

# **Tidelingskriterier for konsesjonstidelinger**

av

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## CRITERIA PROJECT

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### CASH BIDDING ETC.

Earlier discussions have indicated that all non-cash bidding systems are undesirable, as there in most cases will exist optimal levels for the bidding object; hence a push to ever higher levels will yield negative returns. As shown in memo «Cost incentive problem», the discretionary system may (and must) still include non-threshold evaluation criteria, but these are for other reasons unsuitable for bidding (most are related to properties with the applicant, not the bid/application).

We shall therefore focus on cash bidding.

We shall further assume without any further argument that cash bidding will never be the *only*, nor the *main* source of state revenue from upstream petroleum activities. We assume that *income tax* (with or without special tax) will be the main source, and that *state participation* will be retained at least as an option for *gross revenue collection*, since it in periods may be difficult to collect the optimal part of the value creation through special tax alone (marginal tax problem).

This further leads to the conclusion that any cash bidding will have to be seen as an integrated part of the total revenue gathering system. In the medium long term, and other parameters constant, it is normally assumed that *the total possible government take burden* is fairly constant, i. e. that any extra burden (including extra costs) will be corrected because pressure will grow on other parts of the system.

This may not be absolutely correct for all kinds of cash bidding. We do, however, assume (proof is rather difficult!) that cash bidding as a regular and significant cost of acreage acquisition will have this effect.

Since cash bidding for acreage comes before all other government revenue is collected, it will simply correspond to moving revenue forward in time.

If this were the only effect, it is easy to see that it is undesirable, since cash early is considered a heavier expense for companies than it is valued as income for the government (discount rate; cash/time preference).

### ***Cash Bidding as Basic Allocation Method***

The MPE memo «Auctions» lists advantages and disadvantages with a cash bidding system. It is assumed that this refers to using cash bidding as the basic allocation method, probably after a pre-qualification process.

Advantages mentioned are:

\* «Clearer and more simple award criterion for the companies and the authorities»: It is true that cash bidding would eliminate many other undesirable effects of the current system, but as shown in other memos, it is possible to reduce, remove or even reverse many of these effects through other means.

\* «Directly linked to the assumed value of the blocks»: Using the term «assumed», this is obviously true, but the further assumption that there is link between assumed value and actual value is at best very theoretical and less valid the less explored the region around the license is. At the pre-award stage, companies will also have very different perceptions of «assumed value». This may, of course, be seen as an advantage, if one also assumes that the companies with higher expectations to the license will bid higher. This may, however, be a questionable assumption, re opinions from ADL based on its international experience. Also, as long as there are state oil companies etc. around, high bids may be made from political, not commercial considerations.

A related advantage, not mentioned explicitly in the MPE memo, is that it could be possible, using a sophisticated bid system, to obtain a composition of the group optimising each company's incentives based on the information available at the time of the award, perhaps also to optimise the SDFI share, or at least through experimental use of this system determine whether this actually is the case.

Bids would then have to be submitted for a range of shares for each company. Assuming that very small shares would be of very low value or completely uninteresting, and that very large shares would exceed what each company is willing to risk (not a certain assumption), one would expect companies to bid zero from 0% to x% and from y% to 100%. Further, if companies really are aware of the connection between the size of the share and the resources it is willing to allocate, and the expected impact on end value as a function of this (which they claim), one could expect that at least some of the companies would differentiate their bids in between, producing a curve growing from zero to a maximum, then straightening out or even falling.

In theory, one should stop allocating percentages and start retaining the shares as SDFI from the point accumulated marginal cash revenue evens out, or climbs slower than some gradient determined by the state's advantage of taking gross value rather than post-tax value.

Other shapes of the individual company curves are possible. It is also possible that reality is so different from this theory that the system breaks down completely (in this respect), for a larger or smaller part of the licences. Any knowledge on this point would however be very useful for deciding on possible further use of bidding elements and company behaviour/preferences in general.

This is a very strong argument for *experimenting* with cash bidding for a limited number of licences.

It could, however, be possible both to experiment and to include such effects and gain such information through bidding on limited shares, see below.

\* «Not affecting future decisions»: A pure cash bidding system would not commit the winners to any specific work program and other non-regulatory conditions implied in the current process. It is probably true that this is an advantage seen from the company point of view, and hence a point that would enhance the competitiveness of the NCS. This is not so clear seen from the state's point of view. Even if one were to assume that a work program is unnecessary as the commercial companies will explore to an optimal level without a prior commitment, this exploration may be sub-optimised to the actual licence, while the state also would need to find leads to possible resources outside this area. It is not easy to assume that the state could do or finance this itself, inside a licensed area.

\* «Revenues»: Discussed above. It should also be noted that the revenue impact will be significantly reduced if a bidding system is expected to yield other advantages, since this would require «even playing field» conditions, i. e. non-deductibility of the cash payment.

\* «Might reduce pre-license costs»: Cash bidding would reduce actual costs connected to the application itself (less assuming pre-qualification), and eliminate the assumption that the company has to engage in sponsoring and other PR programs to «look beautiful». But would the companies make less of an effort to survey the acreage before bidding/applying? It would seem that the incentive to invest in knowledge about each licence would increase proportionally with the expected expense commitment. Compared to the current system, acquisition costs would increase. This would be offset by reduced obligations connected to the work program, but the value of this depends on the difference between the obligations and the exploration work the company plans itself. Assuming rational decisions by the authorities about the work program, this might equal the exploration costs of any exploration only needed to find leads to neighbouring projects, see above. The net result is undecided (also taking into consideration NPV values of the various costs), and it also seems undecided whether the effects on pre-bidding surveys are beneficial or harmful to the state's interests.

Disadvantages mentioned are:

\* «Affects the authorities' control»: Regulatory controls would not be affected. Many items currently used as part of the award process could be converted to regulations, others could not, in particular

those relating to the composition of each group, and those included to enhance positive incentives (revision of current system assumed!). See memo «Cost Incentive Problem».

\* «The State and the companies have a different discount rate.» See above.

\* «Draws attention to the state's oil revenues and the use of the petroleum fund.» Probably not to a significant degree compared to what is unavoidable.

\* «SDFI and tax». See above.

\* «Question whether the companies that pays the most are the most efficient companies». See above.

*In total, it is very difficult to see major net advantages that would offset the obvious disadvantage of reduced NPV (state discount rate) by bringing revenue forwards in time.*

Based on ADL's information, it seems that host countries with cash bidding as a major award system feature either

\* are countries where the public system is an add-on to or has emerged from a basically private real estate trading system (US), or

\* are countries with a quite different cash/time-preference because of their financial situation

We have, however, no knowledge that full or partial bidding systems have been developed solely for the purpose of achieving good incentives and obtaining important information as described above. *It could therefore be good reasons to offer a limited number of licences for cash bidding on an experimental basis.*

## ***Cash Bidding for a Limited Share***

Another option could be to keep the discretionary system (revised) for normal award procedures while retaining some percentage for SDFI, parts of this to be auctioned immediately or at a later stage. Several of the disadvantages would now diminish or disappear:

\* Since it will be an occasional trade with individual companies, not a generic part of the system, it is somewhat more likely that the revenue would come in addition to taxes and not stay part of the zero sum game

\* All other rules of the game would remain the same, including work program, licence terms and all basic advantages of the discretionary system

\* In the case of an auction at a later stage, companies will at the later stage have more information about the properties of the license, and bidding will reflect values closer to real value (dependent on how much later)

\* The consequences of high bids from less efficient «hi-rollers» will be smaller (and can still be avoided totally through short-listing or keeping the bid within the already selected group)

Admittedly, many of the advantages would also disappear:

\* The elimination of all distorting side incentives

\* The predictability and transparency of a cash bidding system

\* Increased attractiveness because there is no compulsory work program

Still, it does not seem warranted to introduce such systems from a pure revenue gathering system. There could, however, be other major advantages, discussed in the sections below:

## ***Fine-Tuning of Equity Distribution at Time of Award***

Under the discretionary system, final percentages are set in a somewhat arbitrary manner. This is in particular the case for SDFI.

In principle, the SDFI share should be set in the balance between two considerations:

- \* How much is necessary to allocate to the commercial companies to optimise their incentives?
- \* How much is desirable for the state to keep from a risk/reward perspective (compared to the risk/reward profile of other licenses)?

Currently, the share for each participant is set based on assumptions for the first point, based on the MPE's experience. There is really no way to determine how good these assumptions really are.

Much more information about the relationship between the size of the share, each company's incentives and how much each company expects it is able to influence value creation by its own effort, could be obtained through a specially designed cash bidding system (see above).

It could probably also be achieved through a similar system, used only for a limited share. Each applicant/bidder would now be asked to answer this question:

*For varying values of  $x$  and  $y$ , given that you are awarded  $x\%$  on the basis of your application, how much would you be willing to pay for an additional  $y\%$ ?*

The Ministry would then determine the  $x$ 's as  $y$ 's to give an optimal result based on both «discretionary parameters», the total cash value and the optimal SDFI size, like above.

It would be possible both to announce the sum of  $y$  values in beforehand, and to keep it open.

A problem with this system, in particular in the case of an undetermined  $y$  sum, is that companies will know that disclosing their willingness to pay for something they could get for free will make the MPE allocate the lowest possible «free» share to make as much money as possible on the bid shares. This would influence the bids, and there is a risk it would degenerate into a pure bidding system anyway, with the  $x$  sum going to zero and the  $y$  sum going to 100% less SDFI.

For this reason, it is probably best to determine the  $y$  sum immediately and keep it relatively low, for example around 10%. It is also possible to define a minimum  $x$  value. The problem will however be fully avoided if the reserved share is only made subject to bidding *after* the ordinary award process has been finished. To further avoid distortions, the invitation to apply could specify that a limited share *might* be kept back for later bidding (immediately or at later stages, see below) There are minor advantages and disadvantages to each alternative, not developed further here.

Each time this system is used, the MPE will know more. Studying the bid curves will always give information. In the case of a limited total  $y$  value and bidding only after  $x$  shares have been awarded, it is possible that the first attempts will miss totally on the optimal positioning of the «window» for total  $y$  between total  $x$  and SDFI. If this window is positioned «too low» or «too high», it will not «catch» the maximum point, and one could attempt to move it up or down the next time. In the end, as mentioned above, one might decide that there is no real maximum point or that the system from other reasons is of no value or breaks down, but then this will also give very interesting information about the *real* incentives and motivations of the companies.

### *Adjustment of Equity Distribution*

At the time of original allocation under the discretionary principle, companies are picked with a view to all subsequent stages: Exploration, development and operation/marketing. After each stage, the theoretical set of selection parameters changes. When the acreage has been explored, having good explores becomes less important while having good developers becomes more important, and so on.

Further, at each later stage, authorities will know more about possible inconveniences of the actual compositions, such as positioning in front of unification (hereunder the risk that SDFI interests could be harmed), negotiations with other licences that would require length-of-arm positioning and so on.

The state's evaluation of the licence, the state's risk preferences or other factors may change and make the state want to have a smaller SDFI position.

Clearly, all of the above are also arguments for options to *reduce* shares for some companies and *increase* shares for others, or the SDFI share.

Adjustments like these could be achieved in several ways:

- \* normal, voluntary equity trading, subject to approvals under the Petroleum Act and the Petroleum Tax Act, hereunder decisions to buy or sell SDFI shares at any time

- \* return of the sliding scale as an option, but on terms set as part of the original licence (not recommended, since it would only work as SDFI adjustment and maintain the balance between the companies, and represent added risk for licensees)

- \* a set of options for both sides to trade limited shares at later stages at pre-determined terms fitting the various parties' risk preferences (complicated, but interesting)

- \* deciding as part of the award that a certain percentage (range) will be offered for bidding at determined later stages, such as at the time of the first major discovery, declaration of commerciality, submission/approval of PDO or first production (the difference from normal trading being the prior knowledge that acreage in that particular licence will be available at particular stages)

It could, of course also become desirable for the state to bring in a new company in the license. Licence terms should probably include this option (waivers of first right of refusal etc). In such cases, the MPE could decide to invite a group of companies filling certain desired criteria to bid on a part of SDFI.

### ***Cash Bidding for Operatorships?***

There is no doubt that most companies consider it very important to be appointed operator. The invitation for applications does not contain anything about how the operator is chosen, except a request that the applicant specifies the licences it wants to operate.

One could imagine a separate bidding round for the operatorship for each licence, among the group of partners passing the extra requirements. This could give valuable information about how much an operatorship really is worth. This could be a valuable input in a study of how operators use the job to their advantage, not necessarily compatible with the interests of the full group and the state, as frequently claimed by non-operators. On the other hand, it would be difficult to separate such effects from the legitimate advantages of gaining experience and references. Still, it might be an idea at least to attempt some experimental operatorship bidding procedures.

It is, however, easy to see arguments against using this regularly. In particular, it would make it very difficult for the MPE to distribute operatorships f. ex. in order to assure a reasonable workload for each. Net arguments will probably end up against this in the end.

## CRITERIA PROJECT

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# MEASURING COMPETENCE ETC

Under the traditional discretionary award system, each partner is measured with the same yardsticks and has to meet the same standards with regard to competence, experience etc. Further, each applicant has to meet the standards with personnel mostly within his own organisation, and it seems that significantly more credit has been given to resources available in Norway, rather than support available from the group.

As long as we received enough applications from companies meeting these high standards to get sufficient acreage licensed with a good degree of diversity, there hasn't been much reason to modify these practises, which have remained much the same since the early rounds when we decided to have only «proper oil companies». There has been several exceptions, mostly for political reasons; to reward companies active in «industrial cooperation» etc.

To our knowledge, however, there has never been a comprehensive assessment of the modalities of these practises. Assuming that ADL is right in its conclusion that Norway ought to address current hurdles for new entrants, it would seem prudent to make such an assessment now.

Also, it is not evident that these uniform standards represent the best policy even if we expect to be able to maintain the activity level and a reasonable diversity, since the limited number of Norwegian companies, majors and some independents has come to be a fairly static group with few new entrants. Such a group will tend to develop into a static «cluster» with to some extent a common culture and common professional and strategic paradigms. Diversity may be lost not only because of restructuring, but also because companies grow into the same lines of thinking.

Companies with uneven distribution of competence and experience might still be valuable partners and advisors within their fields of speciality. Some might also become good operators through development or by making suitable alliances.

No matter what we do otherwise to improve the competitiveness of the shelf, a policy of excluding companies without a full spectre of competence and resources «in-house» will strongly limit the group of possible new entrants.

In addition to 3 majors, ADL has listed 6 large independents and 61 smaller independents not currently present at the NCS. It would be of interest to know how many of these that are efficiently excluded by current competence evaluation practises.

### *Core Competence*

For the discussion, we'll look at various elements in oil company competence. To start with, these are the elements described as belonging to the «core competence» identifying an «oil company proper» by Gunnar Frognes (Elf) in Norwegian Oil Review #5/98:

- \* technological expertise sufficient to put together and manage projects, including main supplier relations
- \* basic geophysical functions necessary to find the petroleum
- \* financial strength & risk management
- \* host country knowledge & political risk management
- \* network to all kinds of business partners & acceptance as a partner in this market
- \* good general external relations in general, including relevant organisations
- \* an efficient and creative organisation

\* long-term planning & forecasting ability

Everything else can be purchased, as the supply industry develops increased ability to take on major package contracts including engineering, procurement from sub-suppliers, construction etc., and also is the source of more and more of technology and concept development. Also more of the basic functions within the geo-sector may be outsourced, except the final interpretation with its fine elements of creativity and imagination.

It would probably be a significant improvement already if a definition along these lines were accepted, but perhaps it has been to some extent already.

A separate issue is the additional requirements set by the authorities for an operator as opposed to a partner. This is also important in this context, but will be discussed separately.

## ***Group or Each Company?***

The first question is then whether it is necessary that even this list of core capabilities etc. is satisfied by all companies in the group.

Let's start in the opposite end: What would be the situation (operatorship specialities set aside) if each point on the list was covered by only one company (theoretically)?

The obvious answer is that this would be contrary to the need for diversity. It would mean that there would be no real discussion in the group, as somebody would be the superior authority on each point.

Also, this would create significant problems in the case of any farm-out. The MPE could under the Petroleum Act require that the buyer could copy the disappearing capabilities, but then we would have a problem with continuity within those areas.

With regard to financial strength, authorities would face serious problems in the case of a major accident ending with financial liabilities, as these mainly would have to be met by one company with the risks this would represent.

On the other hand, demanding that *all* companies must meet *all* the points may be superfluous. A middle solution seems indicated, solved in the same way as indicated in the memo «Diversity - New Entrants». Another point could be added after the one suggested in that memo:

*\* ALSO, WHEN PRACTISING THE SAME POINT, ENSURE THAT ALL RELEVANT CAPABILITIES, COMPETENCE AND EXPERIENCE THAT NOT NORMALLY IS PURCHASED FROM SUPPLIERS IS COVERED BY SEVERAL COMPANIES, ALTHOUGH EACH COMPANY NEED NOT COVER EVERYTHING*

## ***In-House or Through Alliances?***

The next question is whether it is necessary that all capabilities etc. must be represented by personnel actually employed by the applicant, and, if so, by the applicant's daughter company in Norway.

Could for example a bank, a large supplier and a geophysical company create an umbrella company and be evaluated as a whole? Could an independent make an alliance with a Norwegian supplier the same way? Could any one of these be credited for capabilities in other companies based on simple purchase contracts?

If the point no more is to limit entrance opportunities, we would think that the main consideration would be to ensure that all important functions are firmly committed for the full life time of the licence. This would mean that any contracts or company constructions would have to be constructed correspondingly, with mutual back-to-back commitments and the understanding that the licence could be withdrawn in the case of a break-up. This risk need not be greater than the risk taken all the time with the «old» oil companies, as shown by the current process of outsourcing and restructuring.

Indeed, safeguarding the state's interests vis-a-vis alliances like this might be useful with regard to the «old» companies as well.

With regard to some of the points, perhaps in particular the core geological competence, it might be necessary to have additional requirements. We would want each alliance to be *unique* to make sure that the alliance really contributes to variety and does not simply copy somebody else's work. Hence, we might require that the company providing the geo-competence only could participate in *one single* alliance and that the contractual terms must reflect this exclusivity. Also, any financial backer must not participate in more alliances than its risk coverage capability with a good margin.

There could also be issues of *conflict of interest* that might warrant exclusivity.

## CRITERIA PROJECT

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# DIVERSITY - NEW ENTRANTS

The current restructuring of the industry, in particular the demise of Saga, actualises the question of the accessibility of the NCS for new companies, both international and domestic. ADL has in its earlier reports pointed out the need for Norway to attract more of the large independents, and that also some major suppliers as well as mid-stream distributors (European Natural Gas Companies) are potential new actors.

ADL has pointed out several strengths and weaknesses with the NCS and several entrance barriers. Many of these relate to features outside the scope of the Criteria Projects.

This memo focuses only on certain licensing round entrance barriers, some mentioned by ADL and some not. Many ADL points relate to the general competitiveness of the NCS and are not covered here. Points related to cost incentives, transparency, predictability and «forced marriages» are covered in other memos.

## ***New Entrants - Oil Companies «Proper»***

The main obstacle for international companies wanting to enter the NCS is the tax barrier, making exploration very expensive for companies not in (special) tax position under the Norwegian Petroleum Tax Act regime.

There may also be an issue about the acknowledgement of the competence and experience developed outside the NCS. In principle, such competence etc. is credited a new applicant, but it is also a fact that applications are judged on the interpretation of the acreage in question, giving companies with prior experience from the NCS an advantage. This is also the explanation usually offered when it is pointed out that Norwegian companies still get the lions' share of interesting operatorships and even partnerships, even after the EC licensing directive was implemented.

The perception of this obstacle by relevant companies may also exaggerate actual practises.

Further, it seems that new companies often have to wait for a long time before they are accepted as operators, even though they have been awarded partnerships (example Enterprise, which is recognized as a particularly creative explorer).

The ADL report confirms that all of these are parts of the perception of the NCS, also that Norwegian authorities have a preference for the majors in addition to the Norwegian companies.

It identifies these among other barriers as significant problems for Norway.

Companies that did cross the barrier normally entered the NCS by purchasing equity in producing fields, thus coming into (special) tax position immediately. This opportunity may be considered sufficient. There are, however, some possible ways to improve it.

## *Tax Modification*

We assume that the tax system's basic properties will not be changed, at least not for this purpose.

A small modification could however create a more level playing field for companies in different tax position:

While it should be possible to make payments made for new acreage won through cash bids in connection with a licensing round non-deductible to create a level playing field (see memo on Cash bids), this would be much more complicated and probably not possible for payments made for later purchases. When acreage is offered for normal commercial sale (by companies or the SDFI),

deductibility will tilt the playing field except for shares of fields in production with ample income to create an immediate tax position. This could be seen to limit the opportunities for newcomers too much.

To create a (more) level playing fields in the case of equity in fields under consideration or under development, one could allow a tax write-up for purchase expenses carried forward until there is offsetting income. This could be based on inflation only, or reflect the full NPV loss.

### *Offsetting the Tax Barrier*

Another way to offset the tax barrier is to make sure there are ample opportunities to purchase shares in producing fields by offering SDFI shares.

A good opportunity would be in situations when the authorities want to bring in a new company in a particular licence, for example

- \* when supplementing experience/competence is desirable for additional projects within the licence
- \* when too few separate companies remain in a licence as a consequence of restructuring (example Gullfaks)
- \* when it is desirable to bring in a company with no vested interests in neighbouring licences or other infrastructure, or in front of unification, to protect SDFI interests
- \* if SDFI needs a caretaker and the other companies for any reasons are unwilling or unacceptable

For such situations, necessary provisions may have to be included in licensing terms to avoid complications because of the rights of current partners.

A more radical means could be to offer SDFI acreage in producing fields for bidding in connection with licensing rounds. Bidding could (if compatible with EU rules) be reserved for new entrants, but this may not be necessary since new entrants may have an incentive to bid higher for the very reason of crossing the barrier. Bids could be allowed contingent on actual awards in the concession round, making it possible for potential new entrants to acquire both fresh licences and tax position immediately - potentially a very attractive opportunity.

### *Acknowledging Non-NCS Experience*

It is difficult for an outsider to assess to what extent experience gained outside the NCS actually is considered less valuable when applications for new licences are considered. There are, however, good reasons to favour companies with a good interpretation of the acreage in question, and unavoidable that there is a connection between this and having experience from the NSC.

The fact that Norwegian companies have continued to achieve better results indicates either this or that there still are some non-admitted preferences in the system. Anyway, this is the perception.

Even though a good understanding of the acreage should remain an issue (see memo on the Cost Incentive Problem), it could be argued that it also is beneficial to have partners with high competence but no experience whatsoever from Norway, since these could be expected to represent fresh views and be a corrective to the culture that unavoidably will grow around companies with a long history in Norway, international or national.

This would also be much of the argument of wanting such companies. New, fresh blood could be seen as a means to maintain the much desired diversity.

This could be reflected in the invitation to apply for new acreage. Understanding and experience are currently two different items (*sections 6 c and d*, revisions suggested in memo on the Cost Incentive Problem). A clarification on how these will be practised could be included as a third point of the new section about selection *principles* suggested in the same memo:

*\* WHEN PRACTISING THE ABOVE POINT, AND WHEN RELEVANT, ALSO CONSIDER THE BENEFITS BY INCLUDING AN APPLICANT OR APPLICANTS WITH HIGH COMPETENCE BUT NO OR LIMITED EXPERIENCE IN NORWAY, TO ENSURE A FRESH VIEW AS PART OF THE DESIRED DIVERSITY WITHIN THE GROUP*

### *Operatorship*

It is even more difficult for an outsider to assess whether newcomers must expect to wait longer than normal for their first operatorship. It may be unfair to criticise the MPE for this, but it is to some extent a perception. There are various theories around for why this happens:

\* «keeping the new kid on the block on his toes», i. e. waiting until it seems necessary to give this encouragement since the newcomer will remain relatively happy anyway and strive particularly hard to do his best to please the authorities, like the clever young man who could have qualified for a promotion, but «he is young and has plenty of time»

\* «preserving competent allies», i. e. the possible view that non-operators have vested interests different from operators (that often will support each other with regard to making use of the operator's organisation, long-term contracts etc.), and these are more in line with SDFI interest (a view often voiced by the non-operators themselves; in a period actually claimed by Total as the company's *raison-d'être* in Norway after it decided not to apply for operatorships)

\* a tendency, perhaps more typical for authorities supervising health, safety and environment, to prefer organisations with an establish record, hence arguing to postpone operatorships to newcomers until «sufficient experience with the company has been gained» - which is hard with the limited opportunity as a partner

\* stronger lobby power by the established companies, and stronger expectations by the authorities of negative response if these are bypassed

If any of this is real, which really only can be determined by the MPE by internal review, this should be determined and addressed. If any of these considerations are real *and* worth maintaining, it should be openly stated and included in announcements and feedback. Those *not* worth maintaining should of course not be, and this should be clarified.

Since there anyway still are perceptions around along these lines, it should be considered to include in the announcement a section explaining directly how operators are chosen. This might be a good idea not only from the viewpoint of enhancing diversity.

### *Office in Norway*

ADL further mentions the requirement to establish an office in Norway as a barrier for smaller independents, but concludes that this group may not find the NCS attractive in the short to medium term because it is still too immature. (Larger independents are of more interest.)

In fact, there are licensees in Norway with only a token presence through a lawyer or a single expat. Such companies seem to have entered through acquisitions more than licence round awards, and stand very small chances of being awarded much more. Most of these companies are, however, not very representative of the kind of new entrants Norway should desire, and it would seem that a company that not even can afford this is somewhat on the skinny side for Norway.

This might be worrisome, since ADL lists only 3 majors and 6 «large independents», but as much as 61 «smaller independents». It might therefore still be prudent to keep the smaller in mind.

Anyway, it is probably also the case that a licence round applicant must have a staff in Norway of a certain size to be successful. This could be an understandable obstacle for larger and smaller independents alike. It should be noted that even Chevron, the last entrants from the group of majors, still is keeping its staffing in Norway very modest and relies heavily on UK backup.

The de facto requirement of a certain local staff is more a result of the selection criteria (competence, capacity, acreage interpretation) than the formal requirement to have an office. This again is a function of the way competence is measured and what level of competence is required by each partner as opposed to the full group.

\* The question of NCS-based competence/experience is covered above

\* A related issue is how much of the company's resources that actually is present here and not only a potential support from the group. This may be much of a «hen-and-the-egg» issue: You won't get licences until you have a decent local staff; you won't be staffed by the group until you are licensed. The MPE should decide on how to solve this knot.

\* The question of whether to measure the competence etc. of each company or the full group (with certain minimum standards for the individual partners and the operator) is a major issue and will be dealt with separately.

## ***New Entrants - Niche Companies***

On this point, we have a current sample case in Aker Maritime. Aker identified a small number of possible prospects that Aker expected could be purchased because they might be of limited interest to current licensees, while also having features indicating that Aker for various reasons could make more value from them and hence be an attractive alternate developer. It was also important for Aker not to be considered a competitor to the «proper» oil companies; its customers. Hence, Aker declared it would apply for new licences and only develop fields the current operators/partners didn't give priority.

Aker requested a preliminary clearance from the authorities and were considered for limited non-exploratory operatorships. The result was that Aker was cleared in principle, but the MPE pointed out several requirements for improvement, none of which were considered unreasonable or unattainable by Aker.

As we understand it, a persistent problem is that the current operators are unwilling to consider allowing new actors to take over developments, either through carve-outs or partnership. This problem is enhanced because so many potential projects are operated by Statoil and only very few other companies, representing a quasi-monopoly on the «supply side» for such projects.

We know that other companies are willing to enter into such deals, but the «market» makes it very difficult to match willing sellers and sufficiently good prospects.

Basically, this can only be rectified by redressing the balance between Statoil, Hydro and the international companies, which obviously will take time even with good will.

An interesting question is therefore whether authorities can and want to contribute by using incentives or regulatory means against unwilling equity holders.

The Petroleum Act does contain sections that could be used to enforce project management transfers in various ways. This is, however, not recommended because if the high risk that using such dramatic measures will reduce the predictability of the Norwegian system and harm the competitiveness of the NCS.

What remains is incentives. In the memo «Cost Incentive Problem», the following point is suggested included in the licence round announcement as a *requirement*:

*\*..THAT IT HAS KEPT REASONABLE PROGRESS WITH REGARD TO PROJECTS IN EARLIER LICENSES, WITHOUT WASTE OF NET PRESENT VALUE, AND BEEN WILLING TO TRANSFER RIGHTS TO OTHER DEVELOPERS IN THE CASE OF A PROJECT PORTFOLIO EXCEEDING CAPACITY OR UNDER OTHER CIRCUMSTANCES WHEN IT IS COMMERCIALY PROPER TO DO SO*

During the peak of the field drought, the MPE Minister indicated that companies (Norwegian companies mentioned in particular) could be punished if they kept sitting too long on projects.

## ***New Entrants - Gas Customers***

ADL points out that the European Gas Transmission companies have a desire to integrate upstream, but that the refusal to approve the farm-in by GdF has clouded their expectations of being allowed in.

As we understand it, the negative decision on GdF was formally based on the same criteria as others, i. e. an evaluation of relevant competence as insufficient, but the general belief is that the real reason was a reluctance to have gas customers «on both sides of the table».

In the current world of rapid restructuring and in view of the Norwegian companies' ambition to internationalise, we must expect more and more of our current licensees to appear either as gas customers or as competitors. It might be a losing battle to attempt to avoid such companies anyway.

It has also been said that the GdF refusal did not only discourage gas transmission companies, but that it contributed to the general impression of Norwegian controls and nationalism.

It could be difficult to keep up the «competence based» defence works against GdF etc while adjusting entrance conditions sufficient to improve or even maintain diversity, and to allow new independents to substitute for reduced investments by majors in the case of such a development, as pointed out by ADL.

Hence, it might therefore be a better strategy to prepare for amendments in the total gas sales system with a view to deal with increasing cross-border gas sale or purchase roles by all companies. It might also be a better strategy to encourage deals between Norwegian licensees and European gas customers about mutual up/down-stream integration. This would at least allow us to «view their cards» as well and create alliances and secure market shares useful in Europe's emerging gas market. But these issues are parts of a much larger picture and will not be further discussed here.

## ***New Entrants - Combinations***

ADL suggests that major suppliers could «act 'on behalf' of smaller operators, offering operational base in Norway and assuming total operational responsibility».

This is a special case within the larger option of allowing operators and/or partners that do not qualify on all points alone, but will do so in alliance with other companies with complementary competence and experience. It is related to the question of whether each company must qualify, or only the full group, but this time the parallel question regarding how each partner fulfils the (high or low level) of competence etc required.

This is also dealt with separately.

## CRITERIA PROJECT

HHR 2.1.2000

### GROUP APPLICATIONS

ADL points out that «forced marriages» is a negative feature with the Norwegian system, discouraging new entrants. It is likely that it is less of a burden for the companies established in Norway, since they are accustomed to the system and since their low number means they all have grown to know each other pretty well. Hence, the more desirable it is to attract new companies, the stronger the argument to allow more group allocations.

The pros for group applications are:

- \* Pre-licensing cost saving (a stronger argument the riskier the acreage)
- \* Avoiding «forced marriages» that mean uncertainty for applicants about the co-operation climate in the group and the performance of partners (probably more of a problem for new entrants)
- \* With some reservations a means to reduce the «beauty contest» (se memo Cost Incentive Problem)

The cons are:

- \* Loss of all advantages of the discretionary system (se memo Cost Incentive Problem)
- \* Loss of diversity in the group, and in particular possible loss of exploration projects due to the probable use of only one geophysical culture for seismic interpretation (a weaker argument in mature areas where the geo-structure can be expected to be well known)

It would therefore seem that group applications are less objectionable in both ends of the spectre, i. e. very high-risk areas where pre-licensing cost is a firm obstacle for company interest, re the Barents Sea, and in very mature areas where the benefits of multiple pre-licensing interpretations are small (and projects in general may be marginal).

According to ADL, the larger independents usually succeed the majors as these lose interest in mature areas, which therefore also is where we need to attract these companies. This coincides with one of the ends of the spectrum where group allocations are less objectionable, and with the kind of companies more likely to see «forced marriages» as a problem.

The balance of arguments therefore swings in the direction of group applications in these areas.

A possible exception is those advantages of discretionary licensing that are connected to strategic considerations (avoiding problems related to unification and negotiations about common use of infrastructure). If newcomers really are attracted, that might at least take care of the latter of these problems.

Hence, it seems possible that activity could be boosted by allowing group applications in mature areas.

## CRITERIA PROJECT

HHR 1.1.2000

# COST INCENTIVE PROBLEM

Current award criteria may be evaluated against many objectives. Recommendations on how to make adjustments to achieve each objective will also influence other objectives. This memo is limited to evaluation and recommendations related to the cost incentive problem only.

Discussions have established that the current licensing system, and in particular the perception of it, have properties that tend to reduce applicants' cost control incentives. In particular, companies tend to believe that choosing technologies and standards above basic requirements will give them extra advantages in the competition for the best acreage, operatorships etc. («goldplating» in order to win «brownie points»; «beauty contest»).

The effect can be attributed to

- \* the discretionary nature of the system
- \* the lack of specification in the published criteria whether they should be understood as passed/not passed *requirements* or as evaluation *criteria* that can be fulfilled in varying degree (or, really, the perception that the latter is the case)
- \* the history of declared inclusion of «brownie points» in the selection criteria (industrial co-operation, Norwegian goods and services etc.)
- \* the unavoidable time lag before changes of policy are perceived
- \* the strong public focus on «politically correct» issues, in particular within health, safety and environment
- \* the likelihood that the Norwegian subsidiaries of international companies blame the beauty contest for lack of success, rather than admitting faults with their own work
- \* the high marginal tax, state participation & low equity shares, all reducing the actual net cost
- \* the effects of the currently used EPC contracts, often leaving doubt about which side is responsible for covering the costs of variation orders (and the belief by oil company staff that they can often be pushed over on the supplier anyway)
- \* elements in the regulatory system, in particular relating to health, safety and environment, are open to interpretation by regulatory bodies and will often be interpreted in favour of more costly solutions
- \* «unholy» alliances between company sector interests and regulatory bodies' middle management
- \* other elements directly specify an obligation for the licensees to use the best technology available

Some of these points, but not all, can be rectified or influenced by changes in award criteria.

## ***Discretionary system***

Obviously, the cost incentive problem will be diminished the more we move away from the discretionary system.

Alternatives are:

- \* *A pure (cash) bidding system (discussed further in another memo)*

This would immediately erase all other criteria and therefore all negative cost incentives relating to allocations. It is, however, assumed that, for other reasons, this is not the preferred solution.

- \* *Allowing group applications (discussed further in another memo)*

This would probably eliminate much of the negative effects, since individual company behaviour would be diluted with the other group members' behaviour. It would, however, still be a risk that companies would form more or less permanent alliances and decide to act in concert. Also, if a group responsible for one field development expects to go together for a new application, it would be much as before.

It is, however, assumed that other considerations may be equally or more decisive for when and where group applications will be allowed. Some of these also have to do with costs, but along other dimensions.

### ***Threshold requirements or quantitative evaluation criteria***

If evaluation criteria are given as threshold values, and this is believed by applicants, companies will know that there is nothing to gain by over-fulfilment. The more the criteria are used this way, the better effects on cost incentives.

Obviously, if all criteria are thresholds, most companies must be expected to make sure they pass, and a new set of criteria will have to be applied anyway, as long as we still remain within a basically discretionary system. If only some are not thresholds, the cost push factor will simply be concentrated around these, and may grow just as strong as before.

This can only be avoided if the residual criteria (or post-threshold criteria) are not cost-pushing by their nature. Such criteria could be:

- \* An outright rule that the Ministry will take the companies' actual cost record or internal company policies («good enough») into consideration
- \* Measuring companies' willingness to contribute to cost saving programs, for example EPC contract terms, contractual creativity, standardisation and other «NORSOK» related programs
- \* Distributing in particular operatorships, but also partnerships, according to a policy of optimising total work load for each company (including current projects) to that company's expected optimal capacity, both totally and related to the top management (re Moe report); applicants may in their applications address this issue and explain what they have done to improve management and other capacity and so on.
- \* Measuring companies' progress on existing licences, ability to develop «marginal» projects in a profitable manner (or transfer rights to new owner etc), record on enhanced recovery etc
- \* strategic considerations

### ***Which criteria could be considered threshold criteria?***

Current criteria are described in the document «Innbydelse til å søke om utvinningstillatelse for petroleum».

Sections 1-4 are not relevant, with the possible exception of

Section 4.1 (*requirements for environment and fisheries*): As we understand it, these are rules the applicant must accept, but no action is required until the license has been obtained and exploration etc. is planned.

The mentioned «risk analysis» and «implementation of probability reducing measures» could, however, invite to over-achievement, but this is more a matter of incentives created by regulations and should be dealt with in this connection.

Section 5 is not about criteria, but areas for negotiation, but this is for practical purposes the same. These points, have, as we understand it, in fact developed into *de facto* requirements which are neither criteria nor much negotiable. If this is the case, they should already in this connection be equal to firm threshold criteria.

It may be more complicated, though. The requirements are set after advice from the NPD based not only on its own knowledge of the acreage, but also on the input from the applications. Hence, the work done by applicants prior to application and the level of aggressiveness presented in the application will influence the NPD and therefore the work program which in the end becomes a requirement for all.

If there is an incentive for over-achievement, leading to too ambitious work program requirements, it is related to section 6c and will be dealt with there.

In general, one should decide whether these points really should be points for negotiation or set requirements or frame conditions, and specified as such.

*Section 6* contains the formal evaluation criteria. It has a «preamble» that also contains certain information about principles outside the realm of the applicant's influence that also will be taken into consideration when licenses are allocated. Such principles could be specified further and clearly in a separate section (see below), excluding obvious generalities. The latter («good resource management», «efficient exploration» etc.) would better be placed in a «preamble» for the whole text.

*Section 6a* starts referring to «relevant technical competence, hereunder competence relating to development, research, safety and environment». The way it is written, it is reasonable to expect that these are quantitative criteria. At first glance, incentives for over-achievement could be believed to be modified by the rest of the sentence, «how this can contribute actively to a cost effective ...(etc)».

This may not, however, be the case, since «competence» is something the applicant possesses, while the modifier is about how that competence is applied. It would still seem desirable to be able to demonstrate very high competence. High investment in competence-building could be seen rather to increase the ability to be cost effective rather than reduce it.

If this is true, it is not a problem that the point is quantitative. But it may not always be true.

«Competence» is normally measured using «experience» as proxy. It is difficult for the authorities to «scan» the organisation as such, but easier to check out what it actually has done. Of course, something may be implied by the number of engineers & geologists, R&D programs implemented etc., but actual performance is often «the proof of the pudding».

This criterion therefore will incite the companies to gain experience in «development, research, safety and environment», probably by taking available opportunities to engage in such projects. This will be expected to tell the authorities that the company will have good abilities to implement new projects within the same areas, hereunder in a «cost effective» manner. But the «cost efficiency» can be considered relatively to what the authorities desire. An ambitious project to bring for example «safety» and «environment» up to new levels can be costly, though cost effective, given the expected ambitious objectives, for example «zero emissions» and CO<sub>2</sub> reductions.

If now our objective is to enhance incentives for value creation while keeping incentives for spending on objectives where authorities should set the standards (through a collective cost/benefit consideration), and to eliminate incentives to spend excessively from expectations of «brownie points», then we should separate between different kinds of «competence»:

\* When more competence leads to more value creation within a commercial frame, the criterion should be quantitative

\* When more competence corresponds to more spending on collective values, the criterion should be a threshold.

*It is therefore recommended that section 6 is split into one section for threshold requirements and one section for quantitative criteria.*

*(REQUIREMENT) (THE APPLICANT MUST.) HAVE SUFFICIENT RELEVANT COMPETENCE, EXPERIENCE AND ROUTINES WITH REGARD TO SAFETY. HEALTH*

AND ENVIRONMENTAL PROTECTION TO ENSURE THAT CURRENT REGULATIONS WILL BE OBSERVED IN A COST EFFECTIVE MANNER.

(CRITERION) (APPLICANTS WILL BE FAVOURED ACCORDING TO THE EXTENT THEY CAN SHOW) COMPETENCE AND EXPERIENCE WITH REGARD TO COMMERCIAL AND COST EFFECTIVE EXPLORATION AND DEVELOPMENT OF RELEVANT PROJECTS AND ABILITY TO PROMOTE RELEVANT TECHNOLOGY AND APPLY TECHNOLOGY FOR VALUE CREATION, HEREUNDER ENHANCED RECOVERY AND OTHER MEASURES TO ENHANCE THE RESOURCE BASE

Section 6b is already a threshold

Section 6c is about the applicant's geological understanding of the area and how the applicant plans to explore (re also section 5 above).

One would intuitively expect the first part to be quantitative, as it is natural to assume that higher understanding is better. The second part is ambiguous and would depend on side perceptions: Do the authorities appreciate *all* exploration, also exploration that only would yield scientific information («stratigraphic wells»), or only such exploration that leads to commercial production - or somewhere in between?

This is very significant, as even those who might understand that commercially non-essential aspects («the beauty contest») should be disregarded, still would expect geological understanding and extensive exploration to be perhaps the most important core criteria for selection. If there is a limit to desirable «understanding» and «planned exploration», this should be explained.

It would seem, however, to be hard to express what is an «optimal» level of «understanding» and «planned exploration» in terms that would set an objective threshold value. Geological interpretation is far from an exact science, and variety is in this field especially beneficial, in fact, one of the main reasons we want many independent companies in competition. The criteria should therefore certainly not favour homogeneity, except perhaps in very mature or very marginal areas, where group applications would seem to be called for anyway.

Hence, a threshold requirement would have to be basically subjective, though controllable as such by the NPD, for example

**(REQUIREMENT) ..SUFFICIENT UNDERSTANDING OF THE GEOLOGY OF THE ACREAGE IN QUESTION TO IDENTIFY ALL POTENTIALLY PROFITABLE PROSPECTS AND TO FIND POSSIBLE LEADS TO OTHER SUCH PROJECTS; AND PRESENT EXPLORATION PROGRAMS SUFFICIENT TO VERIFY OR DISCARD SUCH PROJECTS' VIABILITY AND / OR COMMERCIAL USEFULNESS**

Section 6d could be deleted and incorporated in section 6a as competence and experience are interdependent and difficult to keep apart. Both «competence», «experience» and «relevancy» can be combined, see above.

Section 6e is unclear and unlimited and invites to all kinds of speculations. It should be deleted.

The following requirements could be added:

\* ..THAT IT HAS IMPLEMENTED SUFFICIENT INTERNAL COST CONTROL SYSTEMS BASED ON THE PRINCIPLE THAT STANDARDS AND TECHNOLOGY SHOULD FULFIL, BUT NOT EXCEED, ALL RULES AND REGULATIONS DEFINED BY THE AUTHORITIES, EXCEPT WHEN HIGHER STANDARDS AND BETTER TECHNOLOGY ARE EXPECTED TO CREATE HIGHER VALUE, OR FOLLOWS FROM SOUND EMPLOYEE RESPONSIBILITY AND / OR AGREEMENTS WITH EMPLOYEES' ORGANISATIONS, OR FOLLOWS FROM A COMMERCIAL RISK / REWARD CONSIDERATION

\*..THAT IT HAS OR CAN ESTABLISH ORGANISATIONAL CAPACITY AND ADMINISTRATIVE CONTROL ROUTINES SUFFICIENT TO CARRY OUT PROJECTS LIKELY TO RESULT FROM THE ALLOCATION IN A PROPER AND COST EFFECTIVE MANNER, IN ADDITION TO PROJECTS ALREADY COMMITTED OR LIKELY TO BE IMPLEMENTED, ALL WITHIN A REASONABLE TIME PERSPECTIVE

\*..THAT IT HAS KEPT REASONABLE PROGRESS WITH REGARD TO PROJECTS IN EARLIER LICENSES, WITHOUT WASTE OF NET PRESENT VALUE, AND BEEN WILLING TO TRANSFER RIGHTS TO OTHER DEVELOPERS IN THE CASE OF A PROJECT PORTFOLIO EXCEEDING CAPACITY OR UNDER OTHER CIRCUMSTANCES WHEN IT IS COMMERCIALY PROPER TO DO SO

The following could be either *criteria* or *requirements*:

\*..THAT ITS EARLIER PROJECTS HAVE BEEN CARRIED OUT WITHIN BUDGET AND ON SCHEDULE AND OTHERWISE BEEN GOOD VALUE CREATORS

\*..THAT IT HAS PARTICIPATED WITH GOOD WILL AND CREATIVITY IN PROJECTS WITHIN THE OIL INDUSTRY AND WITH ITS SUPPLIERS TO DEVELOP EQUITABLE AND COST SAVING CONTRACTUAL AND OTHER RELATIONS, HEREUNDER WILLINGNESS TO AGREE TO SOUND COMMON STANDARDS.

Further, a new section could define these *principles* for the authorities' own final selection of licensees.

*THE MINISTRY WILL CHOOSE LICENSEES AMONG THE APPLICANTS THAT HAVE PASSED ALL REQUIREMENTS IN SECTION XX. IN THE FINAL CHOICE OF PARTICIPANTS WITHIN EACH LICENSE, THE MINISTRY WILL*

*\* CONSIDER THE EXTENT TO WHICH THE APPLICANTS HAVE SATISFIED THE CRITERIA OF SECTION XX*

*\* MAKE SURE EACH GROUP IS COMPOSED OF COMPANIES WITH A VARIETY OF SUPPLEMENTING COMPETENCE AND EXPERIENCE, TO CREATE A SOUND DIALOGUE WITHIN THE GROUP (IN THE CASE A NEW LICENSE MAY BE EXPECTED TO CONTAIN PROJECTS THAT WILL LEAD TO UNIFICATION WITH A NEIGHBORING LICENSE, THIS CONSIDERATION MAY ALSO BE APPLIED TO THE SITUATION AFTER THE UNIFICATION)*

(Note: Re the Ormen Lange allocations.)

*\* MAKE SURE EACH GROUP IS COMPOSED IN A WAY THAT WILL ENSURE THAT THE SYNTHESIS OF THE COMMERCIAL COMPANIES' DECISIONS IS IN THE BEST INTEREST OF THE STATE'S DIRECT FINANCIAL INTEREST, HEREUNDER EFFICIENT MARKETING OF PETROLEUM*

*\*CONSIDER HOW THE FINAL COMPOSITION OF EACH GROUP MAY FACILITATE UNIFICATION WITH NEIGHBORING LICENSES WHEN IT SEEMS LIKELY THAT UNIFICATION WILL TAKE PLACE*

*\*CONSIDER HOW THE FINAL COMPOSITION OF EACH GROUP MAY ENSURE REAL ARM'S LENGTH NEGOTIATIONS WITH OTHER LICENSES WHEN IT SEEMS LIKELY THAT THE LICENSE GROUPS LATER WILL NEED TO NEGOTIATE ABOUT USE OF INFRASTRUCTURE ETC*

*\* TO THE EXTENT POSSIBLE, CHOOSE LICENCES FOR EACH APPLICANT IN THE ORDER OF THE APPLICANT'S OWN PRIORITY*

*\* TO THE EXTENT POSSIBLE, UTILISE THE DOCUMENTED CAPACITY OF THE ORGANISATION AND THE MANAGEMENT OF EACH APPLICANT (RE SECTION XX) TO AN OPTIMAL LEVEL, TAKING INTO CONSIDERATION THE APPLICANT'S CURRENT PROJECT COMMITMENTS*

Obviously, it may be impossible to use all of these points, and it may be difficult to ascertain what kind of strategic considerations with regard to neighbouring licences, gas marketing etc that may be important in each case at this early stage. Since companies cannot influence any of this (other than through arguments), this uncertainty is not a problem, and it is an advantage that it is clear in advance because of transparency and predictability. In practise, it will be obvious to all parties when strategic considerations will be of decisive importance. It may also be specified for which individual licenses specific strategic issues will be considered.

*Section 7* (state participation and caretaker arrangements) will be discussed separately.

*Section 8* (contents of application) is a function of the earlier sections and should be adjusted accordingly (re for example some bullet points in *section 8c*).

### ***History, perception and political «signals» - feedback***

Rewriting the invitation document, giving as clear information as possible about how the various factor will influence the outcome, should help on the cost incentive problem. Still, there will be a lot of rumours, explanations and other mysticism around. Significant improvements can only be expected when the new policy has been implemented, experienced as credible and thoroughly understood in all of the applicants' international organisation.

It would also be a great advantage if it could be ascertained that the politicians want to set the standards for non-commercial standards (health, safety, environment etc.) themselves or through the administrative system, rather than having companies taking over this function through the «beauty contest». Granted, and as indicated above, there are parts of this that properly belongs in the commercial sphere, in particular safety and labour relations, as these standards may have a direct bearing on efficiency and profitability, but the border should be drawn anyway, at least in principle.

It may seem difficult to make politicians realise that a political push on such costs, allowing companies to make the priorities while spending tax money, actually represents a dilution of democracy. In fact, this is probably not as difficult as convincing them to say it outright. The politicians do not *really* like to be out-competed by companies on political correctness. The image of heroic politicians fighting for the good cause against greedy capitalists is much better. But, of course, they cannot be seen to dislike politically correct efforts by the companies.

It would therefore seem to be the best strategy to

- \* encourage politicians to focus on their own legislative efforts, and do the same in government documents etc
- \* make the bidding invitation as clear and unambiguous as possible, preferably similar to the suggestions made above
- \* ensure honest and specific feedback to each applicant on each point

It is understandable that the Ministry may be reluctant to observe a firm pattern of requirement selection criteria and practises, which may be felt like a straitjacket when actual choices have to be made. It is also easy to understand that it may be difficult to be open to applicants about all the elements in the discretionary selection process.

This should, however, be considered the contribution of the civil service to better cost incentives, higher predictability and in general a cleaner system. Any doubts lingering about the true reasons for unexpected awards or lack of such will give rise to speculations, rumours and continued irrational behaviour. It cannot be in the interest of anybody that applicants have to resort to «cremlinology» when they prepare their applications and plan their behaviour.

The very fact that there is time lag and dysfunction in the communication to decision-makers in mother companies should underline this.

## ***Regulations by other Government bodies***

As described above, many elements in existing regulations are cost-pushing. Much of this is independent of licensing procedures and need not to be dealt with here. Some aspects, however, are strongly connected and should warrant influence from MPE on the work done in other ministries:

- \* lack of clarity, opening for cost-pushing interpretations and «unholy alliances»
- \* delegation of the right to define standards to administrative bodies with no responsibility for costs, income reduction and cost efficiency
- \* non-objective standards calling for «best efforts», «best available technology» etc.

The latter is a particularly vicious kind of regulation, especially if it is connected to any punishment/reward system, and when the state through various mechanisms has to cover the lion's share of the costs. It will tend to consume all taxable profits over and above basic company rate of return requirements, as companies can be expected to protest only when margins gets narrow.

Hence, it will undermine the value creation which is the responsibility of the MPE.

Implementing improved licensing criteria will tend to remove the effects of this kind of legislation, since it is difficult to enforce without a strong incentive on the side. It is hard to fine or jail anybody for non-observance.

Still, as long as such rules exist, companies will expect to be rewarded or punished in some way, and the closest way to assume this will happen is through the award process. Such rules will therefore tend to confuse the issues in award procedures and in principle distort the optimal choice of licensees, and in this case impede the expected cost incentive effects of a criteria revision.

Certainly on this point, but also on the others, the MPE should secure a stronger say in the inter-ministerial decision-making processes, demanding objective and precise regulations and decision-making systems ensuring proper cost/benefit considerations. In this connection, it is vital that the NPD and the MPE are heard on the cost side whenever regulations are considered, and that decisions are taken on a level above both NPD/MPE and the other regulatory bodies.

## ***Choosing the Operator***

The current document does not specify how the MPE intends to choose the operator for each field. It is, however, well known that additional requirements are set for operators. It is also clear that it is important for (most) companies to be accepted as an operator, and that success or failure on this point is subject to just as much interpretation as with regard to the acreage award proper. This issue is therefore definitely relevant to the problems discussed in this memo.

It is therefore recommended that similar requirements, criteria and principles are clearly defined in the invitation and that similar feedback procedures are observed.