producing oil field in Norway's history (Johan Sverdrup) was officially opened in January 2020.

The Climate Change Act adopted in 2017 introduced a target reduction of greenhouse gas emissions by at least 40% by 2030 from 1990 levels. In January 2020 similar target reductions associated with production of oil and gas on the NCS was made by a sector wide initiative supported by the wider Norwegian oil and gas

industry, setting a target of 40% reduction in greenhouse gas emissions within 2030 compared to 2005 levels and a reduction to near zero in 2050.

In 2019, it was announced that in addition to the Johan Sverdrup, Gina Krog, Ivar Aasen and Edvard Grieg fields, the Gudrun, Sleipner, Utgard, Gungne, Sigyn and Solveig fields shall be connected to on-shore electricity. This is expected to reduce CO<sub>2</sub> emissions with 1.15 million tons.

The Ministry received in 2019 the development plans for the Hywind Tampen floating offshore wind farms. The aim for that particular project is to replace one third of the gas-fired power with renewable wind power. Costs under the project will be considered as petroleum cost and thus 78% deductible under the petroleum tax regime (see section 10 regarding the Petroleum Tax regime).

## 2. The regulatory framework

The Norwegian Petroleum Act of 1996 (the Petroleum Act) sets out the main regulatory framework for petroleum activities on the NCS. The Petroleum Act is based on the principle that all petroleum deposits on the NCS belong to the Norwegian State, and that the State can grant production licenses allowing others to explore for and produce petroleum. Governmental control is further exercised through the requirement of approvals in all phases of petroleum activities, from gathering of seismic data and exploration drilling, to development, operation and decommissioning of oil installations, as well as approval for the transfer of already granted production licenses. The Petroleum Act is supplemented by other legislations specifically relating to petroleum activities, such as the Petroleum Tax Act of 1975, as well as general legislation relevant to petroleum activities such as the Working Environment Act of 2015 and the Pollution and Waste Act of 1981.

In addition, there is a significant volume of secondary regulations concerning different aspects for petroleum activities.

## 3. The main regulatory bodies and State participation in petroleum activities

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 Petroleum Safety Authority is responsible for safety and HSE matters.

The Norwegian State has substantial holdings in production licences on the NCS through the State's Direct Financial Interest (SDFI). The formal licensee for the SDFI assets is Petoro AS, a company wholly owned by the State. In addition, the State participates through its ownership interests in Equinor ASA (formerly Statoil) and Gassco AS. The latter is a company wholly owned by the State that is the operator of the comprehensive gas transportation system on the NCS. The Ministry of Petroleum and Energy is responsible for managing the States direct and indirect participation in the petroleum activities.

#### **4. Petroleum activity requires a production license**

Companies wishing to engage in petroleum activities on the NCS must hold a production license, giving rights to engage in petroleum activities within a defined geographical area.

Production licenses can be awarded to existing oil companies on the NCS, or to new entrants that are prequalified to hold such licenses. 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 Health, Safety and Environment (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.

#### **5. Licensing rounds**

Production licenses are awarded through licensing rounds. There are two different kinds of licensing rounds on the NCS. There is an annual system of Awards in Predefined Areas (APA) in mature parts of the NCS. The APA system ensures that very large areas close to existing and planned infrastructure are available to the industry. In addition to the APA

system, there is a system of ordinary licensing rounds which is normally held every second year. These rounds focus on frontier areas on the shelf that are less explored and with less existing infrastructure built.

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.

New production licenses are awarded to a group of companies, that each will hold a participating interest in the license. The license grants the participants exclusive rights to surveys, exploration drilling and production of petroleum within the geographical area covered by the license. The licensees become the owners of the petroleum that is produced.

Production licenses are valid for an initial period (exploration period) that can last for up to ten years. During this period, a work commitment 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 commitment has been fulfilled. If the licensees want to continue the work in the production licence, the license will enter the extension period, which is the period for development and operation.

The production licenses are registered in the Petroleum Registry which is an official and publically available register that among other records ownership and encumbrances. Production licenses can be mortgaged upon application and approval from the Ministry of Petroleum and Energy.

#### **6. Plans for Development and Operation (PDO)**

If the licensees find that it is commercially viable to develop a field, they are required to carry out prudent development and operation of proven petroleum deposits. This means that the licensees are responsible for the development of new projects, while the authorities grant the final consent to start the process. When a new deposit is to be developed, the company must submit a Plan for Development and Operation (PDO) to the Ministry for approval. An important part of the PDO is an impact assessment which is submitted for consultation to various bodies that could be affected by the specific development. The impact assessment

shows how the development is expected to affect the environment, fisheries, and society in general. The processing of this assessment and the PDO itself ensures that the projects are prudent in terms of resource management, and that the consequences for other general public interests are acceptable. The impact assessment is compulsory unless the licensees can document that the PDO is covered by a relevant existing impact assessment.

The petroleum activities shall be conducted in a prudent manner to ensure that a high level of HSE can be maintained and developed throughout all phases, in line with the continuous technological and organisational development. The licensees are responsible for pollution without regard for fault. This is referred to as strict liability.

### 7. Joint Operating Agreements

The license holders 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 of Petroleum and Energy requires all license holders to use. The Ministry nominates one of the participants in the license as the operator, which will be responsible for the operational activities authorised by the license. Major decisions are made by the management committee where all license holders are represented, and have voting rights according to voting rules set out in the license terms. Normally a decision is made by the management committee when at least two of the participants that jointly represents at least 50% of the participating interest vote in favour of a proposal. The participants in the license have joint and several liability for the obligations and liabilities arising out of the license.

### 8. Licensees are required to provide a Parent Company Guarantee

The Petroleum Act section 10-7 gives the Ministry of Petroleum and Energy the right, at any time, to demand adequate security for holders of production licenses 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 requires licensees to provide an unlimited Parent Company Guarantee (PCG) 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 is based on a standard template. This standard form is non-negotiable and is kept in a brief format. There have so far not been instances where the guarantee has been used in practice, and there are therefore several issues where the interpretation is unclear. 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.

The main policy is that the Ministry will require that the parent company guarantee is provided by the ultimate parent company of the licensee. A company is considered a parent company if the company, directly and/or indirectly, owns or controls more than 50 per cent of the licensee. Thus, a company owning and/or controlling *bona fide* less than 50 per cent will not be required to issue a PCG. There are examples where the parent company guarantee has been issued by entities within a group that is not the ultimate parent company. For corporate transactions, the current policy of the Ministry is to return parent company guarantees if a shareholder ceases to have more than 50 per cent of the shares in the licensee.

In May 2019, the Court of Appeal rendered its judgement in a case where the question was whether or not the guarantee covers tax claims incurred by the licensee. A company had unlawfully received refund for the tax value of its exploration expenses. The company was unable to repay the refund. Thus the State, represented by the tax authorities, filed a claim against the company's parent company, upholding that the latter had to cover the repayment expenses under the parent company guarantee. Contrary to the District Court, the Court of Appeals applied a broad interpretation of the parent company guarantee and held that the parent company guarantee covered the particular claim for unlawfully received tax refund of the exploration expenses. The judgement is disputed and appealed to the Supreme Court.

### 9. Decommissioning liability

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 section. The impact assessment provides an overview of the expected consequences of the disposal for the environment and other factors. The disposal part must include proposals for how cessation of petroleum activities on a field can be accomplished. In addition to the Petroleum Act, the Oslo Paris Convention for the protection of the marine environment of the North-East Atlantic (OSPAR) also governs disposal of facilities. As a general principle under the OSPAR convention, facilities cannot be abandoned on-site.

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. Further, practise has now been established whereby such alternative liability also arises from an indirect sale of production licenses through a corporate transaction by way of issuance of a secondary decommissioning guarantee (imposed on the seller by the Ministry of Petroleum and Energy as part of approval the transaction) - see more on this in section 12 below.

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.

### 10. The Norwegian Petroleum Tax System

The petroleum resources belong to the Norwegian State and the State secures its revenues through taxation, direct participation in the licenses and as a shareholder in Equinor. Norway has no additional production sharing or royalty schemes but imposes fees on emission of CO<sub>2</sub> and NO<sub>x</sub>.

For companies participating in production and pipeline transportation of petroleum on the NCS, there are two, partially overlapping income tax regimes: ordinary income tax imposed by the general rules in the General Tax Act and the special petroleum tax on income

imposed by the Petroleum Tax Act 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 22 per cent general income tax and a 56 per cent special petroleum tax to the State levied on income generated by exploitation, treatment or pipeline transportation of petroleum. 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 to be set off against assessed income for special tax purposes (56 per cent) and there are limitations on the right to set off other losses against the general tax base (22 per cent).

Depreciation of production installations and offshore pipelines are permitted under a straight-line method at a rate of 16 2/3 per cent annually from the year in which the investments takes place (tax value of 78 per cent), i.e. deprecation over 6 years. In addition to the depreciation allowance offered, an extra deduction (uplift) is allowed in the basis for special tax (tax value of 56 per cent) to shield normal return from special tax. An uplift of 5.2 per cent per year is thus granted in the special tax basis for a four-year period (from and including the investment year) for investments in production and pipeline facilities.

Financial costs are allocated between the 22 per cent tax base and the 78 per cent tax base. Hence, a licensee on the NCS that is subject to Norwegian tax will be entitled to tax deductions with regard to exploration and production costs (running expenses, net financial items (capped), depreciations and uplift) and transportation costs (tariff payments). Losses and unused uplift may be carried forward indefinitely with an interest. The calculated interest is added at the end of each year. Companies not being in a tax position may annually apply for a refund of the tax value of exploration expenses (save financial costs). Also, there is a system of repayment of the tax value of accumulated tax losses carried forward and unused uplift upon cessation of petroleum activities on the NCS.

Norm prices can be imposed when calculating taxable income from the sale of produced petroleum. The Petroleum Price Council (PPR) determines the norm price. The Council receives information from and meets

with companies before setting the final norm price. This norm price system applies to certain grades of crude oil and NGL. For gas, the actual sales price is used as the tax basis. However, related party transactions may be adjusted by the tax authorities if the gas prices are not in line with the arm's length principle.

### 11. 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 JOA's, 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 which according to law "may provide decisive control of a licensee possessing a participating interest in a licence".

In a letter from 2018, the Ministry gave guidance that the wording shall be interpreted very widely and that approval may be required for transactions where the buyer does not even achieve negative control. Further, it stipulated that any uncertainty with respect to the applicability of the requirement must be discussed with the Ministry.

Approval by the Ministry of Finance is also required for the same transactions for tax purposes. The main principle is that transactions should be tax natural. Hence, the tax basis of depreciation and uplift related to the assets are transferred to the buyer (tax continuity). Further, the consideration is not taxed as income for the seller and is, correspondingly, not deductible for the buyer. Losses and unused uplift carried forward will as a rule remain with the seller.

Transactions can also trigger other regulatory approvals, such as approval from the Ministry of Petroleum 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.

### 12. The government's current approach to companies exiting 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.

As many of the international majors have already exited the NCS or have communicated that they intend to divest, 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 from 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 approach which has yet to be resolved.

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.

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*Further information regarding Norwegian petroleum activities (including unofficial translations of the model production license and JOA) can be found here:*

<https://www.norskpetroleum.no/en/>

*This site is run in cooperation by the Ministry of Petroleum and Energy and the Norwegian Petroleum Directorate.*

### OUR SERVICES

BAHR's legal team has vast experience of working closely with a number of major players on the Norwegian Continental Shelf. 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 expertise in petroleum 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 MATTERS WITHIN THE OIL & GAS SECTOR

- Assisting Sval Energi with the acquisition of Capricorn's Norwegian operations, and the acquisition of the Duva field from Pandion Energy.
- Assisting Point Resources with the merger with Eni Norge to form one of the largest operators on the NCS called Vår Energi.
- Assisting PSP with the sale of its Gassled assets.
- Assisting Aker with entering into petroleum activities in Ghana through Aker Energy Ghana.
- Assisting Aker BP in its down sale of participating interests in Valhall and Hod to Pandion Energy.
- Assisting Point Resources in its acquisition of Exxon Mobile's participating interest in Balder and Ringhorne.
- Assisting Shell with selling its participating interests in the Draugen and Gjøa fields to OKEA.
- Assisting CapeOmega with the acquisition of further Gassled assets through its acquisition of Njord Gas Infrastructure Holding and purchase of assets in Polarled and Nyhamna.
- Assisting Total in connection with the Maersk-transaction.
- Financial assistance to INEOS in connection with the purchase of DONG Energy.
- Assisting Aker BP in its acquisition of Hess participating interests in Valhall and Hod.
- Assisting ENGIE in connection with the global sale of ENGIE's oil and gas assets to Neptune.
- Acting as counsel for Solveig Gas Norway et al in a law suit against the Norwegian State for wrongful reduction of tariffs in the Gassled gas transportation system.
- Acting as counsel for ExxonMobil in a tax law suit against the Oil Taxation Office regarding transfer pricing(financing).
- Acting as counsel for Norske Shell in a tax law suit against the Oil Taxation Office regarding the tax treatment of R&D costs.
- Acting as counsel for Norske Shell in a tax law suit against the Norwegian State regarding duty on GTL.



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