Oil & Offshore

MARKET UPDATE

Since the dramatic downturn in the oil price bottomed out early 2016, the oil price has slowly re- gained previous levels and reached in the second quarter of 2018 its highest level since November 2014. The increase in the oil price, combined with the considerable cost reduction achieved within the industry during the downturn, has led to an increased activity level within most segments of the oil and offshore industry.

There has been an increase in the number of plans for operation and development (PDO) submitted to the Norwegian Ministry of Petroleum (MPE). During the first half of 2018 PDOs for the fields Fenja, Nova, Valhall West Flank, Skogul and Ærfugl and the revised PDO for the Yme New Development have all been approved by the MPE. The Parliament and the MPE have recently also approved Equinor's PDO for the Johan Castberg field, the third field development to be carried out in the Barents Sea.

The increase in activity level is also visible in exploration, which in the first half of 2018 resulted in several positive exploration results. Aker BP discovered oil in the North Sea in the Frosk exploration well near the Alvheim field. OMV has made a gas/condensate-discovery in the Iris/Hades prospects near Åsgard, Wintershall has found gas in the Balderbrå discovery, and Equinor made an oil and gas discovery in the North Sea (Lille Prinsen).

In the 24th licensing round, the MPE has awarded 12 new licenses in in 47 blocks on the Norwegian Continental Shelf. Nine of the licenses are located in the Barents Sea, while three are located in the Norwegian Sea.

Due to the increase in exploration and sanctioned projects on NCS, the demand for oilfield services is gaining significant pace in many segments. The demand for drilling rigs has increased significantly and the drilling market may be on its way to recovery, and subsea and well services companies have also seen a revival of business in recent months. Many of the new contracts have been awarded to Norwegian companies such as Aibel, Aker Solutions and Kværner, which could mark a shift compared to recent projects where many large contracts were awarded to Asian yards.

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In an M&A perspective, the trend of the international E&P majors exiting the NCS has continued in 2018 with Okea acquiring Shell's participating interest in the Draugen and Gjøa fields. Repsol's acquisition of 7.7% in the Visund field from Total was also completed in Q1. The trend of new players entering the NCS continued with Dyas farming into 13.3% in the Fogelberg discovery from Faroe, and with Chrysaor farming into 15% in the Grevling discovery from Okea. DNO is increasing its focus on the NCS through is acquisition of 27.4% of the shares in Faroe Petroleum. Wintershall is increasing its presence on the NCS, partly through a merger with its German competitor DEA, and partly as a result of steadily increasing investments and acquisitions in Norway since 2008. On the infrastructure side, CapeOmega acquired DEA's interests in Polarled, Gassled and the Nyhamna plant. CapeOmega has also acquired Edisons's interest in Polarled and Nyhamna.

TARIFF STIPULATION FOR THIRD PARTY USE OF FACILITIES

Approximately NOK 4000 billion has been invested on the Norwegian continental shelf, the majority of which has been directed towards infrastructure to facilitate production and transportation of petroleum. Investments already made form an important basis for an efficient tie-in of new resources with existing and available infrastructure. Use of existing infrastructure is a key factor, and often a prerequisite, for an optimal utilisation of the resources, particularly in respect of smaller discoveries. Typical subjects for conflict in respect of such third party use of facilities are the opportunity for, timing of and stipulation of the tariffs to be paid by the user field. Two recent rulings by the Ministry of Petroleum and Energy provide important clarifications in this regard.

Pursuant to Section 4-8 of the Petroleum Act ("PA"), regulation no. 1625 of 20 December 2005 relating to the use of facilities by others (the "TPA-regulations") has been passed, wherein Section 4 stipulates that a user *"which needs to use of a facility owned by another party"* shall have the right to such use on terms and conditions to be specified. It further transpires from PA Section 4-8 that the Ministry of Petroleum and Energy ("MPE") can decide that facilities may be used by others *"if so warranted by considerations for efficient operation or for the benefit of society"* and MPE deems that such use would not *"constitute any unreasonable detriment of the licensee's own requirements or those of someone who has already been assured the right of use"*.

While a user field can have an interest of use of existing facilities, the owner of the facility will have an interest in securing a reasonable cost sharing for such use. Prevailing conflicts of interest will on one side be the user's (and the society in general's) interest to utilise resources efficiently, and on the other side the owner's requirement for a sufficient initiative to invest in infrastructure. It transpires from PA Section 4-8 that the owner of the facility via the tie-in agreement shall be *"provided with a reasonable profit taking into account, among other things, investments and risks"*. Equally, it is important to consider that the profit from the production as a general principle shall be earned on the fields and not by payments from third party user's use of the infrastructure, cf. also Section 4, second paragraph of the TPA-regulations.

The TPA-regulations also have several provisions of significance to the stipulation of the tariff level for the user fields. Section 9, third paragraph of the regulations provides a list of tariffs and terms and conditions which can be claimed by the owner. This shall be limited as follows:

- *operating expenses incurred by the owner as a result of the use of the facility*
- *any new investments entailed by the use of the facility*
- *payment for any previous investments in additional capacity undertaken with future third party use in mind*
- *compensation for loss of earnings, including lost and/or postponed production, as a result of the user's use of the facility*
- *other documentable costs or loss incurred by the owner through the user's use of the facility*
- *a reasonable profit for the owner, considering the risk assumed by the owner*

The above list is in principle exhaustive, however, it also transpires from TPA-regulations Section 9, fourth paragraph that *"in special cases"*, tariffs and terms and conditions may depart from the third paragraph if the owner and user agree on this. MPE may also on its own initiative stipulate and amend tariffs and terms and conditions *"based on consideration for resource management and that the owner of the facility is provided with a reasonable profit,"* cf. sixth paragraph.

Any disagreements between the owner and user concerning the provisions of the TPA-regulations can be presented to MPE for ruling, cf. Section 13 of the regulations.

Two cases have recently been decided by MPE: Fenja's use of the Njord facilities, dated 17 November 2017 ("The Njord-Fenja decision") and Nova's tie-in to and use of the Gjøa facilities, dated 16 February 2018 ("The Gjøa-Nova decision").

"The background for why opex sharing could be claimable in such a case is that the host field may have a requirement for opex contribution from the users in order to maintain profitable operation"

An issue that was considered in both decisions was the timing of when sharing of operating expenses (Opex sharing) can come into effect. In the Njord-Fenja agreement it was proposed to share operating expenses from three years before Njord would be economically unviable to operate. In the Gjøa-Nova agreement it was agreed to share operating expenses from 1 January 2023. In both cases, Njord and Gjøa referred to the fact that agreements regarding shared operating expenses had already been entered into with other associated fields, respectively Hyme and Vega. Both of these previous agreements had been approved by MPE.

Generally speaking, shared operating expenses do not come under any of the items in the list provided in TPA-regulations Section 9, third paragraph of tariffs and terms and conditions claimable by the owner. According to this provision, the tariff shall be limited to coverage of incurred costs as a consequence of the tie-in, in addition to a reasonable profit for the owner.

The crucial question in both the Njord-Fenja and the Gjøa-Nova decisions was therefore if the claimed opex sharing could be agreed pursuant to TPA-regulations Section 9, fourth paragraph as a *"special case"*. With reference to previous decisions, MPE stated that one example of a *"special case"* was *"a* *situation where the host field is in the final phase and the production from the host field has fallen to a low level*". The background for why opex sharing could be claimable in such a case is that the host field may have a requirement for opex contribution from the users in order to maintain profitable operation.

> *"A crucial topic of assessment will therefore still be whether the host field has reached a final phase of low production, where the opex sharing becomes a prerequisite for sustained profitable operation."*

In the case of both Njord-Fenja and Gjøa-Nova, MPE still found that the situations in question were not to be regarded as "*special cases*". The fact that Njord is three years away from being economically unviable to operate was not deemed a sufficient basis upon which the user could claim opex sharing. Nor was the fact that the host fields had previously agreed opex sharing with other associated fields considered relevant.

A crucial topic of assessment will therefore still be whether the host field has reached a final phase of low production, where the opex sharing becomes a prerequisite for sustained profitable operation.

Another question in both decisions was whether compensation could be claimed for reduced opex contribution from existing third party users. As far as Njord was concerned, opex sharing was agreed with Hyme as early as 2011, and for Gjøa, opex sharing was agreed with Vega in 2006. The sharing of operating expenses according to these existing agreements was based on a proportion of total through-put. Njord and Gjøa therefore made the argument towards MPE that Hyme and Gjøa's respective shares of operating costs would be reduced as a consequence of adding Fenja and Nova, and that Fenja and Nova therefore should cover this reduction pursuant to Section 9, third and fourth paragraph of the TPA-regulations.

Regarding the assessment pursuant to TPA-regulations Section 9, third paragraph, MPE considered several of the alternatives listed therein:

- The claim could not be regarded as "*operating expenses incurred by the owner as a result of the use of the facility*" cf. Section 9, third paragraph, first item. MPE considered this alternative only to be relevant for increased operating expenses as a consequence of the user's tie-in. The claim made by Njord and Gjøa, however, was based on a reallocation of existing operating expenses.

- The claim could not be regarded as "*compensation for loss of earnings, including lost and/or postponed production, as a result of the user's use of the facility*" cf. Section 9, third paragraph, fourth item. MPE regarded the shared operation of Njord and Hyme, and Gjøa and Vega, as a sharing of expenses and concluded that it could not be deemed as an "income" for respectively Njord and Gjøa.

- The claim could not be regarded as "*other documentable costs or loss incurred by the owner through the user's use of the facility*" cf. Section 9, third paragraph, fifth item. The amendment of the distributions of operating expenses was based on the previous agreements between Njord and Hyme, and Gjøa and Vega, and not Fenja and Nova's use of the facilities.

In addition, MPE considered whether Njord and Gjøa's claims could be substantiated by TPA-regulations Section 9, fourth paragraph, in which tariffs and terms and conditions "*in special cases [may] depart from the third paragraph, if the owner and user agree on this*". MPE did not consider this provision to form a legal basis for Njord and Gjøa to claim compensation for reduced opex contribution as such a solution would be contrary to the purpose of the regulations as well as the coherence with statutory rules.

As far as Njord was concerned, the previous tie-in agreement with Hyme was characterised as a "*special case*" pursuant to the fourth paragraph. Notwithstanding, MPE did not deem this a sufficient basis upon which to justify a new agreement with Fenja being characterised as a "*special case*".

An important point, based on MPE's decisions in the cases between Njord-Fenja and Gjøa-Nova, is therefore that the owner of facilities subject to third party access must not assume that an agreement to share operating expenses can be entered into with new users, even if agreements to share operating expenses are in place with existing users. Opex sharing remain an exception from the tariff elements that can be agreed upon pursuant to Section 9, third paragraph of the TPA-regulations, reserved for *"special cases"* where the host field is in its final phase with a production so low that its' economy and further operation are reliant upon the opex sharing.

Moreover, a central point in the Njord-Fenja decision (cf. also the previous Troll-Fram decision from 26 June 2017) is that in the assessment of the level of tariff claimable from the user field, *"it is a clear prerequisite to claim compensation that the owner documents, also with figures, the underlying costs and risks assumed by the owner as a consequence of the user's use"*. Thus, the owner solely assumes the burden of proof and obligation to provide documentation for the tariff level and the *"reasonable profit"* it would be desirable to claim as an owner.

CHANGES IN THE GUIDELINES FOR PDOS AND PIOS

On 21 March 2018 the Ministry of Petroleum and Energy made changes to the guidelines for Plans for Development and Operation (PDOs) and Plans for Installation and Operation (PIOs). The purpose of these guidelines is to advise companies on how to write a PDO/PIO in order to fulfill the requirements of the Norwegian government, and contribute to an effective interaction between the companies and the government. The changes were made in sections 5.6 and 6.4 of the guidelines, which addresses how the project will be organized and executed.

The objectives behind the changes are, inter alia, to reduce risk of major delays and budget overruns, and increase the social economic profitability in development projects. The changes are partly due to concerns of the Norwegian contracting industry that oil companies have been placing too much emphasis on "headline price" when awarding contracts and not taking other factors which could affect the final project cost sufficiently into account. Changes include stricter demands to the operator's contracting strategy and program for transfer of competence and experience to non-operators. More detailed descriptions of the experience held by the operator's personnel are also required. Furthermore, more emphasis is placed on evaluation of risks and risk management compared to the previous guidelines.

RECENT HIGHLIGHTS

• Assists DNO ASA in connection to the sale of DNO Tunisia AS to Panoro Energy

• Assisted Pandion Energy AS in connection to a NOK 400 million bond as part of the financing of its acquisition of interests in Valhall and Hod

• Assisting Magseis ASA on their application for transfer of listing from Oslo Axess to Oslo Stock Exchange.

• Assisting Unity Invest AS in connection to the acquisition of Solvang ASA

• Assisted DNB Bank ASA as agent and the lenders to Aker BP ASA in connection with Aker BP ASA's USD 4 billion senior secured credit facility

• Assisted Hess Corporation in the USD 2 billion sale of Hess Norge to Aker BP ASA.

• Acted as head of the debt negotiation committee, debt settlement committee and later administrator of the bankrupt estate Reinertsen AS which also included completing a business transfer of the oil and gas activities to Aker Solutions ASA

• Tax advisor to several oil and offshore companies

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