



MINISTRY OF FISHERIES AND NATURAL RESOURCES

COVER SHEET

Parliamentary Bill No. 171/2007

**Proposed Bill
for an
Act of Parliament
Governing the Third Licensing Round
for the Exploration and Exploitation of Hydrocarbons**

**MODEL LICENSE
Annex I
Annex II**

Comments to the Proposed Bill

This is an official translation of "Løgtingsmál nr. 171/2007: Uppskot til lögtingslóg um triðja útbjóðingarumfar til leiting eftir og framleiðslu av kolvætrum" and related Comments. This translation has been prepared specifically for the Earth and Energy Directorate of the Ministry of Fisheries and Natural Resources by sP/F Reveal International, Tórshavn, Faroe Islands. Please Note: The Faroese text remains the only official, legally binding version. This translation is subject to copyright. © 2008 Ministry of Fisheries and Natural Resources. All Rights Reserved.

Parliamentary Bill No. 171/2007: Proposed legislation governing the third licensing round for the exploration and exploitation of hydrocarbons.

**Proposed Bill
for an
Act of Parliament
Governing the Third Licensing Round
for the Exploration and Exploitation of Hydrocarbons**

§ 1. Pursuant to § 7, Clause 2 of Parliamentary Act No. 31, dated 16 March 1998, governing hydrocarbon activities [hereinafter, "the Hydrocarbon Activities Act"], this Act stipulates the areas to be offered for licensing and the standard terms and conditions governing the granting of a license in the third licensing round for exploration and exploitation of hydrocarbons.

§ 2. The areas to be offered for licensing in the third licensing round are the following blocks and partial-blocks of the Faroese continental shelf:

5908/1-3;
5909/1-5;

6004/b2-3, 4-5, b6-8, 9, 11, b12, 13, b16;
6005/b5, 6, 10, 11, b14, 15-24;
6006/1, 5, 6-7, 10-13, 15-25;
6007/1-20, 25, 26-27, 30;
6008/9-10, 13-30;
6009/11-14, 16-30;

6103/b1, 9;

6104/1-8, 11-13, 15, b16-17, 18-20, 22-24,
27-29;
6105/3-5, 8-10, 13-15, 17-21;

6201/1-2;
6202/4-14, 16-18, 21-22, 26;
6203/10-27;
6204/11-21, 26, b29-30;
6205/14-15, 19-20, 24-25, 29-30;

6301/26-28.

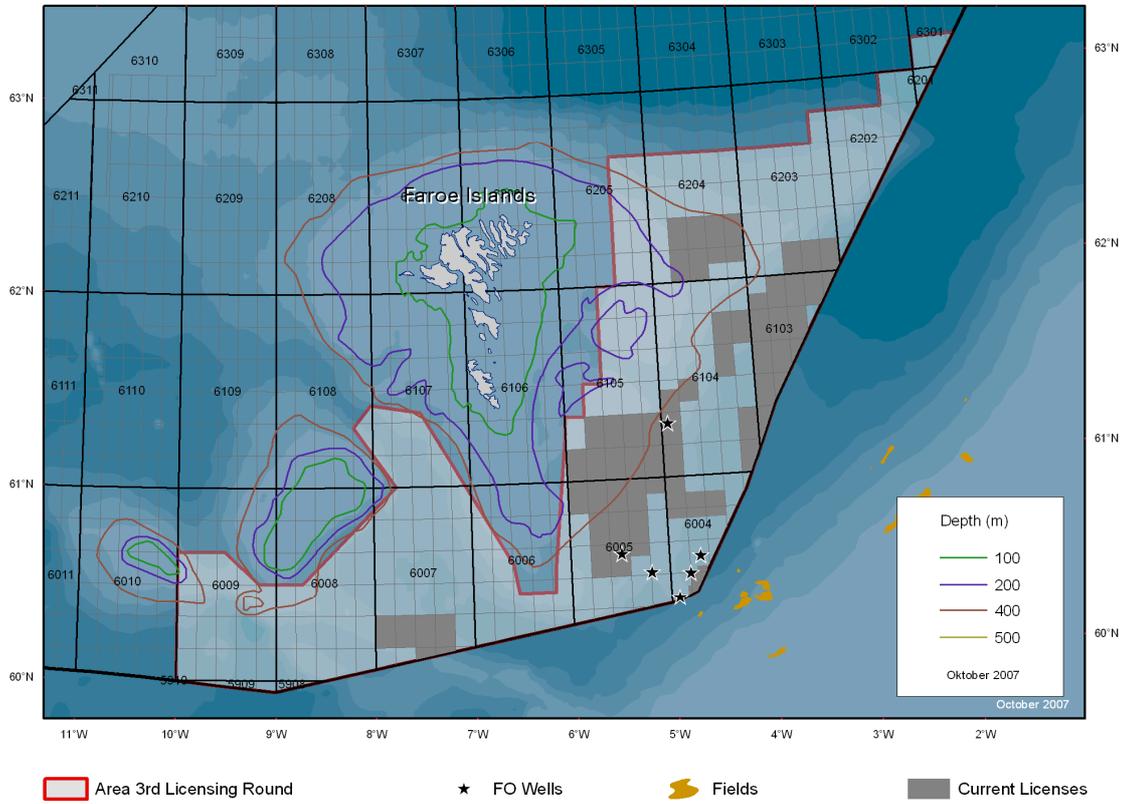
The areas offered for licensing are identified on the map attached as Annex A. The designation "b" indicates a partial-block bordering a previously awarded license.

§ 3. Pursuant to § 6 of the Hydrocarbon Activities Act, the Minister awards the licenses for the exploration and exploitation of hydrocarbons. The standard terms and conditions governing the granting of a license are stipulated in the Model License attached as Annex B.

§ 4. This Act shall enter into force the day after it is promulgated.

Annex A

3rd Licensing Round



ANNEX B

**MODEL LICENSE
FOR THE
EXPLORATION AND EXPLOITATION OF HYDROCARBONS**

THIRD LICENSING ROUND

Pursuant to § 6 of Parliamentary Act No. 31, dated 16 March 1998, governing hydrocarbon activities [hereinafter, "the Hydrocarbon Activities Act"] and based on the information provided in the application of the Company, dated _____ and other information, the Minister of Fisheries and Natural Resources (hereinafter, "the Minister") hereby grants a license to engage in the exploration and exploitation of hydrocarbons in the area stipulated in § 2 hereof (hereinafter, "the License") to the Company or Companies indicated below (hereinafter, "the Licensee"):

Company:

Business Registration No:

Registered Business Domicile:

Share: %

Company:

Business Registration No:

Registered Business Domicile:

Share: %

Company:

Business Registration No:

Registered Business Domicile:

Share: %

The License is subject to the following terms and conditions:

§ 1

In this License, the following terms shall mean:

"*Hydrocarbons*" – crude oil, condensate, natural gas and other hydrocarbons found naturally in the subsoil that can be extracted in a gaseous or liquid form.

"*Hydrocarbon deposit*" or "*deposit*" – a contiguous accumulation of hydrocarbons in the subsoil. The Minister shall resolve any question regarding what shall constitute a hydrocarbon deposit.

§ 2

1. The License is valid for the area(s) indicated on the attached map with relevant corner coordinates and block(s) set forth in Annex I.
2. The mapping and coordinate system implemented herein is based on the geographic latitude and longitude coordinates of the European Terrestrial Reference System 1989 (ETRS89). Each quadrant is labelled according to the south-eastern corner coordinates, e.g. 6105 (N 61°, W 05°). Each individual quadrant is subdivided into 30 blocks of 12 longitudinal minutes and 10 latitudinal minutes each. The blocks are labelled from 1 to 30, beginning in the north-western corner of each quadrant, e.g. 6103/1.

§ 3

1. The License grants to Licensee in the area(s) referenced in § 2 the sole and exclusive right to explore for and exploit any hydrocarbons, as defined in § 1. Hydrocarbons derived from, *inter alia*, the destructive distillation of coal, bituminous shale or other subsoil deposits are not included in this License.
2. The License granted herein shall not restrict the Minister, within the area governed by this License, from granting permission to a third-party (i) to undertake prospecting for hydrocarbons in the subsoil, (ii) to explore for and exploit any natural resources not covered by this License, (iii) to establish and operate pipeline facilities intended for activities falling within the scope of the Hydrocarbon Activities Act, (iv) to use the subsoil for storage or for purposes other than production, and (v) to conduct scientific investigations. The Licensee shall endeavour to ensure that the activities permitted under this License do not impede unnecessarily the third-party activities enumerated in the previous sentence, as well as any other hydrocarbon exploration and exploitation activities carried out under other licenses. The Faroese Earth and Energy Directorate [hereinafter, "the Directorate"] shall endeavour to ensure that the activities enumerated in the first sentence of this clause and the activities of other licensees provided for under other licenses do not impede unnecessarily the activities granted to the Licensee under this License.
3. The Licensee shall endeavour to organise its activities and if necessary revise its operations to accommodate the fishing effort that normally occurs in the area. To comply with this requirement, the Licensee, prior to conducting any seismic or other investigations, shall submit to the Directorate in a timely manner a detailed Work Programme for approval.
4. If the Licensee discovers any natural resources not within the scope of this License, the Licensee shall notify the Directorate thereof.
5. In the event that other natural resources may be exploited at the same time as a necessary extension of hydrocarbon exploitation activity, the Licensee shall be entitled to said natural resources unless owned by a third party. The Minister reserves the right to impose upon the Licensee specific terms and conditions with respect thereto, including payment of a special surcharge in the event said additional exploitation is commercially viable.

§ 4

1. The License Term and Work Programme are stipulated in Annex II. The Licensee shall carry out the exploration programme and the other activities specified in Annex II during the License Term.

2. In the event of any discovery of hydrocarbons, the Licensee shall immediately communicate this fact to the Directorate. No later than eight (8) months after the completion of the well in which the discovery is made, the Licensee shall submit a report on the discovery and a field appraisal programme detailing the work required to ascertain whether exploitation of the hydrocarbon deposit is technically feasible under the conditions present and that the discovery is commercially significant, consistent with best practices within the North Sea oil industry. The field appraisal programme shall include a time schedule and an outline of the work required to support the declaration to be submitted pursuant to § 5, Clause 2 herein no later than four (4) months before the expiry of the Exploration Term stipulated in § 4, Clause 1, (confer Annex II, § 1), or within any extension of the Exploration Term granted by the Minister pursuant to § 8, Clause 1 of the Hydrocarbon Activities Act. The Directorate shall approve the appraisal programme.

§ 5

1. An extension of the License Term, pursuant to § 8, Clause 2 of the Hydrocarbon Activities Act, for production purposes shall be granted by the Minister for the area delimited pursuant to Clause 3 below for a period of thirty (30) years from the date the extension is granted. Extensions may be granted for one or more areas individually.

2. The extension of a license term, as referenced in § 5, Clause 1 above, is conditioned on that the Licensee (i) has fulfilled all its obligations, (ii) has verified a commercially exploitable hydrocarbon deposit, and (iii) has submitted an application for an extension of the license term no later than four (4) months before the expiry of the term specified in § 4, Clause 1 (confer Annex II, § 1). The application shall certify that a hydrocarbon deposit(s) has been demonstrated under such conditions that exploitation is deemed technically and commercially feasible, and that the Licensee intends to initiate such exploitation. The application shall further stipulate the specific area(s) for which the Licensee requests the extension. The Licensee shall designate the area(s) within the region stipulated in the application that the Licensee believes contains the hydrocarbon reservoir(s). The application shall be accompanied by a report that documents the appraisal of the deposit(s) on which the declaration is based. The report shall contain a description and an evaluation of the deposit(s) with respect to its geology and the technical aspects of the reservoir(s), plus a statement regarding the production technology and the economic assumptions upon which the Licensee's declaration is based.

3. The Minister shall delimit the area(s) for which an extended license term is granted for exploitation purposes, designated by geographical coordinates and depth. The specific hydrocarbon deposit(s) that the Minister deems to have been verified by the Licensee in connection with its request for a license term extension shall be further designated within said area(s). The depth of the delimited area(s) is deemed to extend to at least the end point of drilling and shall include without exception all hydrocarbon deposit(s) for which the extension is granted. If deemed necessary, the delimited area(s) may encompass several deposits. If it is not possible to delimit the size of the deposit(s) with reasonable certainty, the Minister shall take this fact into consideration when determining the extent of any additional area(s) to be covered under the license and their associated depth(s).

4. The area(s) for which the Licensee relinquishes the right in which to explore for and exploit hydrocarbons and the area(s) for which this right is preserved pursuant to § 4 Clause 1, as well as the area(s) for which a license term is extended pursuant to § 5, Clause 1 above shall be contiguous and shall be delimited by longitude and latitude, expressed in whole minutes.

§ 6

1. Any extension of the license term to be granted pursuant to § 5 above is subject to the following conditions, (i) that, prior to the deadline stipulated by the Minister with respect to the extension of the Li-

cense, the Licensee shall submit a Field Development Plan for the designated hydrocarbon deposit(s) for approval by the Minister pursuant to § 15, Clause 2 of the Hydrocarbon Activities Act; and (ii) that the Licensee shall initiate production within the time stipulated in the approval.

2. The Minister may promulgate specific directives and regulations governing the content and form of an application, pursuant to § 15 of the Hydrocarbon Activities Act, as well as the information that shall be submitted with or subsequent to said application.

§ 7

1. On each License Date, the Licensee shall pay an annual fee (see Clause 3 below), based on the size of the licensed area(s). This Area and Environmental Impact Fee shall not be assessed on producing hydrocarbon deposit(s) delimited pursuant with § 5, Clause 3 above. In calculating the size of the area(s), the number shall be rounded up to the nearest whole square kilometre.

2. The Area and Environmental Impact Fee is:

Payment 1 – 6 (i.e., payments for license years 1 - 6)	DKK 750 pr. km ²
Payment 7	DKK 1.250 pr. km ²
Payment 8	DKK 1.750 pr. km ²
Payment 9	DKK 2.500 pr. km ²
Payment 10	DKK 3.750 pr. km ²
Payment 11	DKK 5.250 pr. km ²
Payment 12	DKK 7.750 pr. km ²
Payment 13	DKK 11.250 pr. km ²
Payment 14	DKK 17.250 pr. km ²
Payment 15	DKK 26.250 pr. km ²
Payment 16 and subsequent payments	DKK 39.250 pr. km ²

3. The Area and Environmental Impact Fee for each license year for the area(s) covered by the License shall be paid in advance on each License Date, which is defined as the calendar date on which this License was dated and issued (the "License Date"). If a payment is late, the Licensee shall pay interest at an annualized rate equal to the then current official discount rate set by the National Bank of Denmark (Danmarks Nationalbank), plus 6% from the date the payment is due and payable to the date of actual payment.

4. Of said Fee, 250 DKK per square kilometre shall be set aside for the required environmental impact assessment regarding hydrocarbon-related activities. The Directorate shall administer these funds and shall consult with the relevant governmental authorities and the oil industry on how the funds may best be used.

§ 8

1. The Licensee shall pay a Hydrocarbon Production Royalty (hereinafter, "HP Royalty") to be calculated and paid pursuant to § 8, Clause 2 – 4 and §§ 9 and 10. The HP Royalty shall be paid in Danish Krone (DKK).

2. The amount of the HP Royalty shall be based on the quantity of hydrocarbons produced each quarter (1 January – 31 March; 1 April – 30 June; 1 July – 30 September; and 1 October - 31 December) of each calendar year. All produced hydrocarbons, including the hydrocarbons consumed during production activities, shall be included when calculating the quantities of hydrocarbons subject to the HP Royalty. Small quantities of hydrocarbons that are lost during production or any hydrocarbons re-injected back into the reservoir(s) prior to the measurement point shall not be included in the calculation of the HP Royalty, but such quantities shall be noted in the calculation report submitted to the Directorate.

(3) The HP Royalty is two percent (2%) of the value of the production, which is calculated pursuant to the provisions of this License.

4. As and when the Minister determines that the HP Royalty, wholly or partially, shall be paid in-kind, the Minister shall provide written notice to the Licensee of said decision. Within sixty (60) days following the date of said notice, the Minister and the Licensee shall agree on the basis, the location, the measurement procedures (pursuant to provisions governing similar in-kind payments), and the conditions of transfer. Said agreement shall be consistent with the governing principles stipulated in this License and such other usual and customary principles governing the payment of in-kind HP Royalty as the Minister may adopt. In no event shall the decision by the Minister to accept an in-kind HP Royalty payment affect then current HP Royalty payments until payment of the in-kind HP Royalty shall commence. The Directorate shall not incur any costs relevant to the payment of the in-kind HP Royalty, except those that may occur subsequent to the transfer of the in-kind HP Royalty.

§ 9

1. Said HP Royalty, referenced in § 8, Clause 3, is levied on the value of the quantities of hydrocarbons on which each quarterly royalty is based. The value of the hydrocarbons subject to the HP Royalty shall be established based on the rules in the following Clauses 2 - 6.

2. The valuation of the hydrocarbons produced shall be based on the value at the following Transaction Points:

- a) Produced hydrocarbons landed by ship: The value at the shore-based terminal, port or other off-loading point where the hydrocarbons are first landed, without any deduction for transport, handling or other costs incurred prior to such landing point.
- b) Produced hydrocarbons landed via pipeline: The value at the point where the hydrocarbons are landed at a shore-based terminal or other land-based facility via a pipeline, without any deduction for transport costs prior to such landing point.
- c) In the event that produced hydrocarbons are not landed as set forth in a) or b) above, the Minister, in approving the Field Development Plan, shall determine the relevant Transaction Point at which valuation shall be calculated.

3. If, prior to the date specified in § 10, Clause 1 for submission of the quarterly production statement, the quantity of hydrocarbons recovered during said quarter is sold to a third party pursuant to a binding sales agreement without any prior refining or other substantial processing, said quantity of hydrocarbons shall be valued at the sales price stipulated in the sales contract, if delivery is to be made to the purchaser at a Transaction Point that is governed by the valuation share under Clause 2 above.

4. If the Minister determines that the sales price of the hydrocarbons agreed to by the Licensee does not correspond to the price the Licensee could have obtained through a sale to a third party on the open market, the Minister shall stipulate the value of said hydrocarbons. In his valuation, the Minister shall apply the values assessed for the applicable quarter pursuant to Clause 3 above for similar hydrocarbon sales to third parties, provided that the Minister is able to conclude that such sales can be considered representative of the price level. Otherwise, the valuation shall be based on the prices obtained during the relevant period for the delivery of a similar grade and quality of hydrocarbons via third-party sales on the European open market.

5. The value of that portion of the hydrocarbons not sold to a third party within the date stipulated in Clause 3 above shall be stipulated by the Minister consistent with the provisions in Clause 4 above.

6. In the event that the nominal price for produced hydrocarbons is stipulated pursuant to the provisions of Parliamentary Act No. 26 of 21 April, 1999 on the taxation of income derived from hydrocarbon activities, the valuation of said produced hydrocarbons shall always be based on said representative nominal price, notwithstanding the provisions of this License.

7. If any information required for the calculation of the HP Royalty is not fully known at the time the production statement is to be submitted, a provisional production statement shall be issued pursuant to the provisions set forth under § 10 below. The provisional production statement shall be prepared in such a manner as to state, as closely as possible, the final HP Royalty obligation for the respective

quarter. The Minister may promulgate specific rules regarding the basic principles to be followed in the preparation of a provisional production statement.

§ 10

1. The HP Royalty shall be calculated every quarter. No later than thirty (30) days after the end of each quarter, the Licensee shall submit to the Minister a Production Statement declaring the HP Royalty for the relevant quarter. In those situations governed by § 9, Clause 7, a provisional calculation of the HP Royalty shall be prepared, consistent with the rules in this section.

2. Along with the Production Statement, the Licensee shall submit to the Directorate all information relevant to the calculation of the HP Royalty. The information provided shall include, but not be limited to, the quantities, quality, and grade of the hydrocarbons produced; the density of all liquids, the calorific value and the chromatographic analysis for all gaseous hydrocarbons; the disposition of the quantities produced, including the terms relating to prices, delivery and all other conditions agreed upon with the individual purchaser for a particular sale, and any other special circumstances that might have influenced said terms and conditions. The Minister may promulgate specific rules and regulations governing the submission of information, and may require supplementary information in individual cases.

3. In the event a final or provisional Production Statement is not timely submitted pursuant to Clause 1 above, or the information to be submitted pursuant to Clause 2 above is not furnished by the deadline stipulated by the Minister, the Minister shall determine the HP Royalty. In the event the Production Statement is not made in conformity with the then current rules and regulations, and is not revised by the deadline stipulated by the Minister, the Minister shall determine the HP Royalty. If the Minister determines the HP Royalty, the Minister shall further decide if the HP Royalty shall be considered final or provisional.

4. If a quarterly HP Royalty is deemed provisional, the final Production Statement shall be submitted with the Production Statement for the next subsequent quarter. In the event that any information deemed necessary for the final Production Statement is unavailable, the Minister shall stipulate the final HP Royalty, if said information is not produced prior to the deadline established by the Minister.

5. Provisional HP Royalties and HP Royalties due and payable pursuant to final Production Statements shall be paid to the Directorate by the deadline for submission of the Production Statement stipulated in Clause 1 above. If the HP Royalty is fixed by the Minister pursuant to Clause 3 or 4 above, the HP Royalty deemed due and payable shall be paid no later than seven (7) days after the Licensee receives notice from the Minister of the amount of the HP Royalty.

6. If payment of the HP Royalty is made after the deadline stipulated in the second sentence of Clause 1 above for submission of the Production Statement, interest shall be charged at an annual rate equal to the then current official discount rate set by the Danish National Bank (Danmarks Nationalbank), plus 6% from the date the payment is due and payable to the actual date of payment. If the Minister stipulates the amount of the Production Royalty pursuant to Clause 3 or 4 above, interest shall be charged at the same rate from the deadline in the second sentence of Clause 1 above.

7. The following rules shall apply if a provisional HP Royalty is paid and it is finally determined in the final Production Statement that the provisional Production Statement resulted in a calculation of an overpayment or an underpayment: In the event of an underpayment, interest shall be charged on the difference between the provisional HP Royalty and the final HP Royalty for each quarterly period from the date of payment of the provisional quarterly HP Royalty until payment is made pursuant to the final Production Statement. The rate of interest shall be an annual rate equal to the then current official discount rate set by the Danish National Bank (Danmarks Nationalbank), plus 2% from the date the payment is due and payable to the actual date of payment. If the final Production Statement demonstrates that an overpayment has been made and that the Licensee is due a refund, the Licensee may deduct said overpayment from the next subsequent payment of the HP Royalty.

§ 11

1. The Licensee hereby acknowledges and agrees to set aside and distribute 200,000 DKK at the beginning of each License Year as stipulated in Annex II toward meaningful projects related to future hydrocarbon exploration in the territory of the Faroe Islands. This provision is also applicable in the event that the License is extended.

§ 12

1. The Licensee acknowledges and agrees to provide Faroese companies genuine opportunities, in free and open competition with others, to obtain primary contracts or subcontracts to provide goods and services in connection with the performance of the activities stipulated by this License. In this connection, the Licensee shall comply with the procedures stipulated by the Minister regarding the reporting of initiatives intended by this License to be undertaken by the Licensee related to the tendering of work regarding the performance of the activities stipulated under the License, as well as on the reporting of the terms and conditions governing the contracts to provide said goods and services.

2. The Licensee has the responsibility to ensure that the provisions of § 12, Clause 1 above are followed by its employees, as well as its contractors, subcontractors or other third parties that provide services to the Licensee in connection with the performance of the activities stipulated in this License.

§ 13

1. The Licensee acknowledges and agrees to provide employment opportunities in the Faroes and to endeavour to offer Faroese educational and research institutions and the Faroese business community in general the opportunity to participate in such research and development projects that may be undertaken in performance of the activities stipulated in this License. In this connection, the Licensee shall comply with such reporting procedures as may be specified by the Minister.

2. The Licensee acknowledges and agrees to encourage, promote and facilitate the execution of contractual agreements between Faroese companies and foreign contractors engaged in the provision of good and services to the Licensee in order to augment the competence and technological know-how of Faroese companies in the delivery of said goods and services. In this connection, the Licensee shall comply with the directives and regulations on the submission of reports stipulated under § 33 of the Hydrocarbon Activities Act.

§ 14

1. The Licensee shall endeavour to develop Faroese competence in the industry and shall bear the costs of such efforts in compliance with the guiding principles that the Minister has promulgated or shall promulgate in the future. The Licensee hereby acknowledges and agrees to set aside and distribute 200,000 DKK at the beginning of each License Year as stipulated in Annex II of this License. This provision is also applicable in the event that said License is extended.

§ 15

1. Pursuant to § 11, Clause 1 of the Hydrocarbon Activities Act, the Licensee shall transport any and all equipment and passengers via a Faroese quay or a Faroese airport. In special cases, the Minister may issue an exception to this requirement.

§ 16

1. The Licensee's exploration and production activities shall be carried out from the Faroe Islands to the extent specified, consistent with Clause 2 and 3 below.

2. Within three (3) months after the License has been granted, the Licensee shall submit a plan to the Minister for approval on how and where the land-based activities of the Licensee shall be organized during the exploration phase.

3. A similar plan for the production phase shall be submitted for approval by the Minister along with the application for approval of the Field Development Plan, pursuant to § 15, Clause 2 of the Hydrocarbon Activities Act.

§ 17

1. If the License is granted to a consortium, said License is granted upon the condition that a Joint Operating Agreement is prepared regarding the permitted activities within ninety (90) days of the granting of the License. Within thirty (30) days of the execution of the Joint Operating Agreement, said Agreement shall be submitted to the Minister, who may, within ninety (90) days of submission, require the Agreement to be amended to reflect certain obligatory changes and resubmitted prior to the deadline stipulated by the Minister.

2. Any amendment to, deviation from or supplement to said Joint Operating Agreement, including, but not limited to, the designation of a new operator, shall be submitted to the Minister in accordance with the rules stipulated in § 17, Clause 1 above.

§ 18

1. Pursuant to § 33, Clause 5 of the Hydrocarbon Activities Act, the representative of the Directorate has the right to participate as an observer in the Joint Operating Committee created pursuant to the Joint Operating Agreement referenced in § 17 above.

2. The Directorate shall be provided notice of said meetings with the same advance notice and shall receive the same documents and materials, including, but not limited to, the minutes of the meetings, as provided to the individual Licensees.

§ 19

1. Pursuant to § 33, Clause 4 of the Hydrocarbon Activities Act, the owner or user of an offshore installation, as well as any party acting on its behalf, shall be required to grant the staff of a governmental supervisory authority all the assistance required for their investigations. Moreover, when said supervisory authority so requests, the Licensee shall assume responsibility for the transportation of the representatives of said public authority from their place of work to and from the location of the relevant activities, and shall also provide accommodation. All associated expenses shall be borne by the Licensee.

§ 20

1. To ensure in-depth knowledge and oversight of the activities of the Licensee under this License, the Licensee(s) shall submit all information required about its prospecting, exploration and exploitation activities, as well as information about its financial condition, pursuant to the then current rules and regulatory schemes promulgated under § 30 of the Hydrocarbon Activities Act.

§ 21

1. Directorate staff, other public officials and individuals under contract with the aforementioned governmental authorities have a duty of confidentiality pursuant to § 26 of the Faroese Public Administration Act and §§ 152 through 152 (f) of the Civil Penal Code regarding disclosure of confidential information and test samples, etc., as may be received from time to time from the Licensee pursuant to the Hydrocarbon Activities Act and this License.

2. Test samples and/or other confidential information or data covered under § 31 of the Hydrocarbon Activities Act are deemed to be the property of the Faroese people. The Licensee that has submitted said test samples and/or confidential information or data has no right to demand any payment for said test samples and/or confidential information or data that the Faroese governmental authorities may distribute subsequent to the expiry of the duty of confidentiality.

3. Test samples and/or other confidential information or data covered under § 31 of the Hydrocarbon Activities Act may be distributed to entities other than Faroese governmental agencies five (5) years after said confidential information becomes known and available to the Licensee. In the event that the License expires, or the Licensee abandons the License, or the License is totally or partially rescinded, said five-year period shall be reduced to two (2) years, relevant to the area for which the License is rescinded.

4. The provisions of Clause 1 above shall not prevent the disclosure of said confidential information or other data under the following conditions:

- a) the dissemination of general information about circumstances surrounding the exploration and/or exploitation provided in due course by public statements, annual reports or the like, or
- b) the distribution of confidential information pursuant to collaboration with governmental authorities in other countries, on condition that said country has a similar duty of confidentiality for said confidential information. Proprietary and/or confidential information or information that could reasonably be deemed to be proprietary or confidential received from the governmental authorities in other countries shall be subject to the provisions of Clause 1 above.

§ 22

1. In communications to individuals or to the public, the Licensee shall not, without the prior consent of the Minister, directly or indirectly quote or refer to any statements or communications from the Minister, the supervisory authorities, other public authorities or any person employed by or performing duties for these entities that specifically concern, but not limited to, the probability of discoveries, the size of hydrocarbon deposit(s), or the timing and nature of any hydrocarbon exploitation.

§ 23

1. Any equipment, procedures and/or measurement tools designed for the qualitative and quantitative measurement and analysis of recovered hydrocarbons shall be approved by the Minister. Measurements shall be taken consistent with usual and customary methods, and under the oversight of the Minister.

2. If it is determined that the methods or equipment used have provided too low a measurement, the shortfall shall be deemed to have existed since the previous inspection review took place, unless it can be documented that the shortfall has existed for a shorter or a longer period of time.

§ 24

1. If the License is granted to a consortium, each member of said consortium shall be jointly and severally liable for any compensation payable pursuant to Article 7 of the Hydrocarbon Activities Act and for any of the obligations held under this License towards the Faroese Government.

§ 25

1. To ensure that the Licensee complies with all the obligations under this License, including, but not limited to, any compensation for damages, the Licensee shall provide evidence of sufficient security within thirty (30) days from the issuance of said License in an amount and of a kind that is acceptable to the Minister, including a comfort letter guarantee from the parent company, unless the Minister exempts the Licensee of this requirement. The Minister may subsequently require upon 30-days' notice that such security be amended or supplemented.

§ 26

1. This License or any part thereof shall not be assigned or otherwise transferred, directly or indirectly, in whole or in part, to any third party or from one co-Licensee to another, without the prior written approval of the Minister. The same restrictions are applicable to the sale of company stock or other ownership interests that may have a direct consequence to the company or other entity that is a Licensee or co-Licensee, or to any agreements entered into by the Licensee or co-Licensee.

§ 27

1. In the event that the rights granted under this License are relinquished during the exploration phase, said abandonment shall extend to the entire license area, unless the Minister consents to partial abandonment of the area.

2. In the event that the Term of the License is extended for one or more areas for the purpose of production, the Licensee may relinquish the right to similar areas subject to a one-year notice.

§ 28

1. In the event that the License expires, is abandoned or is rescinded, the Licensee shall not be relieved of its obligations under any relevant legislation, this License or other applicable rules and regulations, conditions or directives.

2. In the event that any part of the Work Programme set forth in Annex II hereto is not performed, the Licensee shall, unless the Minister grants an exemption, pay the Directorate an amount equal to the estimated cost of performing that relevant part of the Work Programme. Such cost shall be calculated in light of the expenses that would have been incurred if a third party were to perform the work on behalf of the Minister upon the expiry of the License.

3. Payment of the amount referenced in Clause 2 above is not conditioned upon the Minister arranging for the completion of the abandoned work.

4. Payment shall be made no later than 30 days after the Minister has submitted a demand for payment.

5. In the event of overdue payments, the Licensee shall pay interest at an annual rate equal to the then current official discount rate set by the Danish National Bank (Danmarks Nationalbank) plus 6% from the date the payment is due and payable to the actual date of payment.

§ 29

1. The Licensee shall indemnify and hold harmless the Government of the Faroe Islands, the Earth and Energy Directorate and all related and collateral parties from any and all disputes, actions, claims or causes of action (including attorneys' fee and costs) brought by a third party arising out of or in connection with the activities of the Licensee or co-Licensee undertaken pursuant to this License.

2. The Minister shall notify the Licensee of any claim falling within the scope of Clause 1 above. In the event that the Minister considers any such claim unjustified, the Minister shall reject the claim, if necessary by bringing the matter before the courts. The Licensee may join any action brought in respect of such claim in accordance with the applicable provisions of the Administration of Justice Act.

§ 30

1. This License and any activities undertaken pursuant to this License shall be subject to the then current laws in force in the Faroe Islands, including, but not limited to, subsequent amendments to the Hydrocarbon Activities Act, or relevant regulations or directives. This License shall not be construed in any manner as to restrict the right of the Faroese Government to levy taxes or its authority to issue specific directives or regulations governing how exploration and production activities shall be carried out.

2. This License shall not exempt the Licensee from obtaining any other required licenses and/or approvals pursuant to the Hydrocarbon Activities Act or any other legislation.

§ 31

1. Licensees that do not have a subsidiary company or a branch registered in the Faroe Islands shall establish a subsidiary company or a branch no later than three (3) months after the License is granted.

§ 32

1. Any disputes or controversies arising out of or in connection with this License or with the activities of the Licensee undertaken pursuant to this License shall be resolved pursuant to the then current legislation in force in the Faroe Islands, and shall be brought before a Faroese or a Danish court.

2. The venue shall be Tórshavn.

3. Clause 1 and 2 above shall not prejudice the right of the Minister and the Licensee to decide, in any particular case, that a dispute or controversy referenced in Clause 1 shall be resolved by arbitration.

ANNEX I

MODEL LICENSE
FOR THE
EXPLORATION AND EXPLOITATION OF HYDROCARBONS
THIRD LICENSING ROUND

NOTE: Annex I is provided for illustration purposes only. Based on the offer of the applicant and the determination of the Minister, each individual License Area shall be specifically stipulated.

Area covered by the License (Confer § 2, Clause 1 of the License).

The License encompasses the area represented in block(s) _____,
as shown on the attached map, with the following coordinates:

European Coordinate System: ETRS89

<u>LATITUDE</u>			<u>LONGITUDE</u>		
Degree	Minutes	Seconds	Degree	Minutes	Seconds
..
..
..

ANNEX II

MODEL LICENSE FOR THE EXPLORATION AND EXPLOITATION OF HYDROCARBONS THIRD LICENSING ROUND

NOTE: Annex II is provided for illustration purposes only. Based on the offer of the applicant and the determination of the Minister, each individual Work Programme shall be specifically stipulated.

License Term and the Stipulated Work Programme of the License (Confer § 4, Clause 1 of the License).

The following License Term and Work Programme cover the exploration activities that the Licensee shall undertake pursuant to § 4, Clause 1 of License No. _____ for Exploration and Exploitation of Hydrocarbons, dated _____, which is effective for the License Area represented by block(s) _____. See Annex I.

1. The License Term is _____ years, divided into two parts: (i) an Initial License Term of _____ years with a Fixed Work Programme, and (ii) a Secondary License Term of _____ years with a Conditional Work Programme. In the event that the Licensee does not intend to undertake the Conditional Work Programme, the License shall terminate at the expiry of the Initial License Term.
2. No later than two (2) years after the License is issued, the Licensee shall have acquired _____ km of its own 2D seismic data. Of this data, a minimum of _____ km shall lie within the Licensee's block(s).
3. No later than _____ years after the License is issued, the Licensee shall have drilled one exploration well, pursuant to the following conditions:
4. The exploration well(s) shall be drilled through/to _____ (geological description) or to a maximum depth of _____ metres, whichever is gained first. The decision to drill or to abandon the License shall be taken no later than _____.
5. The acquisition of seismic data and the drilling of the well(s) shall be carried out in a manner consistent with industry best practices and pursuant to relevant governmental directives.
6. Prior to the commencement of the Work Programme, the Licensee may request the Minister to take a decision as to whether the work planned fully complies with the approved Work Programme.

In the event that the Licensee relinquishes the license area, in whole or in part, the Licensee shall submit a final report to the Minister on the hydrocarbon potential of the area that the Licensee has abandoned.

Chapter 1. General Comments

1. Introduction

In order to maintain steady exploration activities, it is usual to have equally spaced licensing rounds. Based on the work that has been conducted on the continental shelf and the potential that exists to find a significant deposit, the Earth and Energy Directorate [hereinafter, "the Directorate"] estimates that the time has come to begin work on a 3rd licensing round.

Parliamentary Act No. 31, dated 16 March 1998, governing hydrocarbon activities [hereinafter, "the Hydrocarbon Activities Act"] stipulates in § 7, Clause 1 that permission to explore and exploit hydrocarbons shall be granted after public notice of an application tender is provided. Pursuant to § 7, Clause 2, an act of Parliament shall stipulate the area to be offered and the standard terms and conditions of a license. The Act also stipulates that the comments to the proposed legislation should evaluate the consequences that hydrocarbon activities could have for navigation, the fisheries, the business community, the natural environment, and other community interests. Moreover, the comments shall evaluate what contribution such activities could make to the economy, to the business community and the labour market as a whole.

Once the law on the licensing round is approved, it is the Minister who shall grant the licenses. The applicants that are granted a license shall comply with the terms and conditions regarding relevant knowledge of the oil industry, experience, competence and financial strength. Moreover, the Work Programme proposed by the applicant is considered quite important and shall be thoroughly reviewed on its merits.

Pursuant to § 44 of the Act on Hydrocarbon Activities, a report, which shall serve as the basis for a debate on overall oil policy, shall be submitted to the Parliament every other year. The latest debate on the oil policy was in connection with the 2nd licensing round in 2004/2005. These comments to the bill on the 3rd licensing round are intended to serve as the basis for the parliamentary debate pursuant to § 44.

2. Background

To date, there have been two licensing rounds. The first was in 2000, the second in 2004/2005. In the first licensing round, interest was quite keen, but when the result did not meet expectations, interest dwindled for the second licensing round. Two types of licenses were granted in the first licensing round. Of the seven licenses granted, four were the so-called "6-year licenses", and three were the "9-year licenses". The 6-year licenses were granted for areas to the southeast, for which there was the most interest, while the 9-year licenses were for areas further in on the continental shelf and farther from the known British fields where knowledge consequently was less than in the 6-year license areas. Altogether, the 6-year licenses required a total of eight wells to be drilled. The 9-year licenses did not require any wells to be drilled. In order to gain more knowledge about the 9-year license areas, the consortia were allotted three years to carry out relevant studies to determine if they wanted to continue with their Work Programmes after the first three years.

The drilling stipulated in the first licensing round has not been completed. Four wells have been drilled in the southeast corner, but the result was not as expected. As a consequence, the prospect of finding hydrocarbons in those licensed areas faded somewhat and the Minister therefore agreed to a request from two of the consortia to convert the remaining obligation to drill four wells in the 6-year license areas to an obligation to drill two wells through basalt in the L006 and L007 9-year license areas, where the probability of finding hydrocarbons was estimated to be greater. The first of these wells was drilled in 2006 in license area L006. The drilling in 2006 demonstrated that drilling through basalt was not as difficult as previously believed. The last well stipulated under the first licensing round began to be drilled in October 2007, but is as yet not completed (March 2008).

Three of the four licenses from the first licensing round granted for the southeast corner are now relinquished, as well as half of the fourth license.

Activities related to the 9-year licenses are progressing well. As stated, drilling obligations shifted to these licenses. Moreover, one of the consortia has given notice that they also will drill a well in their 9-year license area, L005.

As a part of its work programme, it was also agreed that the consortium will use a stipulated amount for research that will have import for future hydrocarbon exploration in the Faroese area. This resulted in the joint establishment of the research group, Sindri, by the licensees in 2001, which has contributed greatly to the increase of knowledge about Faroese geology and the structure of hydrocarbon deposits.

In addition to the geological studies and Sindri, great emphasis has been placed on ensuring that the Licensees are encouraged to support initiatives for competence building within the oil industry for the local business community.

3. Summary of Principle Terms and Conditions

The area recommended to be offered is 38,405 km². This represents a bounded area to the east, south and southwest of the Faroes. Please see Annex A of the proposed Licensing Act.

The intent behind offering this area is to create the foundation for on-going exploration undertakings, the purpose of which is to map out the extent of the hydrocarbon resources and to fully explore the potential for commercial hydrocarbon production in the Faroes.

During the preparation for the licensing round and the final award of the licenses of the 3rd licensing round, and while engaged in the administration of the Work Programmes stipulated in the licenses, the Directorate will keep the purpose of the Hydrocarbon Activities Act fully in mind, namely to work diligently toward a **cautious and reasonable exploration and exploitation of hydrocarbon resources for the benefit of the Faroese economy and the overall business community in the Faroes, and to ensure that the various Work Programmes are organised in such a manner that the necessary precautions are taken to protect the fisheries, navigation, the natural environment and other community interests.**

All the terms and conditions governing the oil companies are not included in this bill. Tax issues are governed by Parliamentary Act No. 26, dated 21 April 1999, on taxable income of hydrocarbon activities, as amended (special taxes) and Parliamentary Act No. 16, dated 14 February 2000 on, *inter alia*, the assessment, collection and oversight of taxes on the income from hydrocarbon activities.

Other Faroese legislation remains in effect.

It is recommended that the same licensing regime for the 2nd licensing round be used, wherein the Minister stipulates in the exploration license how the license term shall be organised and what exploration obligations are binding under the license. The exploration obligations that shall be imposed on each licensee should mirror the assumed potential for each license area.

Pursuant to the Hydrocarbon Activities Act and the Model License (Annex B of the Licensing Act), the licensees are bound to ensure that Faroese businesses are offered actual opportunities, in free and open competition with others, to provide goods and services to the licensee(s) as either the principle contractor or the subcontractor. At the same time, the licensees have the responsibility to diligently strive to encourage an environment in which Faroese and foreign companies and governmental agencies enter into agreements that foster the development of Faroese competencies within and technical knowledge of the oil industry. This shall be done with the intent of making Faroese companies more competitive and encouraging them to enter into new markets.

The license applicants should pay an application fee of 50,000 DKK upon applying for a license to explore and exploit hydrocarbons. In addition, upon being granted a license to a certain part of the continental shelf, the licensees shall pay an annual area fee and a fee for the environmental impact assessment. The fee shall be based on the size of the area covered by the license. A production fee shall be assessed on the hydrocarbon extracted, which is 2% of the calculated sales value. In addi-

tion, a business tax of 27% is levied on production, as well as the special tax. Under this tax regime, the total taxes/duties due the national treasury equates to less than 57%.

4. Summary of 1st and 2nd Licensing Rounds

On 17 August 2000, the first licensing round granted seven licenses for exploration and exploitation of hydrocarbons, four 6-year licenses and three 9-year licenses. The 6-year licenses were granted for the Judd Basin in the southernmost part of Block 6004 and 6005. There is very little basalt in this sedimentary basin in the southeast corner that would hinder oil exploration. Furthermore, this area is near producing oil reserves in the British sector. Oil companies had sufficient seismic data available in the Judd basin well before the licensing round was initiated.

Thus, it was well known prior to the first licensing round that there would be competition for these blocks. The combined work programmes for the licenses that were granted encompassed eight wells, as well as seismic studies.

The three 9-year licenses were granted for areas outside the Judd Basin. The sediments outside the Judd Basin are covered by basalt and are believed to contain hydrocarbon deposits. The work programmes agreed upon for these licenses covered a three-year period, wherein the licensees should undertake various geophysical surveys and studies that could assist in the determination of whether to undertake test drilling in these areas. As stated above, four of the agreed upon wells for the 6-year license areas were exchanged for two test wells through basalt in the 9-year license areas L006 and L007. As a consequence, activities related to the first licensing round are being carried out today in these regions.

As part of the work programmes, it was also agreed that the licensees should set aside a total of nearly 40 million DKK towards research projects administered by Sindri focusing on future hydrocarbon exploration. The Hydrocarbon Activities Act stipulates as well that the licensees should strive to develop the oil industry competence not only of individuals, but also the for Faroese business community as a whole. It was agreed that the oil companies should dedicate around 84 million DKK for this purpose.

On 17 January 2005, seven other licenses were granted in addition to the first seven licenses granted for the exploration and exploitation of hydrocarbons. The areas that were licensed extended more to the north and west of the boundary with the United Kingdom than the first licenses. The license areas offered in this subsequent round were similar to those areas covered by the 9-year licenses granted during the first licensing round, in that the areas of greatest exploration interest are covered by basalt. In spite of the basalt, it is possible in these areas to map out interesting structures that could serve as reservoirs of oil and gas. The work programmes that were agreed upon for the second licensing round were combined into an initial phase with the focus on the development of seismic data before a decision would be taken on whether to proceed with the next phase of the work programme that would focus on more detailed surveys or a test drilling.

It was agreed that Sindri would distribute some 10 million DKK and that 13 million DKK would be used to advance local competence within the oil industry.

4.1 Results of the test drilling

To date, four exploration wells have been drilled in the Judd Basin on the Faroese continental shelf, one well in each of the 6-year license areas. Three wells were drilled in 2001 and one in 2003. The results from the exploratory drilling were varied. All drilling targeted sandy sediments that corresponded with those in the Foinaven and Schiehallion fields east of the boundary between the Faroes and the United Kingdom. Such comparisons proved to be unreliable, because the play types failed. These strata contained high-quality sandstone sediment, which generally can hold hydrocarbons, but in this case, in the main, were filled with water and only small amounts or traces of hydrocarbons. A large quantity of sand, compared to shale, was one reason why the play types failed

The third well, *Marjun*, which was drilled by Amerada Hess in 2001, was drilled deeper than the commitment depth. The borehole went through around 170 m of hydrocarbon bearing sandstone and clay sediment from the lower Palaeocene period. The production potential of the reservoir rock in this

stratum is not good because of the depth. However, there is insufficient data available to determine if commercial production is possible, given the technical possibilities for exploitation and access to existing pipelines for transport of the production.

Subsequent to the verification of the results from the drilling in the Judd Basin, exploration is now focused on the so-called "structural" play types in areas outside the Judd Basin, e.g. on and around the East Faroe High, that is very similar to the Corona Ridge within a UK region where significant deposits have been found in recent years.

In 2006, a test well was drilled in license area L006 through thick basalt layers to determine if hydrocarbon bearing sediments were to be found deeper. Even though only traces of gas were measured in the well, the drilling ended well, with the following results: (i) the drilling went well, (ii) the thickness of the basalt in the region was established, and (iii) there were indications of a working hydrocarbon system below the borehole's terminated depth. This is useful information that can support further exploration.

In October 2007, BP undertook the sixth test well named William in license area L007. This well was also in an area where the anticipated thickness of the basalt was more than that encountered in the first four test wells.

ENI is the operator for the third 9-year license area, L005, and the Licensees have decided to drill a test well. This shall be undertaken before the license expires in 2009.

5. Main Terms and Conditions for the 3rd Licensing Round

The main terms and conditions for the 3rd Licensing Round are listed below. These terms and conditions relate, *inter alia*, to the areas to be offered, the exploration conditions, the economic conditions, as well as business-related issues. In Clause 5.6, other individual standard terms and conditions are briefly described.

The purpose of the 3rd Licensing Round is to create the conditions for on-going activities, the purpose of which is to find and exploit to the fullest extent possible the identified hydrocarbons in the Faroese subsoil.

The blocks intended to be offered are technically challenging because the knowledge of the strata under the basalt, where one would expect to find hydrocarbons, is limited. The basalt layers complicate the results of the geophysical surveys that are used in connection with oil exploration such that it is difficult to map the geologic strata under the basalt. Significant technical advances have been made in recent years that reduce these difficulties.

5.1 Basis for 3rd Licensing Round

The interest for oil exploration in the Atlantic Margin and most especially in the Shetland Trench is steadily growing. This increasing interest is based partly on interesting deposits that have been found close to the boundary with the United Kingdom and partly because technology has advanced so that the difficulties associated with basalt, which covers a large part of the area, are minimized, both with regard to seismic surveys and drilling.

The Faroese region is a frontier oil exploration region with only 5 test wells, four of which investigated the same play type. Thus, only two play types were explored, and these confirmed that hydrocarbons exist in the subsoil. Moreover, we know that there are major structures that could contain hydrocarbons in significant amounts. Some of these are within current license areas, while others lie in other areas of the region, which are now to be offered for licensing.

The area that is intended to be offered covers (i) areas that were previously licensed and now are relinquished or will be relinquished before the license period is concluded, and (ii) areas that have not been offered before (see attached map). The area to be offered now is further north and west, compared to the other licensed areas. The reason to select this area is that it is believed that the need exists to enlarge the area open to exploration, in addition to the fact that the area has been determined to be of interest based on the limited geological information available on the area.

From an oil exploration perspective, the license area covers four quite distinct regions.

The Judd Basin is a part of the Shetland Trench where the first four wells were drilled. We know a good deal about this area and thus the technical risks are minimal, but at the same time it is estimated that there is only a small and deep stratum on which to focus. On the other hand, it is exactly in the Judd Basin that BP showed trace amounts of oil/gas and Amerada Hess discovered its Marjun deposit and thus it is worthwhile to offer the area again in order that other companies might conduct further surveys.

The Shetland Trench, as a whole, is where the latest finds have occurred. This area encompasses most of the existing exploration licenses in the Faroese region and it is here that the well of the L007 BP consortium is located as well as the well of the L005 ENI consortium. Most of the major structures are presently part of existing exploration licenses, but there still are areas that are anticipated to be of interest.

The Fugloy Ridge is a large ridge of which there is but little information relevant to oil exploration and therefore the technical and financial risks are great. However, the increasing interest in the Shetland Trench means that this area could also be of interest to the oil companies.

Area west of the Munkagrinnur Ridge. This is a geologically interesting area with very large structures. In the same way as the Fugloy Ridge, this is an area about which but little is known and therefore the risks are great. It has not been confirmed whether or not there is a structure with potential hydrocarbons here, but it has been confirmed that there is interest for this area in which there is one exploration license. In an area to the south of the boundary, a sector has been offered in the UK licensing round announced on 20 February 2008.

Given that the exploration area is to be expanded into different areas thereby encompassing several different play types, while at the same time strong new companies are desirous of entering the licensing round, oil exploration will be strengthened in the Faroes so that the impact of a single setback will be minimized.

The Directorate has prepared a proposal as to which areas should be offered. The list of areas that had been originally proposed to be offered was subsequently revised following consultation with environmental and fisheries interests.

5.2 Exploration Conditions

It is recommended that the same simple and flexible license regime used in the 2nd licensing round be used, wherein the Minister grants licenses that stipulate how the license term shall be organised, and what obligatory work programmes are to be undertaken under the license. Pursuant to the Hydrocarbon Activities Act, licenses for hydrocarbon exploration can be granted for a period of up to 12 years, which may be extended for up to two years at a time for a total of 16 years at most.

There is little probability that a company that applies for a license in the 3rd licensing round would have a prospect ready for drilling. Rather it is anticipated that the companies would have an interest in certain possible areas about which they have knowledge gleaned from purchased data and possibly from work carried out in connection with the 1st and 2nd licensing rounds. To follow-up by working on these possibilities would be appropriate, thus it is believed that the oil companies would offer a work programme that is segmented into phases such that new seismic surveys and/or other studies would be carried out prior to taking a decision whether to continue on further, including possibly drilling, or whether to relinquish the license.

5.3 Taxes and Fees

Matters related to taxes and fees are set forth in the Hydrocarbon Taxation Act, in the licenses and in regulations and directives promulgated under authority of the Hydrocarbon Taxation Act.

The Hydrocarbon Taxation Act stipulates what activities are covered by the Act. Briefly, the Act imposes on oil companies and their subcontractors the requirement to pay tax on its activities and for individuals to pay personal income tax. Faroese companies acting as subcontractors for the oil indus-

try do not have to prepare a special tax report regarding their participation in these activities because their commercial activities are covered by the income tax report normally prepared by the company.

One goal of the hydrocarbon tax regime is that it shall ensure the Faroese community its financial share. Another goal was to design a tax regime that would be consistent and predictable, meaning that it should be so structured that it would be unnecessary to repeatedly amend it, even though circumstances to a certain extent might change. The hydrocarbon tax regime is therefore two-fold: one part is corporate tax, which levies taxes on "ordinary" income; the other aspect of the tax regime relates to a special tax, which is triggered by especially high earnings from oil production.

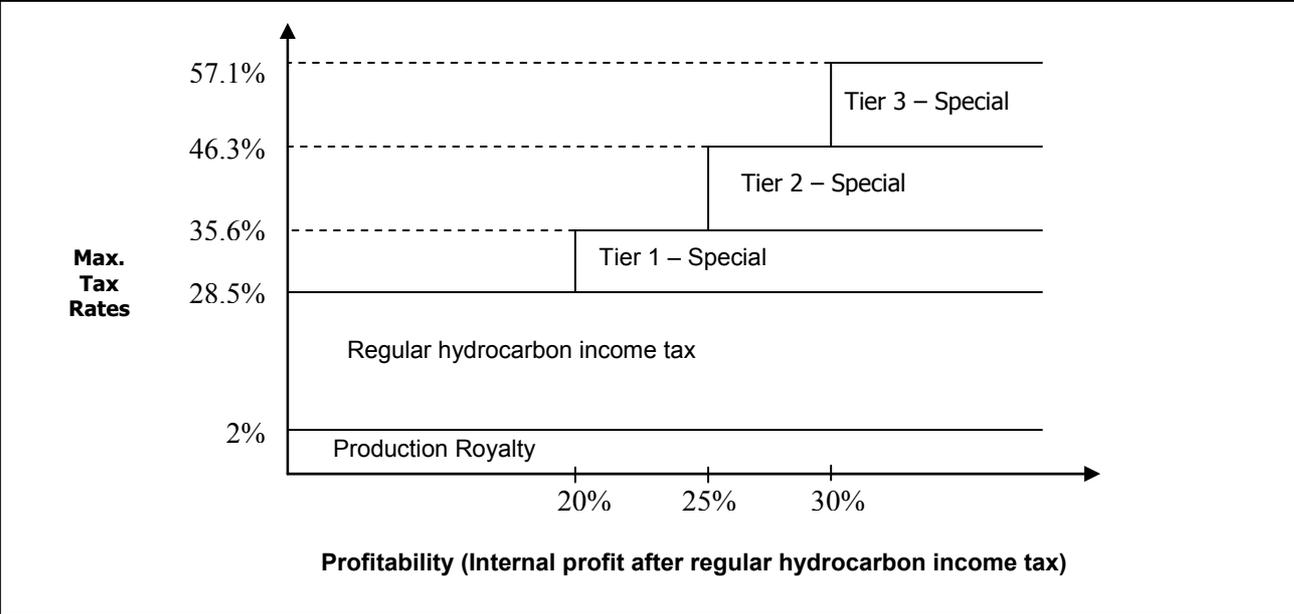
The corporate tax for oil companies is 27%. In the event that an oil company earns a high income, it shall also pay a special tax. This special tax is in three stages, dependent on the rate of profitability. If the rate of return on investment and operations is less than 20%, there is no special tax levied. If the rate is between 20% and 25%, a special tax of 10% is levied, etc. If the rate is 30% or greater, the special tax is 40%, which is the highest rate in effect.

In addition to taxes, pursuant to §§ 8 – 10 of the Model License, the intent is to levy a Hydrocarbon Production Royalty (HP Royalty) on the income of the oil companies. In the first and second licensing round, the HP Royalty was 2% and it is recommended that the HP Royalty remains unchanged in the third licensing round.

The production royalty shall be calculated on the gross value of hydrocarbons sold. This means that when the first barrel is sold, the production royalty shall be paid into the national treasury. This is not the case with taxable income because a company is not subject to taxation as income is earned. Current and carried forward costs shall be recouped first.

The levying of a production royalty was the normal practice in many countries, but it is not so today. The reason is that to a certain extent such a royalty dampens the exploration interest of the oil companies because, as production from a field decreases or becomes marginal, the operational costs thus become proportionally higher. Thus, a gross production royalty could be one reason why production would be discontinued sooner than otherwise may have been the case. One should therefore cautiously apply this method of ensuring the national treasury gains a share of the wealth earned by the oil companies. A production royalty of 2% is, nevertheless, not believed to have any significant impact on oil company interests.

The production royalty can be deducted as an expense from taxable income in calculating the corporate as well as the special tax. An oil company's corporate tax can be deducted from the taxable income for purposes of calculating the special tax. For purposes of clarity, the total tax burden for oil companies is set forth in the Table below.



If the oil companies have a profit margin of less than 20% of investment and operational costs, they would pay around 28.5% in taxes and production royalty. If they come to the highest tax threshold, they would pay around 57% in taxes and production royalty, but this is conditioned on that they have a profitable rate of return of more than 30% of their investment and operational costs.

It should be noted that the corporate tax for other companies is 18%. To some, this might appear odd that there is a difference between the regular corporate tax for oil companies and that of other companies. It is recommended therefore that the tax regime be reviewed to investigate the consequences of a corporate tax of 18% together with a possible review of the special tax regime. A lower corporate tax structure could contribute to making the Faroes more competitive. Possible changes in the tax regime do not have to take effect at the same time as the 3rd licensing round. An amended tax regime would impact all exploration and production licenses in effect.

Of the taxes assessed by the countries around us, some are somewhat higher and some are lower than ours. Ireland has the lowest taxes at 25%. In Norway, which has the highest tax rate of any of the countries in our region, and where quite large hydrocarbon deposits are found, the corporate tax rate is 28%. On top of that is the special tax, which can be upwards of 50%. Between these two extremes lies, e.g., the United Kingdom, where the tax rate for new licenses is 50%. Even though these tax levels give an indication of the tax structures in these countries, the tax regimes cannot be directly compared because, e.g., the deductions, etc. allowed are different and the taxable income basis upon which the tax is calculated is also different from country to country.

In addition to taxes and the HP Royalty, the oil companies, pursuant to § 7 of the Model License, are obligated to pay an Area and Environment Fee for the areas they are allocated. The fee is 750 DKK for each square kilometre for the first six years and increases to 39,250 DKK at year 16 and possible subsequent years. If hydrocarbons are produced in an area, this fee is not required for that area.

The national treasury has derived some income from the exploration activities that have taken place to date. The paid-in taxes from companies and individuals that are not domiciled in the Faroes have amounted to around 63 million DKK through and including 2007. In addition, the area fee has been some 32 million DKK. Income from the fees for the collection of seismic data has been 15 million DKK. Altogether, hydrocarbon-related activities generated around 110 million DKK. Taxes and fees from companies and individuals domiciled in the Faroes levied on income from hydrocarbon-related activities have not been calculated separately, thus it is not possible to state how large this revenue has been for the national treasury.

It is difficult to estimate the amount of income to be derived from the new licensing round, if production of hydrocarbons were to occur. In order to provide an indication as to the numbers possible, an example is provided below for a field with a production of 200 million barrels.

If one assumes a long-term oil price of 50 USD per barrel – which at present would seem low – and operational costs, including the production royalty, of 21 USD per barrel, the taxable income would be 29 USD per barrel. Depending on how this amount was taxed, the nominal income for the national treasury would be between 9 and 17 billion DKK over a 15 – 20 year period. Please note that these numbers are for demonstration purposes only and should be viewed with caution, e.g. not included in these figures is the possible deduction by companies of “old” exploration costs from taxable income.

Field size (production) 200 million barrels	USD/barrel	Income to the national treasury billions USD
Oil price	50	
Fixed costs and production costs	20	
Production royalty	1	
Taxable income	29	
Tax of 27 % & production royalty	8.83	9
Tax of 55 % & production royalty	16.95	17

¹ Assumed exchange rate USD/DKK 5.20

5.4 Double taxation agreements

For oil companies and their employees who work in a variety of countries, taxation issues are a significant determinant in the evaluation of how attractive a particular country might be to work in. Aside from the tax burden, etc. in the various countries, the oil companies also focus on the tax agreements that exist between countries. This is where double taxation treaties are very important. These agreements ensure that a company does not pay tax on the same income in several countries. We have long had double taxation agreements in place with the other Nordic countries, but we do not have a double taxation agreement in place with the United Kingdom. It is anticipated that such an agreement with the United Kingdom will soon come into effect.

5.5 Faroese participation in oil industry activities

It is self-evident that we in the Faroes should attempt to gain as much as possible from the oil industry undertakings, first with regard to exploration, and subsequently from development and production initiatives. The terms and conditions of the exploration licenses were constructed in such a way that the Faroese business community should have the possibility to effectively participate in the oil industry: (i) funds would be set aside for the development of the requisite competencies; (ii) the licenses stipulated specific conditions wherein Faroese companies could effectively participate in tenders for services in competition with others; (iii) the oil companies should facilitate linkages between Faroese and foreign companies; (iv) there should be focused efforts to ensure that the Faroese could obtain work and that Faroese researchers should have the possibility to participate in research that the licensees would be initiating relevant to their exploration undertakings in the Faroese region.

Experience has shown that it is not easy to effectively promote and implement Faroese participation in the oil industry. This is due partly to the fact that drilling activities are so sporadic. When many years pass with no drilling, and different licensees undertake drilling operations, it would appear not an easy task for the oil industry and local industry to cooperate.

5.5.1 Faroese services

§ 11 of the Hydrocarbon Activities Act stipulates that all transport to and from the Faroese region shall take place via Faroese ports or the Faroese international airport. In addition, § 12 in the Model License stipulates that Faroese companies in free and open competition with others should be afforded genuine opportunities to tender the goods and services needed by the licensees in connection with their activities in the Faroese region.

These provisions should ensure that Faroese companies could participate in hydrocarbon exploration activities. These conditions continue to be necessary because, even though these provisions are in place, it is not easy to meaningfully engage in these activities. The question is whether or not these provisions should be strengthened. From the perspective of the Faroese business community, it should be possible. On the other hand, the oil companies view as burdensome the requirement that all equipment and personnel involved in drilling in the Faroes should continue to be transported via Faroese ports or the airport. They believe that this provision does not especially enhance the development of Faroese competence in the oil industry. The Directorate is of the belief that overall the

goal of this provision is reasonable. However, further thought needs to be directed on how specifically the Faroese business community could secure a larger portion of oil-related business activity.

In order to increase Faroese participation overall, more could be done during each drilling to more closely link the needs of the oil companies with the offering of goods and services available in the Faroes. For example, a company engaged in drilling could be required to advertise in the Faroese media and invite Faroese businesses to acquaint themselves with the tender opportunities.

The Faroese authorities could support this effort by amending the relevant regulations that were promulgated in 2000. These regulations could require, for example, that the oil companies submit a report after each test well drilling is completed on which agreements were in effect regarding the drilling effort and of these which were entered into with Faroese companies. After each drilling is completed, a review meeting should be arranged, attended by the licensees involved in the drilling, the Faroese business community and the relevant government authorities.

The local earnings derived from the drilling that took place in the Faroes in 2006 equalled 62 million DKK. Drilling-related agreements that are especially lucrative have been shown to be those related to air transport, navigation and oil bunkering. Thus, the Faroese have gained some experience in air and sea transport in the offshore industry, which has shown to be of benefit in the acquisition of agreements internationally. A major portion of the activities based in the Faroes, on the other hand, will never lead to greater competencies within the offshore industry, even though they spin off some income. Here, one can mention the leasing of office space, hotel accommodation, insurance and telecommunications, etc.

One reason that not more local businesses are involved in the offshore industry is principally that the demands placed on local companies is such that their normal operations are disrupted. Furthermore, the offshore activities are only for short periods of time, which again limits the interest of many local companies. Also, it varies as to exactly how much focus each licensee places on this aspect of their operations.

Even though we should continue to strive to place as many activities as possible in the hands of Faroese businesses, we should also be aware that in the beginning this needs to take place within the limitations of the current level of exploration activity undertaken within the Faroese sector.

§ 11 of the Hydrocarbon Activities Act grants the Minister the authority in special circumstances to grant exceptions to the stipulation that equipment and personnel should be transported via Faroese ports or the airport. With regard to the five wells that have been drilled to date, exemptions have been granted some 15 – 20 times altogether. Exemptions have been granted because, for example,

- severe weather would have greatly delayed drilling,
- there was a temporary need for equipment
- there was an urgent personal need of an employee, and
- in one case, the agreed upon service could not be provided.

On the other hand, reasons based, for example, on the fact that it was cheaper to transport equipment directly to the drilling platform were not deemed sufficient to grant an exemption.

5.5.2 Linkages with foreign companies, employment options and research

Pursuant to § 13, Clause 1 in the model license, the licensees should strive to facilitate agreements between Faroese and foreign companies with the goal of enhancing competency and technical knowledge.

As part of this competency development, Faroese companies have also been assisted in the forging of linkages with foreign companies through which they could gain the skills necessary to participate in the international marketplace.

If the results are to be more widely disseminated, it is necessary to steadily work on this goal. To bring about such agreements is especially demanding and time consuming. It is difficult to say whether this is one reason why companies that have worked toward this goal nevertheless give up. One reason for this is possibility that the licensees have not placed sufficient emphasis on this re-

quirement. The Directorate therefore will strive specifically to ensure that the licensees pay strict attention to this provision.

Pursuant to § 13 in the Model License, the licensees shall strive to offer employment opportunities to Faroese workers.

In the main, what has spun out of this stipulation to date is that Faroese workers have been employed in the offices maintained by some oil companies in the Faroes. There have also been some individual jobs on the platforms. Some Faroese have offered their services to the oil companies, but not in connection with the license provision. In a meeting with the oil companies in August 2007, the Directorate brought this situation up and suggested that the oil companies consider advertising for personnel in the Faroes. Now it would seem that the oil companies have a need for workers and it is in their best interest to advertise locally, not just as a consequence of a specific provision in their licenses. The Directorate shall continue to follow up on how the licensees live up to this requirement.

§ 13 as well stipulates that the licensees should strive to give Faroese governmental agencies and companies the possibility to participate in research and development projects, if undertaken in connection with the work programme of the license.

As part of this requirement, the licensees have agreed to set aside funds for such R&D projects as described elsewhere in these comments, and that have importance for future oil exploration in the Faroese region. As a consequence, Faroese research facilities are participating in research and development projects that are focused on geological issues.

In addition, the licensees have supported Faroese PhD studies and the training at the University of the Faroe Islands and the Faroese Business School, as part of their obligation to support competency development.

5.5.3 Competency Development

As part of their overall license obligations, the licensees in the previous licensing round agreed to facilitate industry-related business development. In the first licensing round, some 85 million DKK was allocated for this purpose and in the second licensing round around 13 million DKK was allocated.

Each licensed consortium administers its own funds set aside for this purpose. If there is any doubt as to whether or not a particular project could be deemed an industry-related business development, the relevant companies shall decide, in consultation with the Directorate. Once a year, the various consortia shall submit a report to the Directorate on how these funds have been used.

In order to ensure a flexible process, the acceptance criteria were structured as simple as deemed advisable. Simple rules made it possible to easily judge whether or not a project was related to business development and thus could be undertaken with oil company support. Although opinions might differ on just how "business-related" a funded project might be, there has never been any disagreement on just how beneficial these projects have been to Faroese society in general. The alternative to this flexible regime is a more rigid scheme, but there is no indication that a more rigid scheme would be better.

Business development projects have been used to support training of staff, innovation in equipment and production, development of quality control processes, management skills and research, etc.

Education support is especially intended for higher education. The University of the Faroe Islands and the Faroese Business School have received funding. Support is especially provided to the University for the training of PhD candidates and education in oil engineering. PhD coursework is focused on, e.g., subjects related to the oil industry, wave modelling and fish farming in open waters. The Faroese Business School has offered, *inter alia*, management training in association with Robert Gordon University in Aberdeen.

The scheme has on the whole worked well. It has been suggested, however, that some changes should be introduced. One suggestion is that a specific amount should be stipulated for compe-

tency development, rather than competency development being just another parameter of drilling that is subject to negotiation. The other suggested change relates to who should administer the funds.

The amount that is dedicated to business competency development will never equal what was allocated during the first licensing round, but will more resemble that which was allocated during the second licensing round. That such funds should be negotiated as part of the drilling parameters, is therefore believed to be unnecessary. It is simpler to stipulate a specific amount and then let the negotiations focus on the content of a specific work programme, i.e., the geophysical work to be undertaken.

It has been suggested that the fee for business competency development be set at 200,000 for each license to be paid at the beginning of each license year. If a license were granted for five years, for example, the total fee for the license would be 1 million DKK.

The licensees are not in complete unity as to what is the best way to administer these funds: whether they themselves should undertake this or whether it should be handled by someone else. Some feel that it would be advantageous that the oil companies themselves administer the funds, while others see it as an administrative burden. The Directorate is of the opinion that it does not matter who administers the funds, if the funding principles are clear and actionable. Therefore, it should not be a problem if some licensees wish to administer their competency development funds themselves, as long as the Minister has the authority to stipulate who shall administer said development funds if certain licensees have no interest in administering these funds. For example, one could envision that such funds could be turned over to one or another of the existing business development initiatives for which the Faroese Government is responsible.

5.6 Other standard license terms and conditions

§ 18 of the Model License stipulates that the government agency responsible for hydrocarbon activity has the right to participate in meetings of the Joint Operating Committee of the respective Licensees. §§ 19 and 20 sets forth the obligations the licensees have to offer assistance to the employees of the various governmental oversight authorities in their investigation efforts. These provisions further stipulate that the government may promulgate specific regulations governing the information that the licensees are required to provide to the various oversight authorities.

§§ 21 and 22 set forth matters related to confidentiality, how long confidentiality must be maintained, etc.

§ 24 stipulates that the licensees in a consortium are jointly and severally liable for the damages and compensation due to fishermen that shall be paid pursuant to Article 7 of the Hydrocarbon Activities Act. § 25 requires that the licensees provide guarantees regarding said indemnification.

Pursuant to § 26, a license may not be transferred or assigned without the approval of the Minister.

6. Government participation

To date, the Government of the Faroes has not directly participated in hydrocarbon activities.

The first question to be addressed with regard to whether the government should directly participate in hydrocarbon activities is what is the purpose of such participation. Is it to derive revenue for the national treasury? Is it to gain a better insight into such activities? Or is it to have a greater influence?

If the purpose is to increase revenue into the national treasury, the consequence will be that less will flow to the oil companies. This is equivalent to increasing the taxes on earnings. It is, of course, difficult to judge if there is sufficient basis to increase the government's revenue share. However, one should bear in mind that there is a point at which the oil companies will determine that there is no longer any justification in continuing exploration activities in the Faroes and they will select another location. Exactly where this point lies is difficult to judge, but they have already indicated that they believe the corporate tax is too high and that the HP Royalty should be rescinded. If one compares the prospects for oil here in the Faroes and how much the national treasury would receive if oil is discovered with, for example, the taxes levied in the United Kingdom, it is doubtful how much we could actually increase the current tax burden.

If the government were to become directly involved in hydrocarbon activities, it is possible that the oil companies in the first instance would pay the expenses related to drilling that would ordinarily be allocated to the government (the so-called "carried interest"). If these costs should be re-paid or be deducted in some other way is a matter for negotiation, but one should anticipate that these costs must be "paid" in one way or another.

Another purpose could also be to gain a better insight into the daily activities of the industry. In one way or another, the government does have access to this insight in that the Directorate has on-going connection with the oil companies and can participate in the meetings of the Joint Operating Committees that the various oil consortia have, plus the Directorate collects all the data from the activities in the Faroes. It is not known whether everything is openly discussed at these meetings, so it could very well be that the governmental authorities do not have access to all relevant knowledge. How significant this might be is difficult to measure. To best achieve this particular goal through direct participation requires as well that people with the right training and experience be hired to undertake this and other tasks, and this has its own costs. Such a course of action will also will increase the competition for the relatively few people who have the necessary skills and competence for this type of work.

Yet another purpose might be to influence the industry. Regardless of what could be done in this area, it is questionable just exactly how much influence such limited participation could actually yield, compared to the influence that can be gained by stipulating the regulations for that which the government wishes to achieve.

Direct governmental participation is, therefore, not included in the proposed law on the 3rd licensing round.

7. Health, safety and the environment, etc.

The Hydrocarbon Activities Act stipulates that only well-qualified applicants will be granted exploration and exploitation licenses. It is the task of the governmental authorities to ensure that the applicants have the necessary industry knowledge, experience, competence and financial strength within the oil exploration and production business.

With regard to health, safety and the environment, the following prequalification criteria are decisive in determining whether an applicant can be adjudged as being sufficiently qualified to be granted a license:

- the applicant's guidelines vis-à-vis drilling operations
- the special challenges addressed by the applicant regarding drilling in deep water
- risk management tools in place, and
- the applicant's internal standards and requirements regarding competency development and the training of its employees

Moreover, the application for an exploration and exploitation license shall describe the requirements that the applicant itself sets with regard to health, safety and the environment, etc. These requirements should be designed to reflect the conditions found in Faroese waters, and the intended work programme delineated in the respective application.

When the license is granted, the regulations in the directives on health, safety and the environment during the exploration period, etc. enter into effect. The Hydrocarbon Activities Act stipulates that the "exploration and production activities shall be sound and reasonable". The licensees bear the responsibility that said activities are organised and undertaken in a safe and secure manner. The governmental authorities meanwhile shall ensure compliance with the respective regulations and directives. The regulations and directives on health, safety and the environment enforce during the exploration phase stipulates the necessary requirements regarding how drilling operations shall be carried out.

The licensees shall have an emergency response plan in place that shall be implemented in the event of accident or if hazardous conditions arise. In this regard, until now it has been required of the licensees to have a SAR helicopter on stand by in the Faroes while drilling was taking place. After evaluating this requirement, the Directorate has concluded that, given a publicly-owned search and rescue

helicopter is now available in the Faroes, it is reasonable to assume that the Faroese public emergency response system would also cover oil activities and that the licensees themselves do not need to ensure that a search and rescue helicopter is available in the Faroes. In the event that the licensees, on the other hand, determine that the public emergency response system is not sufficient, the licensees, of course, can themselves arrange to augment the emergency response system and pay the associated costs. When the licensees apply for a license to engage in drilling operations, the Directorate will determine if the emergency response system in place for all areas is sufficient and shall stipulate additional requirements should that prove necessary.

The emergency response plan shall also cover the actions and equipment necessary to address intermittent pollution of the ocean environment. Suitable oil spill recovery equipment is required to be available on site, in the Faroes, or obtained internationally within an appropriate period of time.

8. Consequences for the fishing industry, the environment, etc.

Pursuant to the second sentence in § 7, Clause 2, in the Hydrocarbon Activities Act, the comments to the legislation regarding the licensing round shall evaluate the impact pending hydrocarbon activities might have on navigation, the fisheries and other business, as well as on the natural environment and other social interests. Moreover, the comments shall address what contribution these activities could make to the general economy, the labour market and to the business community in general.

The Directorate has discussed the licensing round with representatives of various groups within the fishing industry, the Faroese Fisheries Laboratory, the Museum of Natural History, the Environment Branch of the Food, Veterinary and Environmental Agency (now the Environment Directorate) and BioFar.

At the meeting with the representatives of the fishing industry, it was noted that seismic activity disturbs the fisheries and it was deemed necessary to organise these activities better so that the fish stocks would be disturbed as little as possible. Moreover, the fishing industry representatives felt that the boundary of the area to be licensed designated in the original proposal was too close to land.

The Faroese Fisheries Laboratory has shown, *inter alia*, that the Faroe Bank and Munkagrinnur Ridge should not be included in the 3rd licensing round and that it is extremely important that there be direct and specific discussions between the fishing industry and the oil industry to ensure that seismic activities do not unnecessarily distress the fish stocks. Moreover, it was recommended that the areas with corals in which trawling is not permitted also be closed to oil drilling.

The Environment Directorate (previously the Environment Branch of the Food, Veterinary and Environmental Agency) showed, *inter alia*, that, before any final decision is taken as to the extent of the area to be offered for licensing, it is necessary to prepare a comprehensive evaluation of the impact possible hydrocarbon-related activities could have on the region (a so-called Strategic Environmental Assessment or SEA), especially if the Faroe Bank and sections of the continental shelf are included in the area to be licensed. Moreover, the agency expressed its opinion that, before a decision is taken as to which areas shall be offered for licensing, the governmental authorities, especially the administrative and scientific agencies, and the trade unions, etc. should be advised on the intentions and the relevant evaluations and be allowed to submit their comments. It was also felt that the decision to offer a particular area for offshore activities should be built upon a comprehensive knowledge of the area that also encompasses an understanding of the impact such activities might have on the area, not just with regard to exploration, but also with regard to potential exploitation and decommissioning of the well. In conclusion, the Environment Directorate stated that after an area is offered for exploration activities, an environmental impact assessment of the intended activities should be conducted, including a review of the ocean floor in the area as well in order to establish a baseline of environmental conditions before any drilling activities begin in the area.

BioFar had these comments: *A major portion of Faroese territorial waters is actually unknown, especially with regard to topography, sediments and the bio-diversity present on the ocean floor. The region in the main is sub-divided into areas with warm water (500 m or less) and areas with cold water. The animal life present on the ocean floor reflects these divisions as well as the types of sediment and ocean currents present.*

What is most evident is that extreme caution should be taken regarding areas with special conditions, especially those areas with special topography and animal life. Corals abound in much of the area set aside for licensing. Corals are especially sensitive to offshore activity. The coral fields lie in waters between 300 and 600 m in depth, which is essentially all the regions around the banks, but other areas as well.

We believe, therefore, that all oil companies that receive a license to explore for oil should prepare a detailed topographical map of the area. They should take photographs of the area and use other means to thoroughly record conditions in the area in order to assist in understanding the area. Relevant Faroese agencies should, of course, be provided this material for evaluation and study and should preserve it for future reference.

The Faroe Bank is so very special that it should not be offered for oil exploration."

The Directorate is of the opinion that knowledge of the area is sufficient to proceed with the licensing round. This conclusion is based on the following observations: (i) Before the 1st licensing round, comprehensive studies were undertaken to investigate and describe the natural environment within Faroese territorial waters. This work is, *inter alia*, described in the report, *Exploration Drilling in the Shetland Trench: Comments on the Environmental Impact*. The data upon which this report was based covered in large measure the area that is intended to be offered for licensing. In some instances, additional studies were undertaken to describe the licensed areas better after this report was made public. Prior to the 2nd licensing round, a supplemental report was prepared, *Exploration Drilling in Faroese Waters of the Second Licensing Round, Environmental Impact Assessment – EIA Addendum to the GEM Regional EIA of the First License Round*. The conclusions set forth in this report were based in large measure on the data from the first report that covered the entire Faroese region. It is, however, desirable that the work undertaken to describe the impact on the natural environment of exploration and production activities in the Faroes be organised in a manner that is comparable to a Strategic Environmental Assessment (SEA), which is used by our neighbours and is based on the European Union Directive 2001/42/EC on environmental assessments. Therefore, it is recommended that for the 3rd licensing round terms and conditions be stipulated in the Model License that require the licensees to pay a certain amount to finance the necessary studies of the natural environment within Faroese territorial waters and that build upon previous studies in order to ensure that an up-to-date description of the environment is available before oil activities get underway.

Regarding the area to be licensed, most of the comments from the agencies responsible for the natural environment of the Faroes and the fishing industry were noted and addressed.

The Directorate moreover has discussed the terms and conditions regarding oil exploration in the Faroes with the licensees and with the Oil Industry Association with the House of Industry. The conclusion that came out of these meetings was that the current regime on the whole is satisfactory, however, certain aspects regarding the so-called quay regulations and the tax scheme should be adjusted. These issues are discussed in more detail below.

Below are discussed the consequences potentially stemming from activities undertaken in connection with the 3rd licensing round for fisheries, navigation and the natural environment, in addition to other businesses, the economy, etc. The evaluations are based on potential activities undertaken during the exploration phase.

8.1 Consequences for navigation

Exploration activities on the Faroese continental shelf can impact navigation for, *inter alia*, the fishing fleet in two ways:

1. Platforms are moored in a specific area of the sea and as a consequence could interfere with the ease of navigation in Faroese territorial waters. Pursuant to the Hydrocarbon Activities Act, platforms should be surrounded by a safety zone. The ordinary width of the safety zone is 500 m around the platform.
2. Exploration activities on the continental shelf include ship traffic in Faroese waters with regard to both transport and seismic shooting, and thus can impact other navigation and the conditions under which the fishing fleet must operate.

Exactly how the platforms might impede navigation and to what extent ship traffic may be increased is dependent on how extensive the exploration activities are and how many platforms there are over time.

Ships engaged in the gathering of seismic data need to hold their designated course and speed within the designated area to ensure proper collection of data. Therefore, this activity should be arranged in such a way as to ensure that the seismic ships do not have to alter course because of the fishing fleet. Thus, it is necessary to coordinate with the Faroese Maritime Rescue and Coordination Centre (MRCC) to provide notice of these activities. Moreover, it is imperative that Faroese communication liaisons are onboard to facilitate expedient and appropriate communications with other ships that are in the area.

The conclusion is that the exploration activities and the associated navigation will not pose any appreciable hazard to other navigation.

8.2 Consequences for Faroese fisheries

Whether considering one or many wells, a platform, as noted above, must maintain a 500-meter safety zone in all directions. Fishing is not permitted within this area. If a platform is maintained in place with anchors, the anchoring area is greater than the safety zone. As a rule of thumb, the distance from the platform to the anchor equates to 2-3 times the depth of water. When estimating the consequences this has for the fisheries, it is necessary to distinguish between the various types of fisheries and the equipment used. The consequences are varied and depend on the type of equipment: bottom trawl, pelagic trawl, seine nets, lines or small nets, and whether the fishing effort seeks bottom fish or pelagic.

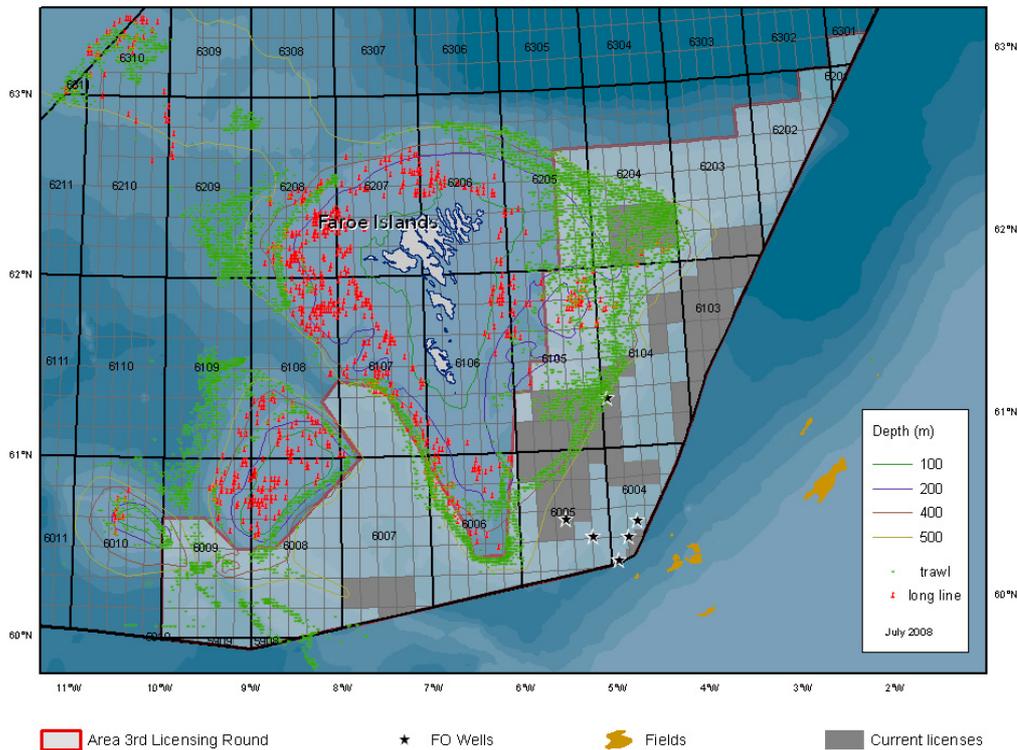
In the review of the proposed area to be offered for licensing, the following comments received during the hearing phase have been taken into account and accepted: (i) Munkagrinnur Ridge and Faroe Bank are not included, plus an area 24 nautical miles east of the Faroes. The shortest distance southwest to the licensed area from Suðuroy is approximately 18 nautical miles. Most of the licensed area lies in water more than 400 m deep. Bottom fish effort occurs mostly in water shallower than 400 m. The consequences for such fisheries are, therefore, limited, if exploration takes place at depths greater than this.

In principle, seismic shooting is not permitted from 1 November to 15 April. For certain areas, the restriction against seismic activity is extended to 31 May and 31 July, respectively.

Since 1998, the Faroese Sea Fisheries Inspectorate has operated a notice regime that provides information about seismic activity on the continental shelf.

Below is a map that shows the fisheries of trawlers and long-liners compared to the licensing area.

3rd Licensing Round



Even though exploration to the east and south of the Faroes can impact the potential of fully exploiting the fish stocks present in these areas, the conclusion of the Directorate is that exploration in the licensing area will not seriously disturb the fisheries. This decision is based first and foremost on the fact that the largest section of the licensing area lies in water deeper than most fishing effort for bottom fish occurs. When exploration wells are drilled, it takes normally only 70 – 100 days. Thus, there is really very little competition for the ocean during the exploration phase, which in most instances stretches over six years or more. Therefore, the catch potential of the fishing fleet will be reduced but little.

Pursuant to the licenses intended to be awarded as part of the 3rd licensing round, the initial activities, in the main, will be seismic shootings. During the period that this seismic activity takes place, the fisheries could be impeded, if they take place in the same area. The ships engaged in seismic shooting need to hold their prescribed course and speed in the area being studied to ensure satisfactory results. Therefore, this activity should be arranged in such a way as to ensure that the seismic ships do not have to alter course because of the fishing fleet. Thus, it is necessary to coordinate with the MRCC to provide adequate notice of these activities, plus the MRCC will need to make sure that Faroese communication liaisons are onboard to facilitate expedient and appropriate communications with other ships that might be in the area. For an exploration license that is in effect for three or more years, seismic studies generally last from 1 – 3 months. Thus, it is believed that seismic activity does not pose any severe threat to the fisheries.

In addition, it is recommended that a requirement be stipulated in the license for exploration and exploitation of hydrocarbons that the activities of the licensees and the fisheries in the area be organised in such a manner as to ensure that neither party is unnecessarily disturbed.

8.3 Impact on other industries – competition within the labour market

Given that activities in the exploration phase are generally minimal and limited to specific periods, experience to date indicates that activities on the platform and the supply bases have very limited impact on the demand for Faroese labour. Generally, the operator leases the platform with crew and

equipment. On any given supply base, there is only a few person-years of work available. This is also the case when there are several platforms operating in succession.

Based on the anticipated exploration activities and the expected demand for labour, there is little basis upon which to believe that the exploration activities connected with the 3rd licensing round in the first years will impact other industries to any notable degree.

In the discussions that have taken place with the oil companies regarding the terms and conditions for the 3rd licensing round, and the legislation as a whole, some have pointed out that the requirement that equipment shall first be transhipped to the Faroes, off-loaded here and then subsequently transported to the platform, makes exploration more costly.

The Faroese Oil Industry Association is of the opinion that the requirement to transport personnel and equipment via the airport and local ports should be continued.

Since the beginning, the Faroese view has been that hydrocarbon-related activities should be carried out via the Faroes for two reasons: (i) the Faroese business community should participate in these activities, and (ii) the activities within the Faroese region in the main should be operated from the Faroes.

8.4 Consequences for the natural environment

Hydrocarbon activities on the whole are believed to be a polluting enterprise in which pollution, first and foremost, stems from discharge from the platform into the sea and the atmosphere. Pollution can also stem from accidents. The extent of the impact on the environment is dependent on the safety protocols in place, the emergency response structure, the comprehensiveness of the actions taken to protect the environment, the attitude toward the environment manifested by the licensees and contractors, etc. On the whole, the oil industry has adopted a new perspective in recent years with regard to carefully organising its activities to protect the environment. However, it is still very important to maintain oversight of the activities undertaken by the oil companies to ensure that they are carried out with the appropriate care and concern for the environment.

It is important to continue to require that only companies/consortia that can demonstrate an environmental protection programme that meets the requirements of such internationally recognised standards as ISO 14001 or EMAS can be granted a license for exploration purposes in the Faroes in which drilling is a part of the work programme.

During test drilling, these discharges especially are anticipated to occur:

- drill bits and mud
- concrete residue
- waste water and sewage
- overflow from the drilling deck
- cooling water
- fumes and vapours
- accidental leakage

Unless the proper prevention measures are in place to prevent such discharges, there is a risk that the environment could be polluted with untoward ecological consequences for the animal life in the area. Most substances that are discharged cause little or no damage in and of themselves, while others could have a negative impact on the environment. Discharge permits specifically stipulate that toxic substances and compounds that bioaccumulate, as well as persistent synthetic substances, may not be discharged. The discharge into the atmosphere increases the overall Faroese discharge of greenhouse gasses, especially carbon dioxide and nitrous oxides.

The Hydrocarbon Activities Act expressly states that "licenses may only be granted to applicants that are deemed to have the requisite expertise, experience, resources and financial strength". Therefore, when applications for licenses are reviewed, careful attention must be paid to determine whether an applicant's competence regarding environmental issues is satisfactory.

Prior to undertaking drilling operations, other more specific requirements regarding the environment are stipulated. The regime stipulated in the Hydrocarbon Activities Act requires that a licensee shall obtain a special permit or approval for each and every activity it wishes to undertake. For example, the licensees may not drill a test well without prior approval for this activity. In addition, it is required that the licensees submit an assessment of the impact that drilling can have on the environment – a so-called environmental impact assessment. Each of the terms and conditions regarding the environment required of the licensee in connection with its test well operations are dependent, *inter alia*, on the conclusions stated in this environmental impact assessment.

The drilling mud that the licensees intend to use must be approved. The regulations on this are stipulated in Directive No. 37, dated 8 March 2001, on the use and removal of substances and materials from an offshore platform. Pursuant to this directive, a so-called discharge permit from the Environmental Directorate is required for the use and removal of all materials that are used in connection with drilling operations. This permit stipulates as well the conditions for the treatment of waste, notice requirements, etc. In the application for such a permit, the licensee must delineate all the information necessary to assess the impact of the discharge on the environment. In addition to this information, the licensee shall provide detailed information on the environmentally related characteristics of each of the substances that the licensee intends to use. Furthermore, the licensees are required to investigate the ocean floor environment at and around the drilling site. The conditions stipulated in said permit and the requirement for an environmental assessment are based on OSPAR¹ Convention regulations and principles.

One direct consequence of exploration is that the animal life in the area around the exploration operations is disturbed to a certain extent, especially small creatures on the bottom and in the ocean, fish, seabirds and marine mammals in general that are attracted to the offshore installation. Fish, seabirds and marine mammals to a certain extent can move away from the area and, when the exploration activities are concluded, can freely move back into the area. This is not the case for animals inhabiting the ocean floor, which for the most part are bound to a certain area.

Seabirds are especially vulnerable to oil slicks that are created from oil spillage and leaks. The previous drilling efforts experienced hardly any problems, aside from 50 litres of diesel oil leaking into the sea during a bunkering incident in 2001.

Our legislation requires an assessment of the potential impact of a drilling operation or a development project. The oil companies shall conduct a survey of the area in order to suitably describe the area so that once drilling operations are concluded it is possible to confirm whether or not the drilling activities impacted the area and to what extent.

For the 3rd licensing round, it is recommended that new terms and conditions be stipulated in the license that requires the licensees to pay a sum certain to finance surveys to describe the natural environment of Faroese territorial waters. In this manner, we can build upon those previous studies that were conducted specifically to gain a better understanding of the ocean environment before oil-related activities got underway. Specifically, these studies include the GEM survey carried out in connection with the 1st licensing round. Therefore, it is recommended that, as part of the licensing fee, the area lease fee be restructured as an "area and environment fee", wherein a part of this amount shall be allocated for the environmental assessment study referenced above (250 DKK per square kilometre per year). The area lease fee shall otherwise be transferred to the national treasury, while it is recommended that the Directorate shall administer the environmental fee and arrange, in collaboration with other governmental authorities, research institutes and the oil industry, which studies should be undertaken. Moreover, it is recommended that the guiding principles and structure of the previously mentioned Strategic Environmental Assessment be followed as much as possible.

8.5 Consequences for other societal interests

To date, we have experienced some exploratory operations and we can confirm that the impact on the Faroese community as a whole has been very little.

¹ On 23 October 1998, the Faroese Parliament adopted the Convention for the Protection of the Marine Environment of the North-East Atlantic (the "OSPAR Convention").

The impact on our society of a discovery of a commercially significant quantity of hydrocarbons is, on the other hand, difficult to predict. People have different opinions on how best to prepare our community for such a turn of events. Some would argue that it is difficult to prepare a society because the consequences could be quite varied, depending on how large the find or finds might be. This is very true. On the other hand, one could well ask whether it might not be reasonable to have a wide-ranging discussion to form a consensus on what issues need to be addressed relatively quickly and which ones could be postponed.

8.6 Assessment on what contribution hydrocarbon activities could offer the economy and the Faroese business community

The contribution that hydrocarbon activities undertaken pursuant to this licensing round can make to the Faroese economy and the local business community is dependent upon the exploration commitments to which the oil companies agree.

Experience has shown that, if only seismic and other geological activities are carried out, the effect on the Faroese economy and local business community will be but little.

Not until commercial quantities of hydrocarbons are confirmed, followed by development of the field(s) and subsequent production, can one expect any appreciable impact on the Faroese business community and the economy. The economic impact is dependent upon how the Faroese themselves wish this development to occur and the level of activity that is desired to actually occur within the Faroes. The Hydrocarbon Activities Act stipulates that before any field development takes place, said development must be approved by the relevant governmental authorities. Through such an approval process, the Faroese people can themselves ultimately control how development shall take place.

9. Implementation of the 3rd licensing round

This section briefly discusses the implementation of the licensing round subsequent to the adoption by the Parliament of the 3rd licensing round legislation.

9.1 Announcement of the licensing round

Subsequent to the adoption of the licensing law by the Parliament, the 3rd licensing round shall commence upon public notice in relevant Faroese and international media. The Minister intends that this will take place immediately after ratification of the law. The application deadline is anticipated to be three months after the date of public notice.

The invitation shall describe the main criteria that the applicants must comply with in order to be granted an exploration license, as well as the requirements for any substantiation documentation, etc. In addition, the invitation shall describe the area to be licensed and the standard terms and conditions of the Model License.

An individual company as well as a consortium of companies may apply for a license.

9.2 Prerequisites for the granting of a license

Pursuant to § 6 of the Hydrocarbon Activities Act, a license for exploration and exploitation of hydrocarbons may only be granted to an applicant that is deemed to have the necessary expertise, experience, competence and financial strength to undertake such activities. The designated operator shall comply with the technical specifications, while the consortium shall jointly and severally be held accountable for the financial requirements. The Model License stipulates that the licensees, joint and severally, are responsible for the payment of any damages assessed, etc.

One other prerequisite that is much emphasized in connection with the granting of a license is the competency of the applicants with regard to safety, health, work environment, and environmental issues, as well as emergency preparedness and disaster response protocols. See §§ 7 and 8.4 above.

The Minister shall moreover consider the extent to which the government is able to gain insight into and benefit from the activities related to the license.

9.3 Evaluation criteria when assessing the final licensees

When selecting the final licensees from among the applicants that meet the general prerequisites to be granted a license, considerable emphasis is placed first and foremost on an applicant's proposed work programme, including the documentation provided that demonstrates the applicant's competence and determination to undertake reasonable hydrocarbon exploration activities in the licensed area.

10. Administration, etc.

The work of the Directorate is anticipated to increase somewhat as a result of new licenses being awarded pursuant to this licensing round. However, it is believed that the tasks and duties of the Directorate will not increase very much immediately after the granting of the licenses. The current number of staff is believed to be sufficient to take on these new duties.

It is difficult to estimate the income that could be derived from the proposed licensing law. The income directly linked to the licensing round stems from the application fee. In addition, the area and environmental fee will provide some income.

In connection with the processing of the application, an application fee of 50,000 DKK is levied for each application. This is the same amount stipulated in the 2nd licensing round. This fee shall finance the costs incurred by the Faroese authorities to prepare the licensing round and to process the applications.

The proposed legislation on the 3rd licensing round for the exploration and exploitation of hydrocarbons will also have an impact on the activities of other governmental authorities and institutions, e.g. those involved with the administration of the ocean environment laws, the law on hydrocarbon taxation, etc.

11. Recommendations

During the process of drafting the proposed legislation, the Directorate held meetings with various interested parties.

The licensees at a meeting indicated, *inter alia*, that some of them deem that the requirement to transport goods, services and personnel via a Faroese port or airport increases the cost of operations and, therefore, could as well have a negative impact on the interest of an oil company to operate in the Faroese zone. In addition, they indicated, *inter alia*, that it would appear exorbitant that the corporate tax for the oil companies is set at 27%, while for other companies operating in the Faroes it is 18%.

The Directorate is of the opinion that there would appear to be grounds to review these issues, but such a review is not part of this proposal.

The Faroese Oil Industry Association associated with the House of Industry has indicated, *inter alia*, that while we are in a development phase it is important to maintain the requirement to transport goods, services and personnel via a Faroese port or airport.

From the very beginning, it has been a goal that the Faroese business community ought to have the opportunity to participate in hydrocarbon-related undertakings. One step in this regard is the above-referenced provision. The Directorate believes that the Faroes should continue to pursue this objective.

The Faroese Fisheries Laboratory, BioFar, the Environment Directorate (formerly the Environment Department of the Food, Veterinary, and Environmental Agency) have met with the Directorate and have prepared written comments to the law. The Museum of Natural History has also met with us, but has not prepared a written comment. It would appear that part of the region that the Directorate has proposed to be licensed should not be offered, because of their environmental sensitivity. Moreover, it was shown that the need exists to conduct several environmental assessments of the area to be offered for licensing.

The Directorate has taken into account the comments on the licensing area and has therefore removed the Faroe Bank and Munkagrundur Ridge from the original area proposed for licensing. With

regard to further environmental assessments, it is recommended that these be undertaken as soon as possible after the licenses for the 3rd licensing round are granted.

The Shipowners' Association, the Faroese Captains and Navigators Association, the Long-liners Association, the Trawlers Association, the Cargo Shipowners' Association, and the Maritime Industries Association have reviewed the documents related to the proposed legislation and met with the Directorate. Based on the comment that part of the proposed licensing region comes too close to land and would therefore disturb the fisheries, they recommended that the boundary of the licensing region should be moved further away from land. They also noted that seismic shooting at times is disruptive, and they recommended that these activities should be better planned in collaboration with the fishing industry.

The Directorate has taken into account their comments on the licensing area. Moreover, their comments on better collaboration with the fishing industry regarding seismic activities are noted as well.

Other representatives from the fishing industry and representatives of the various environmental interest groups also received the documentation regarding the proposed legislation and were invited to meet with the Directorate, but they declined.

Chapter 2. Overall consequences of the proposed legislation

Financial Impact

A. For the country

Initially, the only oil-related activities being considered are feasibility studies and possibly some exploration efforts. These will have but little financial consequence for the country. However, some revenue could be derived from the area lease fee, and, if drilling takes place, some additional revenue could be derived.

If hydrocarbons are discovered, considerable revenue could be expected to flow into the national treasury as a result of the Hydrocarbon Tax Act.

B. For the municipalities

During the exploration phase, there will be little if any financial consequences for the municipalities.

If hydrocarbon production is undertaken and such operations are conducted from the Faroes as the Hydrocarbon Activities Act so stipulates, those individual municipalities involved with such operations will derive some revenue.

C. For the business community

During the exploration phase, it is possible that certain companies will derive some income, but for most companies there will be but little revenue to be derived from activities during this period.

If production is undertaken, it can be expected that there will be much activity on land.

Administrative impact

A. For the country

The exploration phase is not expected to have any significant administrative impact on the country. If production takes place, it will be necessary to strengthen, *inter alia*, the Earth and Energy Directorate and the finance department responsible for the Hydrocarbon Tax Act.

B. For the municipalities

Rather limited impact.

C. For the business community

The proposed legislation does not propose any administrative changes on business.

Environmental Impact

The exploration phase is not expected to have any special consequences for the environment, however, this is dependent on the size of the operations undertaken. If there is development of one or several fields, it will be necessary to undertake this development cautiously and with due respect for the natural environment.

If hydrocarbon production is undertaken, one can expect increased discharge of greenhouse gasses.

Consequences for certain areas of the country

In the event that field development and production takes place, one can expect there to be repercussions for the business community in the Faroes, but it is difficult to assess which parts of the country will be most affected. One could anticipate that second-tier consequences will more than likely impact the entire country.

Consequences with regard to international conventions and directives

There are no consequences vis-à-vis existing agreements or directives. However, if the Faroes accedes to reduce its discharge of greenhouse gases, the challenge of reducing such discharge will be greater if there is hydrocarbon production.

Societal consequences

There are no direct and immediate consequences.

Table 1: Overview of Consequences

Consequences	For the country/ government	For the municipalities	For specific areas in the country	For various community inter- est groups and associations	For business
Financial / Economic	<i>Exploration phase:</i> Little <i>Production phase:</i> Significant	<i>Exploration phase:</i> None/Little <i>Production phase:</i> Some/sufficient for some municipalities	<i>Exploration phase:</i> None/Little <i>Production phase:</i> Some/sufficient for some areas	None	<i>Exploration phase:</i> None/Little <i>Production phase:</i> Some/sufficient for some areas
Administrative	<i>Exploration phase:</i> Insignificant <i>Production phase:</i> Considerable for some authorities	Insignificant	Insignificant	None	None
Environmental	<i>Exploration phase:</i> Depends on the activities <i>Production phase:</i> Increased discharge of greenhouse gas- ses	Insignificant	None	None	None

Comments to specific sections of the law

To § 1

Pursuant to § 7, Clause 2 in the Hydrocarbon Activities Act, the Parliament shall decide which areas shall be offered for hydrocarbon exploration and exploitation and which standard terms and conditions shall be required in this regard.

Following the passage of the licensing law, the Minister shall take the necessary steps to implement the licensing round and grant licenses to those applicants who are deemed to have met the prerequisites to be granted a license and who have committed themselves to the best work programme for their respective blocks.

The licenses are granted pursuant to the Hydrocarbon Activities Act, which stipulates both the rules under which licenses are granted and the rules regulating the various phases of hydrocarbon activity, i.e., prospecting, exploration and appraisal, field development and production as well as decommissioning.

To § 2

Pursuant to § 7, Clause 2 of the Hydrocarbon Activities Act, the proposed legislation stipulates the area to offered for the 3rd licensing round.

Please refer to the map attached herein as Annex A and made a part of this report by reference herein, and the General Comments above.

To § 3

Pursuant to § 7, Clause 2 of the Hydrocarbon Activities Act, the proposed legislation stipulates the standard terms and conditions for the licenses granted under the 3rd licensing round. The standard terms and conditions are set forth in the Model License, which is attached as Annex B and is made a part of this report by reference herein.

The standard terms and conditions are the same for all licenses and are not subject to negotiation prior to the granting of a license during the licensing round. If, during the licensing round, it becomes apparent that certain minor adjustments should to be made to the standard terms and conditions, the Minister is authorised to so amend the standard terms and conditions as required.

In addition to the standard terms and conditions, exploration and production licenses shall incorporate specific terms and conditions relative to the individual licenses. Unlike the standard terms and conditions, the individual terms and conditions cannot be stipulated before the applications have been submitted and negotiations have occurred with the individual applicants. Specific terms and conditions to be negotiated under the 3rd licensing round pertain to the area covered and the proposed work programme for the individual licensee.

Some of the provisions of the Model License authorise the Minister to promulgate specific regulations and directives under various circumstances. For example, § 12 of the Model License stipulates that the Minister may establish the procedures as to how the licensees shall report on their activities, which work is to be subcontracted, etc. The Minister shall ensure that said procedures comply with existing legislation governing commercial undertakings, trade agreements, etc.

Minister for Fisheries and Natural Resources

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