

## **EXPLANATORY NOTES ON THE PARLIAMENTARY ACT ON THE SECOND LICENSING ROUND**

### **1. Introduction**

In accordance with section 7(2) of Act No 31 of 16 March 1998 on Hydrocarbon Activities (the Hydrocarbon Activities Act), the objective of the Act is to define the areas to be offered for licensing and to establish the general terms and conditions on which licenses will be granted in the Second Licensing Round for the exploration for and production of hydrocarbons.

The Hydrocarbon Activities Act authorises the Faroese Minister of Trade and Industry to issue licenses for the exploration for and production of hydrocarbons in specific areas and on terms and conditions to be specified. In accordance with the Hydrocarbon Activities Act, licenses may be issued only after licensing rounds have been held. Such licensing rounds can be initiated upon the adoption of a Parliamentary Act defining the areas to be comprised by the invitation and the general terms and conditions on which licenses will be granted. Besides indicating the areas offered for licensing and setting out the general terms and conditions, the explanatory notes to such Parliamentary Acts on licensing rounds must include an assessment of the impact of the hydrocarbon activities on a number of areas of special importance to the Faroese community. When the areas offered for licensing and the general licensing conditions have been set out in a Parliamentary Act, the Minister of Trade and Industry will be responsible for carrying out the licensing round and granting licenses.

The first licenses for hydrocarbon exploration on the Faroese Continental Shelf were granted in August 2000. Parliamentary Act on the First Licensing Round for exploration for and production of hydrocarbons was passed by Parliament on 8 February 2000. The licensing round was launched on 17 February, and when the deadline for submitting license applications was up on 17 May the Ministry of Petroleum had received 22 applications from 17 companies, of which two were Faroese.

On the 17 of August 2000 seven licences were granted to five groups of companies, representing 12 oil companies. Four licenses were granted for a period of 6 years and three licenses were granted for 9 years. The total award area measures around 4,200 square kilometres or around 30% of the area originally offered for licensing. The work programmes for the 6-year licenses covered 8 well commitments in addition to a number of seismic and other surveys. The 9-year licenses consisted of two phases, for which an initial work programme was agreed for the first three years.

As part of the work programme it was decided that the oil companies should spend a certain amount of money on research focusing on future hydrocarbon exploration in the Faroese area. As a consequence the license holders jointly established the Sindri programme, which has contributed to increasing the understanding of the Faroese geology.

In 2003 new work programmes were agreed for the 9-year licenses. Initially it was expected that an extension of the work programmes for the 9-year licenses should cover 6 additional years and a well commitment. The work carried out under the 9-year licenses has given the license holders an interest in continuous surveys in the areas covered by the licenses. On the other hand, the results have not provided the oil companies with the necessary knowledge to undertake well commitments. The new work programmes therefore cover continuous geological surveys of the license area in addition to competence lift and research. The work programmes were extended for two years.

In addition to the geological work programmes Faroese Participation also formed part of the award criteria when the licenses were granted. The oil companies allocated DKK 85 millions to Faroese Participation. Around DKK 50 millions have been used to date.

To maintain a stable exploration activity countries tend to hold new licensing rounds at regular intervals. Based on the work carried out on the Faroe Shelf and the possibilities of commercial finds the Faroese Petroleum Administration and the Geological Survey believe that the time is right to instigate the second licensing round.

When licenses are granted, importance will be attached to the licensee's exploratory commitments, as these commitments reflect the minimum work to be carried out by a licensee to determine whether hydrocarbon reserves are present in the license area. In addition to exploratory commitments, it is vital that Faroese trade and industry are given an opportunity to take part in the activities in order to improve their skills and international competitiveness for the benefit of the Faroese community as a whole.

In planning the licensing round and supervising the activities carried out under the licenses, the focus of the Petroleum Administration will be the objective of the Hydrocarbon Activities Act, i.e. *"to provide for prudent and appropriate exploration and exploitation of hydrocarbon resources for the benefit of the Faroese economy and employment opportunities, and to plan the activities with due consideration given to fishing, navigation, the environment, nature and other interests of society."*

Not all the terms to which oil companies will have to conform when operating in the Faroe Islands are part of this Bill. The fiscal terms and conditions are regulated in Parliamentary Act No 26 of 21 April 1999 on the Taxation of Revenue relating to Hydrocarbon Activities with later amendments (special tax) and Parliamentary Act No 16 of 14 February 2000 on assessment, collection, audit, etc in connection with taxation of income derived from hydrocarbon activities (the Hydrocarbon Tax Administration Act).

Section 44 of the Act on Hydrocarbon Activities stipulates that every other year, a statement must be submitted to Parliament, which is to form the basis of a debate on oil policy, the next statement is to be submitted in 2004. The reading in Parliament of the Act on the Second Licensing Round will replace this debate.

## **2. Summary of the main licensing terms**

The recommended area offered for licensing covers approx. 19,000 square kilometres. It is a contiguous area to the east and southeast of the Faroe Islands and two smaller separate areas to the south and south west of the Faroe Islands. See Schedule A to The Parliamentary Bill on the Second Licensing Round.

The objective for licensing this area is to create a basis for continued exploration activities with the purpose of identifying commercial quantities of hydrocarbons in the subsoil and subsequent hydrocarbon production in the Faroe Islands. In the process importance will be attached to the testing of different exploration models.

It is proposed to use a simple licence regime where the Minister in the granted license specifies how the license term shall be organised and which exploration commitments shall be part of the licence. The exploration commitments imposed on the licensee shall reflect the prospectivity of the individual license area. The exploration commitments also include the licensee's support of future hydrocarbon exploration in the Faroese area.

In accordance with the Hydrocarbon Activities Act and the Model Licence (Schedule B to the Bill on the Second Licensing Round) it is proposed that obligations are imposed upon the licensees, which ensure that Faroese companies are provided with genuine opportunities, in competition with other companies, to obtain general contracts and subcontracts and to provide goods and services. Furthermore, licensees will be obligated to promote the forming of contracts between Faroese and foreign companies to build up competence and technological know-how of Faroese companies. These obligations are introduced in order to improve the competitiveness of Faroese industry and to promote the entry of Faroese companies into new markets.

It is recommended that the fiscal regime for the second licensing round remains the same as in the first licensing round.

This implies that applicants shall pay an application fee when applying for exploration and production licenses. Furthermore, once an exploration and production license has been obtained, the license holders shall pay an annual rental based on the size of the area comprised by the license. A royalty calculated as 2% of the landed value of production shall be paid for all quantities of hydrocarbons produced. The corporation tax on production income is fixed at 27%. On top of this, a special hydrocarbon income tax shall be paid. The marginal tax rate does not exceed approx. 57%.

### **3. The Macro Environment**

Petroleum exploration is a worldwide industry with the Faroese area being only one of many investment opportunities for oil companies.

A number of factors determine which areas the oil companies choose to invest in with the most important factor being the prospects of finding hydrocarbons in commercial

quantities. The fiscal regimes of the various countries and company strategies also form part of the decision making process.

Prior to the first licensing round the knowledge of the Faroese area was limited to data obtained from geological and geophysical surveys whereas extensive data on the Shetland Channel on the UK side of the boundary was available from exploration activities over the last 30 years. The drilling activities in 2001 and 2003 have substantially increased the geological data available from the south eastern part of the Faroese shelf where the 6-year licenses are located. The results from the drilling campaigns made oil companies revise the plays on which the drilling activities were based, consequently increasing the *exploration risk* in these areas compared to before the first wells were drilled. On the other hand, geological and geophysical survey data from other areas mean that the *risk* attached to exploration drillings has been reduced.

The exploration activities so far have confirmed that there is a working petroleum system on the Faroe Shelf, which is important knowledge for the oil companies.

With only a limited part of the Faroese area explored to date the prospects of finding large hydrocarbon deposits cannot be ruled out. Many other oil provinces around the world have been thoroughly explored and the prospects of finding large hydrocarbon deposits in these areas are therefore relatively small.

Gas discoveries in the Faroese subsoil could be more interesting now compared to a few years ago. Gas is normally transported to land by pipelines and no pipelines were in the area. Gas pipelines have now been established on the UK side of the boundary and a closer infrastructure could be an advantage for a possible future gas find. Forecasts predict that UK will be a net importer of gas within a few years. However, new pipelines in continental Europe will eventually lead to an integration of the UK and continental European markets and thus diversify the importing options for UK.

The Faroese area still holds interesting prospects and experience gained during the first licensing round has confirmed that the working environment in the Faroe Islands is good with political stability, reasonable fiscal conditions and a well organised society.

There are however obstacles: basalt layers, deep waters and challenging weather. The requirement that transport of equipment and passengers shall take place via a Faroese quay or airport is likely to constitute an - albeit small - extra cost and also requires changes in the working procedures for companies which perhaps otherwise would prefer to work out of a supply base located in Scotland.

The number of oil companies worldwide is decreasing. The past years have seen several oil companies either being taken over or merged with competitors, a factor which could limit competition for exploration areas. Moreover, concurrent with fewer commercial finds in the North Sea and west of Shetland oil companies are increasingly turning to other deep-water areas e.g. West Africa where the prospects of new hydrocarbon discoveries exceed those in our area. However, even with better prospects, the lack of

political stability together with other conditions that may not be as good as they are here, are factors which also are considered by oil companies when deciding which areas to explore.

In conclusion there is a certain interest in the Faroese area, all though it might be on a smaller scale compared to the first licensing round. The results of the drilling operations have not fully met the expectations held by oil companies, but the results have nevertheless produced positives indications of finding hydrocarbons.

#### **4. Main elements of the first licensing round**

The 6-year licenses were granted in the Judd basin in the southernmost part of blocks 6004 and 6005. The basalt cover in this sedimentary basin is very limited or absent and therefore not deterring exploration. The area is close to producing oil fields on the UK side of the boundary, and extensive seismic data was available of the Judd basin even before licenses were granted.

Prior to the first licensing round it was expected that oil companies would compete for licenses to explore these particular blocks. The work programmes for the four 6-year licenses encompass in total 8 well commitments as well as seismic surveys.

The three 9-year licenses were granted in areas outside the Judd basin where the sediments are covered by basalt layers of various thickness. The work programmes for the 9-year licenses covered various geological and geophysical surveys during three initial years with the purpose of identifying prospects for future exploration wells in the awarded areas.

##### **4.1 The geological results of the drilling operations**

Four exploration wells have been drilled in the Judd basin on the Faroese side of the boundary, one in each of the 6-year licences. Three wells were drilled in 2001 and one in 2003. The results of the drilling campaigns varied. All four wells targeted sediments corresponding to the Foinaven and Schiehallion discoveries east of the border. However, the wells demonstrated a discrepancy between the play types and the actual drilling results. The reservoir rock contains high-quality sandstone which may hold hydrocarbons, but in this case the reservoir rock mainly consisted of water with traces of hydrocarbons and hydrocarbons in non-commercial quantities. This shows that the properties of this reservoir rock are complex and that it is uncertain whether this type of reservoir rock in this area can warrant hydrocarbon production.

Despite the discouraging results the third well demonstrated that hydrocarbons are present deeper in the Judd basin than originally predicted. The Marjun well, which Amerada Hess drilled in 2001, was deepened beyond the commitment depth and encountered light hydrocarbons over a 170 m gross interval in the lower Palaeocene layers. In 2002 the same partnership drilled a well in the UK sector just opposite the

Marjun well and it confirmed the presence of hydrocarbons in the same sections as in the Marjun well. However, no production testing was performed in either of the wells, in the Marjun well due to technical reasons whereas the presence of hydrocarbons was said to be insufficient to warrant production testing in the other. These signs indicate that the properties of the reservoir rocks in these layers are complex and that the question of commercial production remains unanswered.

Some additional wells have been drilled in the UK sector of the Judd basin the past years. Although no well data has been released, the focus appears to have been on targets using the Foinaven/Schiehallion play-type, and that the exploration targets were found non-commercial. Based on this information and the results of the wells in the Faroese area the prospects of finding oil in the upper Palaeocene layers of the Judd basin are small. Therefore focus is now turned towards other play types.

The seismic surveys which were part of the 6-year licences have been carried out and the oil companies that have remaining well commitments are currently interpreting seismic data and drilling results in order to identify future drilling prospects. No drilling activity is planned for 2004.

In the autumn 2003 the work programmes for the 9-year licences were extended. The new work programmes comprise geological and geophysical surveys which shall contribute to the decision on how to proceed with exploration wells in the area. Seismic data shows large structures below the basalt, which under the right circumstances could contain significant volumes of hydrocarbons. The purpose of the geological and geophysical surveys that will be carried out under the 9-year licenses is to improve the quality of existing sub-basalt data and thus reduce financial and technical risks in connection with future drilling. However, geological and geophysical surveys can only assess potential hydrocarbons, it is necessary to drill to verify whether the sub-basalt structures hold hydrocarbon layers. In two of the licenses individual companies carry respectively 75% and 100% of the license commitments. Whether the companies will undertake drilling operations is therefore dependent on whether they succeed in farming in other companies to undertake parts of the commitment and thus share the risk of the drilling operation.

## **5. Main Elements of the Second Licensing Round**

Below, the main elements of the second licensing round will be discussed. Topics covered include areas offered for licensing, exploration conditions, financial aspects and commercial conditions. Chapter 5.6 briefly addresses a number of other general licensing conditions.

### **5.1 Rationale for the Second Licensing Round**

The objective of the Second Licensing Round is to create a basis for continued exploration activities on the Faroe Shelf with the purpose of identifying commercial quantities of hydrocarbons in the subsoil.

The areas offered for licensing are technically challenging because of the limited knowledge of the sub-basalt structures, in which it is hoped to find hydrocarbons. The basalt layers constitute an obstacle to the geophysical data acquisition methods which are used when exploring for oil.

British and Norwegian authorities have opened up new acreage for exploration along the Atlantic Margin. Norway's 18<sup>th</sup> licensing round closed in March 2004. The area offered for licensing comprises several deep-water blocks in the Norwegian Sea northeast of the Faroes. In its 22<sup>nd</sup> licensing round the British Department of Trade and Industry is offering the entire unlicensed area West of Shetland for licensing. The application deadline for licences closed in June 2004. The British authorities have introduced a new type of license applicable to particularly challenging areas. This license allows oil companies to explore larger areas than normally in an initial phase so they can identify the interesting parts of the area and then relinquish other parts.

As part of the preparation for this licensing round the Faroese Geological Survey in the autumn of 2003 invited oil companies to nominate blocks that they would like to see included in the second licensing round. The invitations were sent to companies operating along the Atlantic Margin. Firstly, the nominations are an indicator as to the interest in the area, and secondly, the nominations will be part of the decision making process when the petroleum authorities choose which areas to offer for licensing in the second licensing round. When the deadline was out seven companies had nominated blocks that they would like to see included in a forthcoming licensing round. The nominations were consistent with assessments and plans made by the Faroese Petroleum Administration and the Faroese Geological Survey.

Two wells are expected to be drilled during the summer of 2004 in UK waters close to the boundary. Although no information is available on the drilling operations it is considered likely that they will target play types that could be applicable to the Faroese area. Results from the drilling activities on the UK side of the border may effect the Faroese second licensing round for those companies that will have access to the well data. In addition, in preparation for the British 22<sup>nd</sup> licensing round, oil companies will make assessments of the area West of Shetland. Geology knows no boundaries and it is therefore considered likely that the oil companies will extend their preparation to also cover the Faroese area.

The nominations indicate that there is sufficient industry interest for continuous exploration for hydrocarbons on the Faroese Continental Shelf. However, only limited data is available for the area offered for licensing and in addition it is a technically challenging area. Expectations to the number of applications and scope of the work programmes are lower than prior to the first licensing round.

Based on the above it is proposed to initiate the second licensing round and to offer the area specified in Parliamentary Bill on the Second Licensing Round for licensing.

## **5.2 Exploration Conditions**

The prospectivity of the blocks offered for licensing in the second licensing round can be compared to that of the existing 9-year licenses.

It is proposed to use a simple and flexible license regime in which the Faroese Minister of Trade and Industry grants licenses stipulating the license term and the agreed work programme. Parliamentary Act No 31 of 16 March 1998 on Hydrocarbon Activities stipulates that a license can be granted for an exploration period of up to 12 years, with a right to be extended for up to two years at a time. However, the total exploration period may not exceed 16 years.

The hydrocarbon potential of the Faroese continental shelf remains uncertain, and the area must still be considered a frontier area with regards to oil exploration. A majority of the area is covered by basalt layers, which impede both seismic acquisition and drilling. It is therefore considered unlikely that companies applying for licences have identified drilling prospects, except perhaps in certain areas close to the UK border. It is more likely that companies are assessing possibilities based on spec and trade data and data obtained from work carried out in the first licensing round. For continued evaluation of these possibilities it is likely that the companies will propose a work programme with a phase covering seismic and/or other surveys, before determining whether to undertake drilling commitments or whether to relinquish the license area.

The Petroleum Administration and the Faroese Geological Survey estimate that the best work programmes can be achieved by not stipulating limitations in the Model License as to a fixed term of years. This license regime provides for licenses similar to the existing 6-year and 9-year licenses as well as other combinations regarding term and decision points.

## **5.3 Areas offered for licensing**

The recommended area offered for licensing in the second licensing round covers approx. 19,000 square kilometres divided into 83 whole blocks and 39 part blocks. It is a contiguous area to the east and southeast of the Faroe Islands and two smaller separate areas to the south and southwest of the Faroe Islands, close to the UK border.

The main area to the east and southeast, approximately 20-120 nautical miles off the coast, is located on the outer part of the Faroe Platform, towards the Shetland Channel. Closest to shore the depth is 200 metres, but in the channel the depth increases to approximately 1,500 metres. The blocks are all contiguous except for the blocks licensed in the first licensing round.

To the north, the area extends to 62° N; to the west, the area zigzags along whole blocks from 4° W in the northern most part, to 6° W to the east of Munkagrinnur Ridge as the western most part. To the east and to the south, the blocks extend to the UK continental shelf boundary. 24 part blocks are located along the boundary, and 11 part blocks are part of blocks already offered for licensing. These are marked “b” on the map in Schedule A.

The two smaller areas offered for licensing to the south and southwest of the Faroe Islands cover the Faroese part of the Wyville Thomson Ridge and the Ymir Ridge. These blocks are located between 25 and 55 nautical miles off shore and the water depth in the area is 500 to 1,100 metres. The area by the Wyville Thomson Ridge is divided into 6 whole blocks and 2 part blocks. The area farther to the west by the Ymir Ridge is smaller and divided into 2 whole blocks and 2 part blocks (see enclosed map).

The reasons for offering this area for licensing are manifold:

- to test various play types in order to diversify future hydrocarbon exploration
- to encourage oil companies to continue taking on technical challenges to examine the prospects of finding hydrocarbons in the Faroese area in the future
- to have oil companies utilise available geophysical data
- to profit from existing and future experience from hydrocarbon exploration on the UK sector

The recommendation to offer this area for licensing is based on the above reasons as they are believed to be the best foundation for continuous hydrocarbon exploration. As the Faroese area must be considered a technically challenging frontier area the initial activities are expected to mainly consist of geophysical work such as seismic surveys rather than exploration drillings. Experience from neighbouring countries and from the first licensing round shows that licenses are in fact only granted for parts of the entire area offered for licensing, mainly because some of the blocks are considered less attractive and because some of the applicants do not meet the stipulated requirements. Moreover, it may be advisable not to grant exploration licenses for some blocks, unless the applications are particularly qualified. Pursuant to section 7(3) of the Act on Hydrocarbon Activities, the Minister can decide to not grant licenses on the basis of some of the applications.

Structures of significant size are identified below the top basalt in some areas including the separate areas on the Wyville Thomson Ridge and the Ymir Ridge to the south and southwest. These areas will therefore require thorough mapping. Advanced technology is required to obtain the necessary knowledge of the sub-basalt structures. If new and innovative technology is being developed it would promote future drilling in these areas.

### **5.3.1 Work programme**

Great importance is attached to the work programme when licenses are granted see clause 4(1) of the Model License, thus the authority is ensuring that the exploration activity is carried out efficiently and technologically founded in order to achieve the main objective which is to locate commercial hydrocarbon reserves in the sub-soil.

### **5.3.2 Size of license areas**

The licences granted in the forthcoming licensing round are expected to cover areas of approx. 1,000 – 1,500 square kilometres corresponding to the size of the areas covered by the 9-year licenses from the first licensing round.

### **5.4. Fees and Taxes**

The fiscal conditions are regulated in the Hydrocarbon Tax Administration Act, in the licenses and in executive orders under the provisions of the Hydrocarbon Activities Act.

The Hydrocarbon Tax Administration Act stipulates which activities are covered by the act. In outline, oil companies, including their contractors and subcontractors are subject to taxation of income generated from their activities, and individuals are subject to personal income taxation. Faroese companies, which are suppliers to the oil industry, are not required to submit individual tax returns for this particular part of their activities as it is considered to be included in their regular tax return.

When the sections concerning corporate taxation of the Hydrocarbon Tax Administration Act were prepared the initial aim was to secure a share of a potential profit from hydrocarbon activities for the Faroese society. Moreover, it was important to establish a stable fiscal regime such that alterations to the regime were not required even if circumstances for the oil industry change. This part of the fiscal regime is therefore divided in to a corporate tax on production income, and a special tax on particularly high production income.

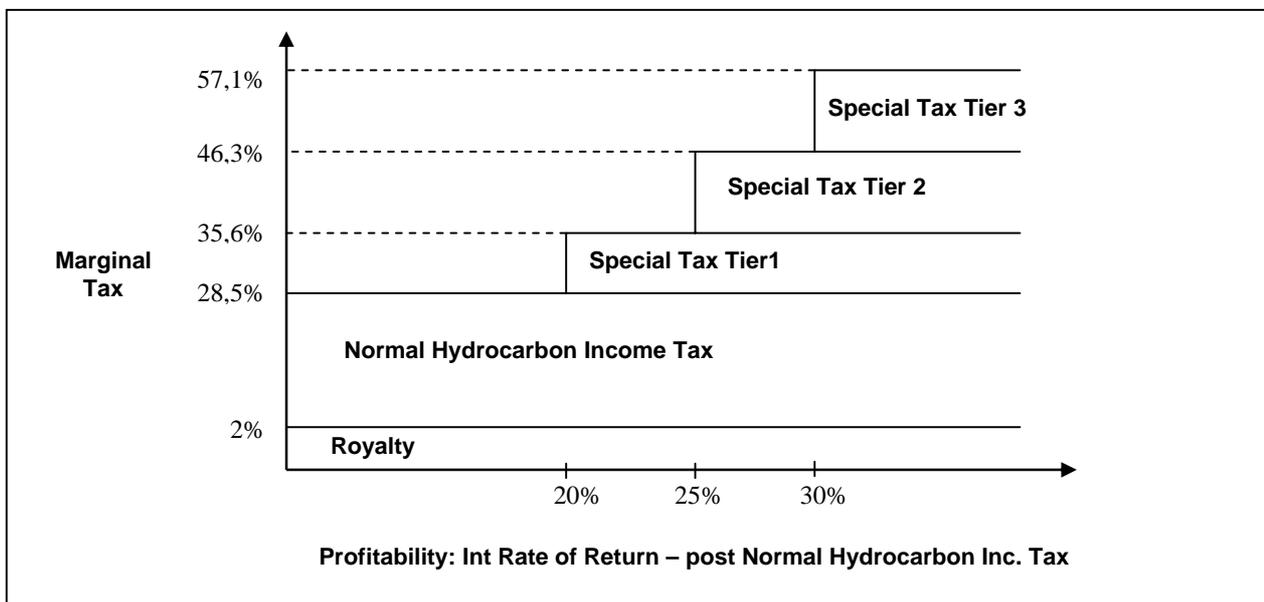
The corporate tax rate is 27%. In addition, if oil companies generate particularly high income they are subject to a special tax. The special tax consists of three levels: If the rate of return on investment and development cost is below 20% no special tax is paid. If the rate of return is between 20% and 25% the special tax rate is levied at 10% etc. If the rate of return exceeds 30% the special tax rate is levied at 40%, which is the highest rate payable.

In addition to taxes, the license imposes a royalty on the license holder's income, calculated as 2% of the value of the hydrocarbon production, cf. clauses 8 - 10 of the Model License. The royalty was levied at 2% in the first licensing round and it is recommended that it remains the same.

Royalty shall be calculated on the basis of the gross price of sold hydrocarbons. For the Treasury, one advantage of levying royalty, as opposed to taxes, is that revenue is obtained as soon as production starts.

Royalty as an instrument is not much in use anymore, because it can have a negative effect on a company's production interest. When production from a field decreases or is small and the production cost therefore is considered relatively high, a royalty may cause production to be discontinued sooner than it otherwise would have been. These measures of securing the Treasury its share of the profit should therefore be used with care. However, a royalty of 2% is not considered to affect the oil companies' interest.

Royalty is corporate tax and special tax deductible, and corporate tax is special tax deductible. The chart below shows the marginal tax rate.



If oil companies have a rate of return below 20% of investment and development costs the payable tax and royalty rate is 28,5%. The highest rate payable of taxes and royalties should not exceed approx. 57% which requires a minimum rate of return of 30% of investment and operating cost.

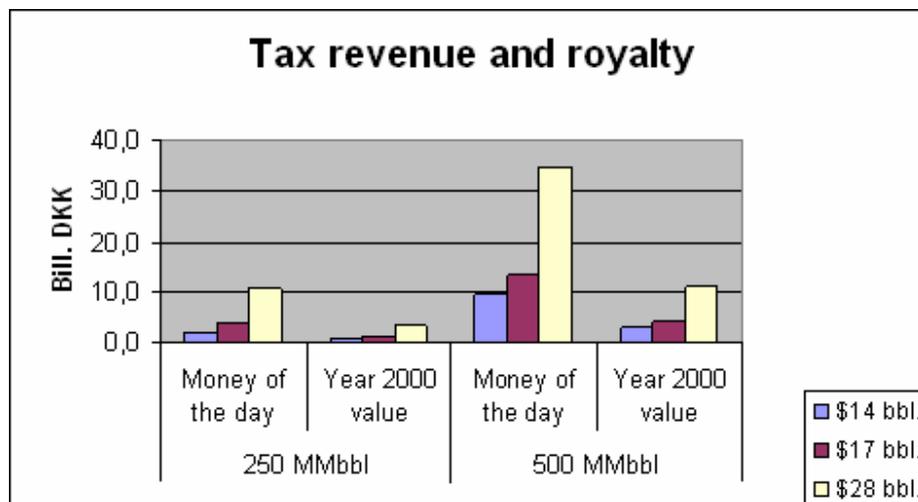
Compared to our neighbouring countries the tax regime is considered reasonable. Ireland has the lowest corporate tax of only 25%. However, there is only limited hydrocarbon activity there. Norway has a large share of hydrocarbon activities and the highest corporate tax in our neighbouring countries with 28%. In addition Norway imposes a special tax of up to 50%. UK has a corporate tax of 40%. Even though the tax rates are an indication of the fiscal regimes in these countries, deduction rules etc. differ and therefore the tax base varies from one country to another.

In addition to taxes and royalties the companies shall pay an annual area rental for the licenses. This will also apply for the second licensing round cf. Clause 7 of the Model License. The rental fee is DKK 500 per square kilometre for the first six years increasing to DKK 39,000 per square kilometre for the 16th and possible subsequent years. The

revenue from this progressive rental increase may however be reduced if companies relinquish parts of their license area. One of the objectives of the progressive rental is to induce companies to relinquish areas, which they are not willing or able to explore thoroughly.

The exploration activities have generated revenues for the Treasury, even though oil production has not been initiated in the Faroe Islands. According to figures from the Ministry of Finance from the autumn 2003 tax revenue from taxpayers (companies and individuals) who are non-Faroese residents has been approx. DKK 43 millions for the years 2001 to 2003. In addition, the annual area rental for the license constitutes approx. DKK 2 millions per year in 3 years. In total, the revenues generated these years have been more than DKK 50 millions, not including VAT etc. Faroese companies and individuals are not subject to submitting independent tax returns on income from hydrocarbon activities, therefore it is not possible to determine the share derived from hydrocarbon related activities.

It is difficult to predict which income a second licensing round could give the Faroese economy if a production phase is initiated. The chart below shows which revenues could be generated from taxes and royalties from oil companies. The figures must be treated with caution as a potential hydrocarbon production lies many years ahead and the conditions certainly will change.



### 5.5 Faroese participation in the activity

Under the term Faroese participation the license holders shall:

- Provide Faroese companies with genuine opportunities, in competition with other companies, to provide goods and services
- Promote the conclusion of contracts between Faroese and foreign companies to develop competence and technological know-how within Faroese companies
- Provide employment opportunities for Faroese manpower
- Endeavour to give Faroese research institutes etc. the opportunity to participate in research and development projects carried out under the license requirements
- Encourage the development of industrial competence

### **5.5.1. Faroese supplies**

Clause 11 in the Model License stipulates that Faroese companies shall be provided with genuine opportunities, in competition with other companies, to provide goods and services, which the licensees require in connection with their activities in the Faroese area.

In 2000 the Minister of Petroleum implemented procedures, which the licensees shall comply with. The procedures stipulate, amongst other things, that licensees in good time shall submit information about what goods and services will be required in connection with their activities in the Faroese area. Moreover, the procedures stipulate that large contracts shall be subdivided whenever possible so that Faroese suppliers have an opportunity to submit tenders for accessible subcontracts.

Derived activity from the three wells drilled in 2001 was quite substantial, especially in connection with air transport and shipping. It is estimated that the turnover in the Faroe Islands was about DKK 150 millions or approx. 25% of the drilling expenses. However, a large share of this amount was used for helicopter rental, fuel etc. In 2003 only one well was drilled and consequently the turnover was much less.

Experience shows that not only general terms and conditions set out in legislation and licenses determine to what extent Faroese companies are given an opportunity to provide goods and services. The license holder's attitude is also imperative, which in most cases has been positive towards providing access for Faroese companies to the activity. On the other hand, a negative approach can always find a motive for not providing genuine opportunities for Faroese participation.

Faroese access to the activities can provide vital experience, which again can form the basis for further business development within other areas. One example is the contract Atlantic Airways obtained for air transport in Norway. Atlantic Airways has obviously obtained the contract due to several reasons. However, one reason is the experience the company gained during the first licensing round providing flight services to the oil companies, and another is that one oil company in particular promoted the conclusion of the contract, pursuant to the stipulation of clause 12 of the license.

Section 11 of the Hydrocarbon Activities Act stipulates that all equipment and passengers to and from the Faroese shelf area must be transported via a Faroese quayside or airport.

This stipulation is part of the license requirements which the license holders have to comply with.

The license holders' attitude towards this stipulation varies. It has been claimed that it increases costs compared to direct transport between the offshore installation and the country concerned.

In addition, oil companies have pointed out that their internal procedures need to be adjusted which is relatively strenuous considering how little activity is involved in drilling an exploration well.

The necessity of a quayside and airport regulation has been questioned as Faroese companies are expected to be given an opportunity to participate in the activities provided they are competitive. It is however uncertain to what degree Faroese companies would have had access to participate even if they are competitive, if the licensees' activities were not based in the Faroe Islands. It would have been a disadvantage for Faroese companies compared to Scottish companies if all operations to the Faroese area were organised via a supply base in Scotland.

According to section 11 of the Hydrocarbon Activities Act, the Minister of Trade and Industry may in special cases grant exemption from the quayside regulation. In connection with the four wells that have been drilled, 10-15 exemptions have been made, typically:

- because bad weather would otherwise cause an unreasonable delay to the operation
- because of immediate requirement for equipment
- because of urgent crew member's personal matters

On the other hand, exemptions will not be granted based on the reason that it would be less costly to ship equipment directly onto the rig rather than via a Faroese quay.

In conclusion, it is estimated that the stipulations in section 11 of the Hydrocarbon Activities Act have created activities for Faroese companies, which they otherwise would not have gained access to. In view of this, the inconveniences that the regulation may cause to some of the license holders are not considered significant enough to give cause for changes.

### **5.5.2 Co-operation with foreign companies to develop competence and technological know-how of Faroese companies**

In accordance with section 12 of the Model License, it is the license holder's responsibility to enable and promote the conclusion of contracts between Faroese and

foreign companies to build up the competence and technological know-how of Faroese companies.

Moreover, as part of the development of Faroese industrial competence, the current license holders have promoted the co-operation between Faroese companies and foreign companies and thus increased the competitiveness of Faroese industry with regard to entering into new markets.

The co-operation between Atlantic Airways and a Norwegian company mentioned above is partly arising from the terms in section 12. Other contacts may also lead to business co-operations whereas some are more uncertain. The varying results may be due to several conditions. Continued and dedicated work is required in order to achieve results. It is both time and work consuming to establish business relationships, however it is difficult to determine whether it is why some of the Faroese companies, that have been involved in this type of co-operation give up

The commitment required when promoting business co-operations applies both to the licensee and the Faroese companies.

### **5.5.3 Employment opportunities**

In compliance with Clause 13 of the Model License the licensee is obligated to provide employment opportunities for Faroese personnel.

All current partnerships have established offices in the Faroe Islands, employing a total of approx. 10 people who all are Faroese.

The employment opportunities for personnel on offshore installations are limited. Drilling activities will only take place over a limited period of the year and moreover wells will not be drilled every year. Correspondingly, the employment opportunities on offshore installations during the exploration phase will probably be limited. Employment opportunities will rather lie with Faroese companies participating in the activities. For example during the drilling campaigns in 2001 a Faroese company provided the catering services. Several of their employees were offered similar employment opportunities abroad when the drilling activity ended in the Faroe Islands.

On the other hand, employment of engineers and geologists should be further promoted. However, during the past years several oil companies have merged etc. decreasing the staff requirements. Consequently, employment opportunities might not be easily accessible, but the Petroleum Administration intends to raise this issue with the oil companies.

Moreover, it should be noted that oil companies increasingly are subcontracting their activities with contractors and subcontractors carrying out the activities on behalf of the oil companies. This does not make it easier for Faroese workers and companies to get access to the activities. However, oil companies are still in the position to influence who

carries out the work, and moreover, the requirements for Faroese participation apply to both licensees, contractors and subcontractors. To require that a certain number of Faroese personnel should be offered employment on an offshore installation while it is in Faroese waters is unlikely to generate any income for the Faroe Islands. Rather the stipulation to provide Faroese companies with genuine opportunities to participate should be maintained. This provision is in the long term expected to lead to a continuous development of Faroese companies and industry, and will thus indirectly affect employment.

#### **5.5.4 Research**

Clause 13 also stipulates that licensees shall endeavour to give Faroese educational and research institutions and Faroese industry the opportunity to participate in research and development projects, which may be undertaken in the performance of activities under the license.

As part of the work programme the licensees are committed to allocating a certain amount of money to the Sindri programme, which is mentioned elsewhere in these Explanatory Notes. In connection with the Sindri programme Faroese research institutions are participating in research and development projects focusing on Faroese geology.

In addition, the licensees have sponsored Faroese PhD projects.

#### **5.5.5 Competence Development**

In the first licensing round one of the bidding parameters was the priority that oil companies attached to developing industrial competence in Faroese industry. When the license applications were submitted only a few relevant projects had been identified. Subsequently it was decided that the licensees should allocate money targeted at developing Faroese industrial competence to allow Faroese companies to participate in a future oil industry in the Faroe Islands or abroad. Moreover, the competence development should be beneficial, regardless of the rate at which an oil industry would be progressing in the Faroe Islands. The oil companies allocated DKK 85 millions to Faroese Participation, around DKK 50 millions have been used to date.

The licensees administer the allocated money themselves. The companies can however consult with the Petroleum Administration, if it is questionable whether a project comes under the term development of industrial competence. Once a year the companies are required to submit a report accounting for the spend.

In practice it turned out to be difficult to determine which projects were *not* related to the oil industry. The oil industry, as do other industries, requires a variety of goods and services, which might not be directly connected to the oil industry e.g. telecommunication, catering and cleaning and it proved to be quite time consuming to determine whether a project complied with the objective of competence development.

Subsequently, it was decided to alter the requirements in such a way that projects, which are developing industrial competencies, and as such are fulfilling the original main goal, qualify for receiving funds.

Consequently, education - especially higher education - could receive funding. As a general rule, individuals are not granted money, rather grants are given to companies and institutions e.g. for PhD studies.

Of the approx. DKK 50 millions allocated so far, approximately 60% have been spent on industrial development whereas 40% have been granted to business or industry related education

Industrial development projects have encompassed training/education of employees, development of equipment and production, implementation of quality management systems, management development, research etc.

The majority of the industrial development projects have provided competence development through training and education of employees. Also a fair proportion of money has been spent on developing equipment and production. On the other hand, fewer funds have been spent on management development within companies. However, as part of the competence development scheme, a MSc in management has been instigated as a co-operation between the Faroese Business School (Føroya Handilsskúla) and the Robert Gordon University in Aberdeen. Approximately 40 people are following these classes.

The educational funds are in particular intended for higher education. The University of the Faroe Islands (Fróðskaparsetur Føroya) and the Faroese Business School have been the main recipients. The funds granted to the University of the Faroe Islands have primarily funded PhD students and the education of petroleum engineers. The PhD students have researched on oil industry related subjects such as wave models and fish farming in ocean currents.

The Petroleum Administration expects the oil companies to also support industrial development in the forthcoming licensing round although the funds may be on a smaller scale than in the first licensing round. The question had to be asked whether the system needs adjusting or whether it should continue in its present form. The Petroleum Administration has therefore assessed whether oil companies should continue to administer the funds and whether the focus still should be the development of industrial competence.

The initial objective was that the Faroese industry should benefit from the oil industry's experience and knowledge and thus be better prepared to participate in the oil industry, this was also one of the reasons why it was decided to let the oil companies administer the funds themselves. Another objective was that oil companies should gradually become part of the Faroese society. The objectives still apply, in addition the oil companies appear to be satisfied with the system and require no changes.

The money spent so far has initiated interesting activities, which have and are expected to continuously contribute to developing the Faroese industry. However, development of industrial competence is still required. Conditions are constantly changing and require a constant adjustment of competence both with regard to existing industries as well to new industries. Clearly, there is basis for maintaining the development of industrial competence as a bidding parameter in the competition for licenses in the second licensing round, and the funds should be targeted at developing industrial competence.

#### **5.5.6. Summary of Faroese Participation**

It appears that the Faroese industry had too optimistic expectations to the short term exploration activities. The industry has acknowledged that the activity during an exploration phase is limited. Even though the activity takes place in our waters, continuous commitment is required to obtain further results. On the other hand, the Faroese industry has proven that it is capable of performing the tasks, which it has been given.

Continuous promotion of Faroese participation in the activities is necessary. The authorities must aim at a proper balance between short-term benefit and the main objective of petroleum exploration which is to find hydrocarbons.

With a few adjustments regarding the equipment that a drill ship is allowed to bring into Faroese waters, and with continuous reminders to the oil companies of their obligations in connection with Faroese Participation, the conditions are considered satisfactory and will therefore not be changed.

#### **5.6 Other general licensing terms**

Clause 17 of the Model License stipulates that representatives of the Petroleum Administration shall be entitled to participate as observers in joint operating committee meetings.

Clauses 18 and 19 address the obligation of licensees to grant the staff of the supervisory authority all the assistance required for their investigations and to provide the authorities with relevant information according to regulation to be specified in executive orders.

Clauses 20 and 21 address confidentiality obligations, confidentiality period, etc.

Clause 24 stipulates that co-licensees shall be jointly and severally liable for any compensation and damages payable to fishermen pursuant to section 7 of the Act on Hydrocarbon Activities. Licensees must provide security for this liability.

According to Clause 26, the license cannot be transferred without the approval of the Minister of Trade and Industry.

## **6. Health, Safety and Environment etc.**

According to the Act on Hydrocarbon Activities, exploration and production licenses may only be granted to qualified applicants. The authority is responsible for ensuring that the applicants have the necessary expertise, experience, resources and financial capacity with regard to exploration and production activity.

With regard to health, safety and environment the following qualifications are required in order to be granted a license:

- guidelines for drilling operations
- special circumstances to be taken into account when drilling in deep waters
- the applicant's hazard management systems
- the applicant's own standards for training and involving its personnel in the planning and implementation of drilling operations

In addition, the applications must outline the applicant's own standards for safety, environment and emergency procedures, with due consideration to the exploration area and the intended activity comprised by the application.

When licenses are granted the terms in the Executive Order concerning Health, Safety and Environment etc. apply. The legislation stipulates that all *exploration and production shall be carried on in a safe and appropriate manner*. It is the licensee's responsibility to ensure that activities are planned and executed with due regard to safety. The authorities are responsible for monitoring compliance with this requirement. The Executive Order concerning Health, Safety and Environment in the Exploration Phase stipulates accurate requirements for a drilling operation.

The operator shall have a SAR helicopter service on standby in the Faroe Islands during the drilling of exploration wells, and shall keep suitable oil spill response equipment available at a base in the Faroe Islands.

## **7. Impact on fishing, the environment, etc.**

According to section 7(2), second sentence of the Act on Hydrocarbon Activities, the explanatory notes to the Bill on the Second Licensing Round must include an assessment of the possible impact of hydrocarbon activities on navigation, fishing and other commercial activities, and on nature, the environment and other community interests. The explanatory notes shall also include an assessment of the effect of the activities on the Faroese economy and employment opportunities.

Chapters 7.1 to 7.7 below assess the possible impact of hydrocarbon activities on the interests here mentioned.

The assessments referred to in chapters 7.1 to 7.5 were made by specialists representing the Ministry of Fisheries, the Fisheries Laboratory and the environmental department at the Food, Veterinary and Environmental Agency. In addition the Petroleum Administration held an information meeting with the fishing industry and other organisations to determine whether the expected exploration activities on the licensed area would coincide with other community interests. The meeting was held on 12 March 2004. After the meeting the Explanatory Notes were submitted to the organisations for consultation.

The organisations that received the Bill on the Second Licensing Round for consultation were: *Felagið Ídnaðarskip, Felagið Laksaskip, Felagið Línuskip, Felagið Nótaskip, Felagið Rækjuskip, Felagið Trolbátar, Felagið Trolskip, Fiskimálaráðið, Fiskirannsóknarstovan, Fuglafrøðifelagið, Føroya Fiskimannafelag, Føroya Havbúnaðarfelag, Føroya Maskinmeistarafelag, Føroya Náttúru- og Umhvørvisverndarfelag, Føroya Reiðarafelag, Føroya Sílaveiðufelag, Føroya Skipara- og Navigatørfelag, Heilsufrøðiliga starvsstovan, Meginfelag Útróðramanna, Meginfelag Vinnurekandi Útróðramanna, Náttúrugripasavnið, Reiðarafelagið fyri Farmaskip and Vaktar- og Bjargingartænastan.*

The Petroleum Administration only received commentary to the bill from the Náttúruvísindadeildin (Department of Natural Science) and Føroya Náttúru- og Umhvørvisverndarfelag (Faroese Environmental Group). Náttúruvísindadeildin states that when environmental impact assessments are made the department wishes to receive a copy of any acquired material regarding natural science and biology.

In connection with the first licensing round Faroese and foreign researchers and research institutions worked closely in supplying data for an environmental impact assessment. It is important that all acquired data in connection with these assessments is gathered in the Faroe Islands for the benefit of future research within the various disciplines. The Petroleum Administration should therefore, in cooperation with the relevant institutions and the oil companies ensure that such data acquisition is continued in the Faroes Islands.

Føroya Náttúru- og Umhvørvisverndarfelag states in their comments to the bill that FNU supports the bill and has no further comments.

The assessments apply to the area offered for licensing; see Schedule A. They are based on an average level of activity in the exploration phase. The assessments are further based on information on industrial and environmental conditions obtained from public authorities and institutions, e.g. data from logbooks on fishing in various areas and information obtained from the satellite system used by Faroese and foreign fishing vessels.

## **7.1. Impact on navigation**

Exploration activities on the Faroese continental shelf may have a two-fold effect on the navigation of fishing vessels and other vessels:

1. Offshore installations occupy certain acreage and may therefore hinder navigation in Faroese waters. According to the Act on Hydrocarbon Activities, offshore installations require a safety zone. The standard extent of the safety zone around the offshore installation is 500 m.

2. Exploration activities on the Faroese continental shelf will increase traffic in Faroese waters and may consequently affect navigation and the fishing industry.

The extent of such effects on navigation and traffic depends on the scope of the exploration activities and the number of offshore installations. The exploration activities and resulting ship traffic are unlikely to constitute any severe hindrance to navigation.

## **7.2 Impact on fishing**

In an assessment of the impact of exploration activities on fishing, the key issues are the location of exploration sites, how the exploration activities will be conducted and the nature of any fishing activity in these areas.

If one or more wells are drilled, the offshore installation, as mentioned above, occupies a 500 m safety zone within which all fishing activity is prohibited. In the case of anchored installations, the anchor zone may have a larger radius than the safety zone, depending on the water depth in the area. Generally, the distance from the installation to the anchors is 2-3 times the depth. When considering the impact on fishing, it is necessary to distinguish between various types of fishing activity and fishing gear. The impact depends on whether bottom trawls, floating trawls, seine, longline or gillnets are used, and whether demersal or pelagic fish are targeted.

Fishing for demersal species normally takes place in water depths less than 500 m. The impact on this type of fishing activity is therefore limited if the hydrocarbon activities are carried out in deeper waters. Most of the area offered for licensing is located in waters deeper than 500 m.

Trawlers using bottom trawls will experience the greatest impact from exploration activities carried out from an offshore installation, because the 500 m safety zone reduces their fishing area. The impact varies, depending on whether the trawling area is on a slope or a more even seabed with only minor topographical variations, as it is easier to trawl around offshore installations situated on an even seabed than on a slope with sudden changes of depth.

The effect on longline and gillnet fishing is generally less than on bottom trawling. However, it depends on the type of fishing activity in the exploration area and the extent to which other fishing grounds can compensate for any reduced or lost fishing grounds.

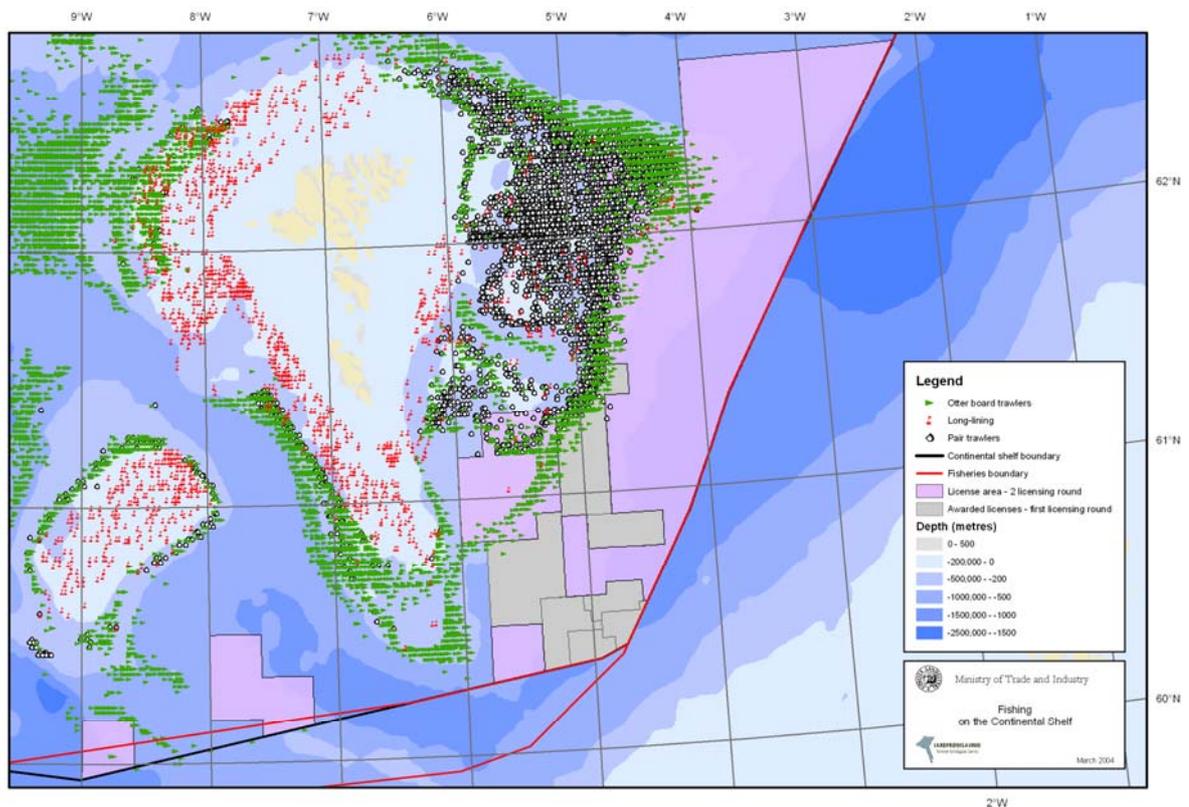
The Faroese fishing fleet consists mainly of small vessels operating close to shore with jigging machines and longlines.

Pelagic fishing mainly takes place by purse seine (herring and mackerel) or pelagic trawls (blue whiting). The location and time of year depend on where the fish are to be found at any given time and may vary from one year to the next. International research shows that hydrocarbon activities are unlikely to affect migration patterns. Furthermore, offshore installations rarely affect the location of pelagic fishing.

Research has demonstrated that seismic activity may cause evasive behaviour in fish. Currently, seismic activity is only allowed from 15 April to 1 November.

Since 1998 the Fisheries Inspection has operated a seismic warning system, which gives information as to seismic activities on the continental shelf. The system has operated satisfactorily.

Below is a map of fishing areas for otter board trawlers (lemmatrolarum) (red stars), pair trawlers (green stars) and positioning for long line fishing vessel (yellow stars) in addition to the area offered for licensing (marked with reddish lines).



The map shows that the seismic activity to the east of the Faroe Islands may affect fishing activity for otter board trawlers. To the south of Faroe Bank and on the Wyville Thomson Ridge the fishing for blue whiting may be affected in April and May, when the fish migrates north. It is therefore recommended to prohibit seismic activity in this area in the period April/May.

In conclusion, the exploration phase will not pose any serious obstacles to fishing, although exploration activities to the east and south of the Faroe Islands may affect fishing opportunities in certain fishing grounds. Mainly because the depth in most of the area offered for licensing exceeds 500 m, whereas fishing vessels generally operate in shallower waters. If exploration wells are drilled it would normally only take 50-80 days and therefore competition for fishing grounds is not likely to occur. Thus, the activities will not substantially reduce fishing opportunities.

Moreover, the authorities are able to plan the activities with a view to minimising any consequences for the fishing industry. The rules and regulations implemented for the fishing and oil activities have been worded with due consideration to the interests of both parties. So, communication between the parties is vital. Fishing interests will be considered whenever drilling approvals are given to an oil company. The Minister of Trade and Industry intends to hold information meetings with representatives from the fishing industries before areas are offered for licensing. When licenses are granted, details of the allocation of blocks, oil company work programmes (drilling and seismic activities), the expected commencement and location of drilling activities, etc. can be publicised.

### **7.3. Impact on other industries - competition for manpower**

Since activities will generally be limited both regarding size and time, the offshore installations and supply bases are unlikely to cause any substantial increase in the demand for Faroese manpower. Normally, the installations are chartered fully equipped and staffed, and the man-year requirement of the supply bases is limited, even if they have to service several offshore installations at the same time.

The indirect impact will be felt as increased activity in other industries due to rising overall demand for goods and services. This is likely to effect the competition for manpower between the oil industry and other industries. The indirect impact has generally a greater effect on competition for manpower.

The extent of the indirect impact will depend on the scale of the exploration activities, the number of new jobs created and the role of the Faroese business community. However, it is vitally important that the fishing industry remains competitive. If personnel from the fishing industry prefer to work in the oil industry or associated onshore activities, the reasons must be analysed. Experience from other countries shows that income is not the only motivation: leisure time, pension schemes, future prospects, etc., are also important.

However, in light of the anticipated level of exploration activity and manpower demand, the second licensing round is not likely to have any substantial effect on other industries in the first years.

#### **7.4. Impact on nature**

One direct impact of exploration activity would be the disturbance to the fauna of the exploration area, especially bottom dwellers, marine organisms, fish, birds and marine mammals. Fish, birds and marine mammals can to a certain extent leave the area and return unhindered when the exploration activity is over. This does not apply to bottom dwellers, which are more confined to a particular place.

Oil leaks and following oil spots on the sea can cause a lot of pollution for birds. Experience from the four wells has been good. No leaks have occurred with the exception of 50 litres of diesel oil in connection with bunkering oil in 2001.

#### **7.5. Impact on the environment**

The hydrocarbon industry as a whole is regarded as a source of pollution, mainly due to the discharge of waste and other residues from offshore installations into the sea or air. Accidents can also cause pollution. The type and extent of environmental impact will depend on safety regulations, emergency response, measures to protect the environment, license holder and supplier's attitude to environmental protection etc. Generally, in recent years, the oil industry has improved the organisation of its activities to include the necessary measures to safeguard the environment and nature. However, it is important to ensure that the companies which are granted licenses in the Faroese area are environmentally conscious and possess the necessary competence.

It should continue to be a requirement that only companies which have implemented environmental management systems that comply with international standards such as ISO 14001 or EMAS should be granted licenses to explore in Faroese waters when drilling is part of the work programme.

Discharges resulting from the drilling of exploration wells are predominantly:

- drill bits and drill mud
- concrete residue
- sewage and household waste
- discharge from drill deck
- cooling water
- fumes and vapours
- accidental leakage

Unless the necessary measures are taken, it may cause environmental pollution with potential ecological consequences for the animal life in the area. Most substances that are

discharged have little or no effect whereas other may have a negative impact on the environment. Discharge permits emphasise the restriction of especially toxic substances and substances, which accumulate in living species as well as persistent substances. Discharges to the air will increase the Faroese discharge of climate gasses, mainly CO<sub>2</sub> and NO<sub>x</sub>.

According to the Act on Hydrocarbon Activities, "licenses may only be granted to applicants who are considered to have the requisite expertise, experience, resources and financial capacity". The applicant's environmental competence is therefore important when license applications are considered.

Other, more specific environmental requirements must be fulfilled before the licensee is allowed to commence drilling. The Act on Hydrocarbon Activities stipulates that the licensee must obtain a specific permit or approval before undertaking a particular operation. For example, the drilling of an exploration well cannot commence before a drilling approval is obtained. Moreover, it can be required that the license holder, prior to the granting of the license, has to submit an assessment of the environmental impact of the contemplated activities – a so-called environmental impact assessment. The environmental requirements stipulated in the drilling approval will depend on the conclusions of the assessment.

The license holder is required to obtain approval for the use of drill mud. Rules as to the approval are specified in the executive order concerning usage and discharge of material and substances from an offshore installation. According to the rules – a so-called discharge permit – is required from the Food, Veterinary and Environmental Agency on usage and discharge of all substances used in connection with the drilling activity. The aforementioned permit also imposes conditions concerning waste management, notification etc. The application for usage and discharge of material and substances should contain information, which is necessary in order to assess what impact the discharges have on the environment. In addition, thorough information about environmental properties of every substance, which might be used, shall be submitted. Moreover, the license holders are subject to implementing environmental surveys of the sea bottom on and around the area in which the drilling activity takes place. Approval for usage and discharge of material and substances from an offshore installation and the environmental survey requirements are based on OSPAR<sup>1</sup> regulation and guidance.

## **7.6. Impact on other community interests**

Prior to the first explorations drillings on the Faroe shelf opinions were voiced as to the impact oil related activities could have on the Faroese society including language and culture. The Minister pointed out, that the activities in the exploration phase would be limited, and that an impact assessment regarding petroleum production could not be

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<sup>1</sup> The OSPAR Convention is guiding international cooperation on the protection of the marine environment of the North-East Atlantic. On 23 October 1998 the convention was adopted by the Faroese Parliament.

carried out until a commercial discovery is made and the relevant information regarding hydrocarbon volumes and type of development is available.

The activities in connection with the four wells that have been drilled to date have had little or no impact on society. Prior to the first wells in 2002 it was claimed that housing prices in Tórshavn were increasing, because oil companies rented houses and flats in the city. Following a question in Parliament, the Ministry of Petroleum inquired into the matter, and although the demand for houses was high at the time, it was estimated that the demand only to a minor degree was related to the oil industry.

In general, the impact on society from a petroleum industry can to a certain degree be controlled by means of the requirements that are imposed on the oil companies to carry out their activities from the Faroe Islands.

If oil fields are developed in the Faroe Islands it is recommended to analyse the anticipated impact on society before a development and production phase is instigated. In addition it is recommended to carry out research and to prepare policies on a sensible handling of such impact.

## **7.7. Stimulating effects on economy and industry**

The contribution to economy and industry following the second licensing round depends on which exploration commitments the oil companies undertake.

Experience shows that if only seismic and other geological activities are carried out the effect on the economy and industry will be minor.

Not until hydrocarbons in commercial quantities are encountered, and a development and production phase is instigated, can any significant effect on the Faroese industry and economy be expected. The extent of the effect is dependent on how the Faroese people progress the matter and on how much of the activity we wish to place in the Faroe Islands. The Act on Hydrocarbon Activities stipulates that an approval from the authorities is required before a development phase can be instigated. The authorities are therefore in the position to determine the progress.

## **8. Implementation of the Second Licensing Round**

This chapter deals briefly with the implementation of the licensing round following the passage of the Bill on the Second Licensing Round through Parliament.

### **8.1. Public notice inviting applications**

After the passage of the Bill through Parliament and its subsequent enactment, a public notice announcing the initiation of the second licensing round will be inserted in Faroese

publications and in relevant periodicals and trade journals abroad. The Minister of Trade and Industry intends to open the licensing round immediately after the passage of the Bill. The period during which applications may be submitted is expected to be fixed at three months.

The invitation will contain a description of the areas offered for licensing, the general terms and conditions on which licenses will be granted and the main criteria for the granting of a license for the exploration for and production of hydrocarbons. In addition, the invitation will state the requirements for the documentation, etc. to be submitted.

Both individual companies and groups of companies (consortia) may apply for licenses.

## **8.2. Conditions for granting licenses**

According to section 6 of the Act on Hydrocarbon Activities, licenses for exploration and production of hydrocarbons may only be granted to applicants that are considered to have the requisite expertise, experience, resources and financial capacity. The operator is to comply with the requirements as to technological expertise, while the consortium will be assessed as a whole with regard to the financial requirements. The Model License stipulates that if the license is granted to several parties jointly, they will be jointly and severally liable for any obligations to pay damages etc. Moreover, in determining to whom licenses are to be granted, the Minister of Trade and Industry must have regard to the extent to which the Faroese community will gain insight into and benefit from the activities carried on by virtue of the license.

Another condition that will be accorded great importance in the granting of licenses is the applicant's ability to attend satisfactorily to safety, health and environmental issues as well as to questions related to emergency preparedness; see chapters 6 and 7.5 above.

## **8.3. Award criteria**

In selecting the successful applicants among those fulfilling the basic requirements, first and foremost emphasis will be placed on whether the proposed work programme and the attendant documentation demonstrate the applicant's willingness and ability to thoroughly explore for hydrocarbons in the area comprised by the license. Emphasis will also be placed on the applicant's commitment to support research with focus on future hydrocarbon exploration in the Faroese area

In addition to the working commitments attention is paid to Faroese participation in the activity including the supply of goods and services, co-operation between companies, employment opportunities, education and research etc. cf chapter 5.5 above.

## **9. Administration etc.**

Petroleum affairs are placed with the Ministry of Trade and Industry. However, the Petroleum Administration and the Faroese Geological Survey are responsible for all administrative tasks related to petroleum affairs.

9 people are employed at the Petroleum Administration and 16 at the Faroese Geological Survey. In addition to geological tasks related to hydrocarbon activity the Faroese Geological Survey is also responsible for other geological tasks.

An increase in administrative tasks is expected following a second licensing round and the granting of licenses. However, the increase will not be significant immediately after licenses have been granted. Therefore it is estimated that the current number of employees will manage to undertake the tasks. Moreover, the proposed Budget for the year 2004 for the two institutions is considered to be appropriate.

It is difficult to estimate the amount of revenue, which the proposed Bill on the Second Licensing Round will generate. Revenue directly generated from the licensing round stems from application fees. In addition there is income from the annual rental of the area comprised in the license.

For processing applications, an application fee of DKK 50,000 will be charged per application. The application fee was DKK 100,000 in the first licensing round. The application fee covers expenses that the authorities have in preparing the licensing round as well as the application processing. The expenses are lower now than during the first licensing round. The necessary preparations were more expensive than and there was a larger need for external expertise. It has therefore be decided to lower the application fee.

The licensees will have to pay an annual area rental, which will constitute DKK 500 per square kilometre during the first few years. These fees are discussed in more detail in chapter 4.3.1 above and will only generate limited revenue for the authorities. The annual revenue from area rental for the current licenses, which covers approx. 4.200 square kilometres, is approximately DKK 2 millions.

To some extent, the Bill on the Second Licensing Round for exploration and production of hydrocarbons will affect the work of other authorities and institutions, for example in connection with the administration of the act on the Protection of the Marine Environment, the Hydrocarbon Tax Act, etc.



## **NOTES ON THE INDIVIDUAL SECTIONS OF THE BILL**

### **Notes on section 1**

According to section 7(2) of the Hydrocarbon Activities Act, Parliament decides which areas are to be offered for licensing and lays down the general terms and conditions for granting licenses.

After the passage of a bill through Parliament, the Minister of Trade and Industry initiates the licensing round and grants licenses to the applicants who are considered to fulfil the conditions for the granting of licenses and who commit themselves to the most favourable work programme for the individual blocks.

Licenses are issued in accordance with the Hydrocarbon Activities Act, which regulates the granting of licenses for exploration and production of hydrocarbons, as well as all the phases of hydrocarbon activities, i.e. prospecting, exploration and appraisal, field development and production, and decommissioning.

### **Notes on section 2**

As stipulated by section 7(2) of the Hydrocarbon Activities Act, the Bill defines the areas to be offered for licensing in the second licensing round.

Reference is made to the map attached as Schedule A and to the general notes on the Bill.

### **Notes on section 3**

As stipulated by section 7(2) of the Hydrocarbon Activities Act, the Bill establishes the general terms and conditions on which licenses for exploration and production of hydrocarbons will be granted. The Model License attached as Annex B sets out the general terms and conditions.

The standard terms and conditions will be common to all licenses. These terms and conditions will not be negotiable in connection with the awarding of licenses. However, if in the course of the second licensing round, weighty reasons are found for making minor adjustments to the general terms and conditions of the individual licenses, the Minister of Petroleum may incorporate such adjustments.

In addition to the general terms and conditions, exploration and production licenses will contain terms specific to the individual licenses. Unlike the general terms and conditions, the individual terms cannot be laid down until offers have been received and negotiations have been held with each applicant prior to the granting of licenses. Individual terms to be negotiated in the second licensing round concern the area comprised by the individual

license and the work commitments of the individual licensee. Furthermore, some of the terms relating to Faroese participation in the hydrocarbon activities will be negotiated.

Several of the general terms and conditions incorporate an authorisation for the Minister to draw up more detailed rules and regulations. For example, clause 11(1) of the Model License provides that the Minister may prescribe special procedures for the licensees' reporting on planned activities, as well as for inviting tenders and reporting on contractual relationships. In drawing up such procedures, the Minister will pay regard to legislation relating to commercial activities, trade policy agreements made with neighbouring countries, etc.

**Bjarni Djurholm**  
Minister of Trade and Industry

/Arne Poulsen