

Storting proposition no 60 (2006-2007)

Merger of Statoil and Hydro's petroleum operations

Recommendation from the Ministry of Petroleum and Energy of 30 March 2007, approved by the Council of State on the same day.

Unofficial translation

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1. Introduction and summary

The boards of directors of Statoil ASA (Statoil) and Norske Hydro ASA (Hydro) announced on 18 December 2006 that they had reached agreement on recommending a merger between Hydro's petroleum business and Statoil ASA to their shareholders. The boards of the companies also considered and signed on 12 and 13 March 2007 a plan for demerging Hydro as part of the merger. This plan, hereafter called the merger plan, will be submitted to the general meetings of the companies for approval. This proposition is presented by the Ministry of Petroleum and Energy, but has been prepared in cooperation with the Ministry of Trade and Industry. The Ministry of Labour and Social Inclusion and the Ministry of the Environment have contributed to the text in chapter 8.

This chapter provides a summary of the other chapters in the proposition.

Chapter 2 outlines the reasons given by the boards for the merger as presented in the merger plan of 12 and 13 March 2007 and the draft prospectus submitted to the US Securities and Exchange Commission (SEC) on 20 March 2007. The boards believe that combining the resources and knowledge of the companies will contribute to a financially and technologically sound company which will be a stronger international player than the two companies are separately. Statoil and Hydro also envisage that the merged company will be better able to explore for, develop and produce oil and gas in technically demanding areas of the Norwegian continental shelf (NCS), such as the Barents Sea.

Chapter 3 provides a review of Statoil's present position. The company has shown good and stable progress for profits in recent years. Net profit for 2006 was its best ever, amounting to NOK 40.6 billion compared with NOK 30.7 billion in 2005. This increase primarily reflects higher oil and gas prices.

Statoil's total oil and gas production in 2006 was 1 135 000 barrels of oil equivalent (boe) per day. The company's goal for total production in 2007 is 1 300 000 boe per day, based on an average oil price of USD 60 per barrel. The goal is that 1 060 000 boe per day will derive from the company's operations in Norway and about 240 000 boe per day from its international business. The company has paid out an average of 46 per cent of its net profit as dividend over the past few years.

Chapter 4 provides a corresponding review of Hydro's present position. The company became involved in oil and gas activities in 1963 and participated in the first discovery on the NCS in 1969. When the new century began, oil and gas, aluminium production and fertiliser formed the three main cornerstones of Hydro's business. In the summer of 2003, the company resolved to establish its agricultural division as an independent Norwegian-based company listed on the Oslo Stock Exchange. Hydro's operations have subsequently consisted primarily of the oil and energy and aluminium business areas.

Hydro has shown stable growth in profits over recent years. The company achieved its strongest result in 2006, when net profit increased by 11 per cent from 2005 to NOK 17.4 billion. Higher prices for oil, gas and aluminium, combined with efficient operation, boosted the 2006 result to a record level. The company has paid out an average of roughly 32 per cent of net profit in dividend over the past five years.

Chapter 5 outlines the merger plan. This will be presented to the general meetings, which will be asked to accept or reject it. By voting for the merger plan, an implicit decision is also taken in favour of all the conditions included in the merger plan, such as the exchange ratio, the articles of association, changes to the capital and so forth.

In terms of *company law*, the merger will be accomplished through a *demerger* of Hydro's petroleum business with a direct transfer to Statoil as the acquiring company. Put briefly, the merger process involves the transfer to Statoil of Hydro's total oil and gas business and activities relating to wind power, its shares in Naturkraft AS and Hydro IS Partner AS, and interests in Norsk Hydro Canada Inc. Shareholders in Hydro will receive 0.8622 shares in the merged company for every share they hold in Hydro as compensation for the transfer of the petroleum business. They will also retain their shares in the continued Hydro. According to the merger plan, shareholders in Statoil and Hydro will receive 67.3 per cent and 32.7 per cent respectively of the shares in the merged company.

It has been proposed that the new company will be called StatoilHydro ASA. The board of the merged company will develop proposals for a new name and logo. A proposed new name will be submitted to the general meeting of StatoilHydro for approval in 2008.

It has been proposed that the company's business office will be in Stavanger. Corporate functions will be located in both Stavanger and Oslo, and the chief executive will have offices in both places. The most important commercial functions and business areas will be operated from Stavanger, Oslo, Bergen and Trondheim.

The provision in Statoil's articles of association that the company will handle the sale of the government's petroleum is to be retained by the merged company.

Chapter 6 provides a review of the merged company. Its object will be to conduct exploration for and production, transport, processing and marketing of petroleum and derivative products as well as other forms of business. The merged company will also make a commitment to renewable energy as well as to carbon capture and storage.

StatoilHydro will have about 31 000 employees and a presence in almost 40 countries. The company will have an estimated market value approaching that of the large, but not the largest, listed oil and gas companies. Its production and development portfolio, both on the NCS and internationally, will be strengthened. The company is expected to have an overall output of 1.9 million boe per day in 2007, including 1.6 million boe per day from Norway. Its proven oil and gas reserves are estimated at 6.3 billion boe.

The company's business areas will be Exploration & Production Norway, International Exploration & Production, Natural Gas, Manufacturing & Marketing, Technology & New Energy and Projects. In addition come accounting and finance and the company's corporate centre with staff, support and service functions.

Operations in Norway will remain the most important area for the merged company. Sixty-eight per cent of its proven reserves will be on the NCS.

The companies have commissioned an independent calculation of the total cost benefits of the merged company. These cost benefits are estimated at roughly NOK 4 billion per year before tax. This embraces both enhanced efficiency related to exploration activities, development and operations, and savings in administration and business support. Gross cost benefits relating to running the business operated by the company are estimated to be significantly higher than NOK 4 billion.

Chapter 7 provides a review of the continued business in Hydro. Following the demerger of the petroleum activity, it will concentrate primarily on being an integrated

aluminium company. However, it will also own a substantial power output. Hydro will be the world's third largest listed aluminium company. In addition to a strong commitment to primary aluminium and metal products, Hydro will continue to build on its leading European position for rolled and extruded aluminium products and building systems. Combined with increased production of metal and the raw material, aluminium oxide, this will provide the main basis for realising the company's growth ambitions in the aluminium business.

The continued Hydro would have had an estimated turnover of more than NOK 100 billion in 2006 and a net profit exceeding NOK 6 billion. It would have been among the largest companies on the Oslo Stock Exchange, and have about 25 000 employees.

Chapter 8 begins with an overview of the merged company's position on the NCS. It will control more than a third of the remaining proven resources on the NCS. Statoil controls substantially larger resources than Hydro. Merging Statoil and Hydro's petroleum activities will result in a company with a significantly larger portfolio of production licences than the other licensees, but the NCS will retain a multiplicity of licensees.

The largest fields on the NCS have been developed. Up to now, major projects have presented the development teams in Statoil and Hydro with demanding assignments, and these challenges have meant a lot for the development of the companies. The discoveries which will be developed in the time to come are smaller than before, and a more diverse group of players will be responsible for their development.

Substantial gains stand to be made by taking a collective view of several fields and areas. Statoil and Hydro are operators for many of the major fields in mature areas, and the merged company will therefore play an important role in their continued development.

The trend is towards more but smaller fields. A requirement accordingly remains for a multiplicity of players in exploration, development and operation. Calculations by the Norwegian Petroleum Directorate/Ministry of Petroleum and Energy show that the merged company controls about 30 per cent of proven oil resources and 40 per cent of proven gas resources in 2007. The proportion of oil resources controlled by the merged company will fall to about 20 per cent up to 2020, while its share of the gas resources will only decline to a little under 40 per cent.

Further development of the reserve base and production in Norway is dependent on making and developing new discoveries, and on the most efficient possible operation of the production fields. The merged company will occupy a key position in petroleum activities on the NCS, while the bulk of its operations will also be located there. The merged company will accordingly play an important role both in the continued development of the large fields and in contributing to an active exploration of the non-mature areas.

Players on the NCS comprise both the big, established oil companies and the new players who have arrived since 2000. Diversity is greatest in exploration activity in mature areas, but we also see a more nuanced player picture for development of new fields. Such diversity ensures that competition is maintained over the best ideas for exploration, development and operation.

At the same time, parts of the NCS are moving in a direction where economies of scale and integration make a bigger contribution to good resource management. That applies particularly to the big fields in the North Sea and parts of the Halten Bank.

The Ministry of Petroleum and Energy has considered whether the merged company will acquire too strong a position on the NCS, and possible measures to compensate for this.

One possible way to reduce the company's influence is for the authorities to require, in

connection with merger, that the company disposes of participatory interests in fields and/or transfers operatorships to other players. The purpose of setting such conditions would be to reduce the company's position as a key licensee and operator, and strengthen other players in an effort to compensate for the role Hydro has played as a licensee and operator in the joint ventures. The Ministry has assessed the possible positive effects of setting such conditions against their cost and risk. It has concluded that such conditions would not contribute to improving resource management and increasing value creation from the petroleum industry.

On the basis of these assessments, the government has concluded that it would not be relevant to impose conditions for the disposal of participatory interests or the transfer of operatorships in connection with the merger.

Two factors in particular suggest that the merged company will have little opportunity to exploit its position as operator in a way which causes a loss of petroleum resources and reduces value creation on the NCS:

- A multiplicity of players, the licensing system and voting rules in the production licences will help to ensure that alternative views on exploration, development and operation are studied and assessed.
- The merged company's operatorships lie to a great extent in areas of the NCS with substantial opportunities and challenges related to efficient operation and area optimisation – the merger will thereby provide opportunities for enhanced value creation from these areas.

It is important that the relevant government bodies responsible for such considerations as resource management, health and the environment continue to monitor activities by the merged company and to assess how the company fulfils its operator role. The merged company is expected to be able to maintain and continue the commitment required to operate in an acceptable manner

In the time to come, relevant government bodies will assess the need to review their instruments and working methods, and how far these are sufficient for adequate exercise of their jurisdiction over the petroleum activity.

Statoil and Hydro are important players today in research and development (R&D). The bulk of their R&D is financed by the joint ventures for the fields operated by the companies. Combined with the significance of new technology for the company's competitive position, this should indicate that the company has a strong focus on R&D. The company will be better able to pursue large research projects than was the case before. However, the merger could lead to a reduction in diversity and less creative solutions. The government will expect the merged company to maintain its R&D work in Norway on a par with the present level of activity pursued by the two companies separately.

The merged company will exercise great influence over the Norwegian-based supplies industry – particularly in the production phase. It is expected to be conscious of the responsibility associated with this position. The consequence is that the merged company must stimulate broad competition and diversity among suppliers in order to continue securing good solutions in technological and efficiency terms in the future.

Chapter 9 provides an overall assessment of the merger between Statoil and Hydro's petroleum business.

The government shares the view of the two boards that changes in international frame conditions have substantially altered the competitive position of Statoil and Hydro and that

greater international weight is required. The merged enterprise will be a strongly-based energy company, competitive both nationally and internationally.

The merged company will continue to have its principal business in Norway, and will have a strong self-interest in further developing this. However, the merger does mean the unification of two important communities for conducting studies in the petroleum sector. This will be countered in part by a multiplicity of players, particularly in the exploration and development phase, who will help to maintain competition. It is also necessary to ensure that the authorities can retain a broad perspective on the management of the oil and gas resources.

The government supports the plans of the two companies for a merger, and has great expectations for the company as the leading player on the NCS. The company must be expected to encourage continued diversity and competition between suppliers and research communities. A number of unsolved assignments exist in the Norwegian petroleum activity. StatoilHydro will have a special place in helping to find good solutions in the future.

The government believes that the StatoilHydro name conserves the traditions of the two merged companies in a good way and supports the proposed name. The government will take a position on a proposal for a new name as a shareholder at the general meeting.

The government assumes that the head office will be in Stavanger, where Statoil's head office is already located. This location will maintain Stavanger's strong role and position in the Norwegian oil and gas industry and facilitate further development of the expertise community in the region. At the same time, the government assumes that the company will maintain the strong expertise communities possessed by the two companies at several locations in Norway. It is important that the company facilitates further growth in northern Norway when the level of activity provides a basis for this. The government expects that expanding activity will have industrial effects in the far north, with naturally associated management functions. It is the company itself which determines the organisation and location of its commercial functions and business areas.

The Ministry of Petroleum and Energy and the Ministry of Trade and Industry have made use of an external independent financial adviser, Lehman Brothers, which has conducted an analysis of the financial aspects of the merger on behalf of the Ministries. Lehman Brothers has concluded that the exchange ratio negotiated and supported by the boards is fair from a financial perspective for the government as a shareholder in both Statoil and Hydro.

Under the merger plan, the government will have a shareholding of about 62.5 per cent in the merged company. In accordance with the Storting's decision in 2001 that the government holding in Statoil should be at least 67 per cent, and with White Paper no 13 (2006-2007), the government intends that the state shareholding in the merged company will be increased over time from 62.5 per cent to 67 per cent, see draft resolutions III and IV. A government shareholding of 67 per cent will help to ensure that the intentions on state ownership specified in connection with the decision to list Statoil are also maintained for the merged company. The government's intention is that the purchase of shares in the merged company will take place in the market over time.

Hydro's aluminium business has been strengthened in recent years. The company will now be established with a minimum of debt. The government accordingly considers that the demerger of the oil and gas business will not undermine Hydro's opportunities to realise its strategies for the aluminium business. The company will be a big player in the global aluminium market. In the government's view, Hydro will have sufficient size and financial strength to continue developing as an independent company. The government is concerned

that the business can continue to be developed in Norway, including further processing, and that the expertise community built up by Hydro will be preserved.

The government wants to maintain the state's existing shareholding in Norsk Hydro ASA and sustain the stable ownership which Hydro has enjoyed. In the government's view, the transaction takes care of the goals which the government has set for this business.

This proposition recommends that the Ministry of Trade and Industry be mandated to vote at the extraordinary general meeting of Norsk Hydro ASA in favour of the board's proposal to demerge the petroleum business as a step towards the merger of Hydro's petroleum business with Statoil by and large on the terms detailed in this proposition, see draft resolution I. It further recommends that the Ministry of Petroleum and Energy be mandated to vote at the extraordinary general meeting of Statoil ASA in favour of the board's motion to merge Statoil and Hydro's petroleum business by and large on the terms detailed in this proposition, see draft resolution II.

2. Reasons given by the companies for the merger

The two boards of directors take the view that the merger will create a strong and viable Norwegian-based player in the global oil and gas industry. Combining the resources and knowledge of the companies will contribute to a financially and technologically sound enterprise, which will be a stronger international player than the two companies could be separately. It will be better able to develop itself and to respond to competitive changes and challenges facing the oil industry, while also providing a better basis for long-term value development for its owners.

The company will be a leading operator for oil and gas production in deep water, with access to leading-edge subsea, drilling and well technology, and sub-surface expertise. Its overall experience from exploration, risk management and project execution on the NCS will make the merged company a robust international player. It will occupy a strong position internationally, with a presence in almost 40 countries, while also acquiring a larger production and development portfolio on the NCS.

Under the merger proposals, Hydro's oil and gas business and operations in wind energy, its interest in Naturkraft AS, its shares in Hydro IS Partner and its holding in Norsk Hydro Canada Inc (hereafter called Hydro's petroleum business) will be merged with Statoil. Hydro's aluminium and hydropower activities will continue on an independent basis as one of the world's largest integrated aluminium companies.

Statoil and Hydro maintain that the positive effects of merging Statoil and Hydro's petroleum business will be realised in the following areas:

Size and scale benefits

The company will be one of the world's leading oil and gas companies, among its largest offshore operators and a major player in the rig market. Through its combined financial, technological and operational strength, the company will be better able to pursue new growth opportunities. Examples of these could include:

- International oil companies face ever more demanding financial and operational challenges from nation states in the competition over access to new reserves and production.
- Developing and combining the workforce of the two companies – which totals some 31 000 people, including 20 000 engaged in exploration and production – will put the merged company in a strong position. The oil and gas industry faces substantial challenges in securing the required expertise in the years to come. The merger will create a company with a bigger human capital, project execution capability and operator expertise, both at home and internationally. The technological expertise acquired by both companies in Norway over the past 40 years will make the merged enterprises internationally competitive.
- As one of the world's largest operators of petroleum production in deep water, the company will be an attractive customer for the supplies and service industry. Given the capacity restrictions which currently prevail in that sector, the merger could contribute to more efficient use of resources and reduced costs.
- By combining their resource, Statoil and Hydro will be more strongly equipped to meet the growing demand for renewable energy.

Geographical proximity

Statoil and Hydro overlap to a great extent in their participation on the NCS and elsewhere in the world. With the exception of Canada, for instance, Statoil is involved in every country in which Hydro has production rights. In Norway, Statoil participates in all but six of the fields in which Hydro is involved. The two maintain that the merged company will contribute to more efficient operation and thereby extend the producing life of the NCS.

In future mapping of the continental shelf, Statoil and Hydro expect new discoveries to be smaller than before. Parts of the NCS are largely mature and accordingly call for greater expertise and commitment of resources to maintain production in the medium and long terms. Activities in the mature areas of the NCS are characterised primarily by fields in the production phase. Exploration operations there focus on finding additional resources in order to optimise the use of existing infrastructure. Statoil and Hydro envisage that the merged company will be better able to search for, develop and produce oil and gas in technically demanding areas of the NCS, such as the Barents Sea.

International presence – exploration & production

By combining the international production and development portfolios of the two companies, the merged enterprise will benefit from a broader global presence while simultaneously strengthening its position in a number of areas. These include the Gulf of Mexico as well as west and north Africa. The merged company will possess a diversified portfolio of future development projects. It will also have the opportunity to pursue more and larger exploration and development projects simultaneously than the two companies could manage separately. The boards of Statoil and Hydro regard the geographical spread of the merged company's oil and gas production as strategically important for developing their combined reserves in the medium and long terms.

Technology

Both Hydro and Statoil are very far forward as developers and users of offshore technology in such areas as subsea development, multiphase pipeline transport, and horizontal and vertical drilling. Statoil and Hydro believe that combining their technological expertise and knowledge will stimulate faster development and greater use of innovative solutions. This will strengthen the company's position among the world's leading technology-driven oil and gas companies.

Synergies

Statoil and Hydro take the view that the merger could contribute to substantial synergies and cost savings. Cost synergies are expected to arise through improved efficiency in the exploration, development and production phases. Liberated internal resources will be transferred as far as possible to other value-creating activities. The merger is also expected to lead over time to higher revenues for the merged enterprise than the two companies could achieve separately, through more efficient use of limited resources in drilling and well activities, improved recovery, integrated operation, management of core areas and international experience.

Shared values base of the companies

The values base and management philosophy of the two companies largely coincide, and both are committed to sustainable financial progress and innovative technological

development. Both give great weight to maintaining high safety, environmental and ethical standards. Statoil and Hydro are committed to active support of the societies in which they operate. They believe that their shared values base and management philosophies will simplify integration of the two companies and contribute in the longer term to greater opportunities for the merged company.

3. Statoil ASA

3.1 Statoil's development in recent years

Statoil was established as a wholly-owned state oil company in 1972 with the object, either by itself or through participation in or together with other companies, of carrying out exploration, production, transport, refining and marketing of petroleum and petroleum-derived products, as well as other business.

The Storting resolved in favour of a stock market listing of Statoil on 26 April 2001, see Proposition no 36 (2000-2001) to the Storting on the ownership of Statoil and future management of the SDFI and Recommendation no 198 (2000-2001) to the Storting. This opened the way for new shareholders to own up to one-third of the value of the company. Ahead of the stock market listing, SDFI assets corresponding to 15 per cent of the portfolio's value were sold to Statoil. The company secured a listing on 18 June 2001. The Statoil share is listed on the Oslo and New York stock exchanges. Following the listing, the government retained 81.7 per cent of the shares in the company. Further sales to institutional investors and private individuals were implemented in July 2004 and February 2005. The government currently owns 70.9 per cent of the shares in Statoil.

Statoil's head office is located in Stavanger, but it also has substantial operations in other parts of Norway – including Oslo, Bergen, Trondheim, Harstad and Hammerfest.

The company ranks as a substantial international oil and gas company, with some 25 000 employees at 31 December 2006 and operations in 34 countries. Statoil has activities throughout the oil and gas value chain, from exploration and production to processing and marketing. The bulk of its revenues derive from the upstream business. Statoil is a leading producer of oil and gas in Norway, one of the world's largest oil traders and a substantial seller of natural gas to the European market.

Through the marketing and sales instruction adopted at Statoil's annual general meeting of 25 May 2001, the company has been given responsibility for marketing the government's petroleum together with its own production. This resolution reads:

“The company will be responsible for marketing and sale of the government's petroleum produced from the State's Direct Financial Interest (SDFI) in production licences on the Norwegian continental shelf as well as petroleum supplied in lieu of royalty pursuant to the Norwegian Petroleum Activities Act of 29 November 1996 no 72. The company's general meeting can adopt instructions for such marketing and sale by a simple majority.”

Statoil's duties in connection with the SDFI's petroleum embrace marketing, purchase and sale, and delivery of government petroleum to the buyer – including transport, modulation, swapping of delivery commitments, processing and storage. All revenues from such marketing and sale go directly from Statoil to the Treasury.

The government has established a common ownership strategy for Statoil, the SDFI and Petoro. Petoro manages the SDFI portfolio on behalf of the government, and is charged in part with checking that Statoil markets and sells the government's oil and gas in compliance with the marketing and sales instruction.

Annual results

Statoil's annual results have made good and stable progress in recent years. The company achieved its best-ever net profit in 2006, at NOK 40.6 billion compared with NOK 30.7 billion the year before. This represents an increase of 32 per cent over the period, which

largely reflects higher oil and gas prices. Statoil's total oil and gas production in 2006 was 1 135 000 barrels of oil equivalent per day (boe/d).

The company had proven reserves of 4 185 million boe at 31 December 2006 as against 4 295 million a year earlier. A total of 307 million boe was added during 2006, largely through upgrades and discoveries, compared with 453 million in 2005. Production in 2006 was 415 million boe as against 427 million the year before. The reserve replacement rate came to 73 per cent in 2006, compared with 102 per cent for 2005.

Statoil's goal for total production in 2007 is 1 300 000 boe/d, based on an average oil price of USD 60/barrel. Of this, an estimated 1 060 000 boe/d will derive from its operations in Norway and about 240 000 boe/d from the international business. The company has communicated that this goal is demanding and that production is more likely to fall short of the target than to exceed it.

The development of the Statoil share price during recent years is shown in table 3.2 (prices at 31 December).

The share price was NOK 157 at 20 March 2007, and NOK 173 at 15 December 2006 (the last day of trading before the merger was announced).

Statoil has a share capital at nominal value of NOK 5 415 359 287.50, divided between 2 166 143 715 shares with a nominal price of NOK 2.50. At a share price of NOK 157, Statoil has a total market value of roughly NOK 340 billion. The government's share of this is just over NOK 241 billion.

Return and dividend

Statoil's return on average capital employed was 27.1 per cent at 31 December 2006 as against 27.6 per cent a year earlier.

The company's ambition is to pay a rising ordinary cash dividend measured in kroner per share. It also aims to distribute an annual sum in the order of 45-50 per cent of the consolidated net profit to its shareholders through cash dividend and share buy-backs. However, the sum of cash dividend and share buy-backs could be larger or smaller than 45-50 per cent of net profit in individual years, depending on the company's assessment of anticipated cash flow developments, investment plans, financing requirements and appropriate financial flexibility.

The figure *Statoil dividend* (see separate pdf file) shows the historical dividend since 2001 in kroner per share and as a percentage of net profit. The company has delivered 46 per cent of the consolidated net profit on average in dividend over the past five years. The proposed dividend for 2006 is NOK 9.12 per share.

3.2 Business areas

Statoil has divided its operations into the following business areas: Exploration & Production Norway, International Exploration & Production, Natural Gas and Manufacturing & Marketing. In addition comes the Technology & Projects business area, responsible for the company's technological expertise, development and research, and for planning and executing development projects. This business area is also responsible for commercialisation of technology and industrial rights.

Exploration & Production Norway

The Exploration & Production Norway business area is responsible for the company's exploration, development and production activities on the NCS. Statoil's operations in

Norway are divided into four core areas: Troll/Sleipner, Halten/Nordland, Tampen and the Tromsø Patch. It is the largest operator on the NCS, with responsibility for 25 producing fields. The company also has participatory interests in a number of other oil and gas fields. Statoil's proven reserves in Norway are 3 323 million boe. Its total production from the NCS in 2006 averaged 958 000 boe/d.

International Exploration & Production

The International Exploration & Production business area is responsible for exploration, development and production activities outside Norway. Statoil's international production is expanding. At 31 December 2006, its international proven reserves were 861 million boe and it produced 178 000 boe/d outside Norway.

Statoil has interests in 17 producing fields in Angola, Algeria, Azerbaijan, China, the UK and Venezuela, as well as exploration operations in Algeria, Angola, Azerbaijan, Brazil, the Faroes, the Gulf of Mexico, Ireland, Libya, Nigeria, the UK and Venezuela.

Natural Gas

The Natural Gas business area is responsible for transporting, processing and marketing gas belonging to Statoil and the government from the NCS. In all, this represents two-thirds of Norwegian gas exports. The business area is responsible for gas marketing internationally and for the company's commitment to the market for liquefied natural gas (LNG). Statoil has major interests in and responsibility for technical operation of export pipelines, land-based plants and terminals.

Manufacturing & Marketing

Statoil ranks as one of the world's largest net traders of crude oil, selling some two million barrels of crude and condensate per day. The group's total activities in oil transport, processing, crude oil trading, product sales and retailing are concentrated in the Manufacturing & Marketing business area. This is responsible for sale and processing of crude oil, natural gas liquids, refined products and natural gas belonging to Statoil and the Norwegian government in the Nordic region.

The company sold 597 million barrels of crude oil in 2006. Its principal market is Europe, but large volumes are also sold to the USA and Asia.

Its manufacturing operations are concentrated in the refineries at Mongstad in western Norway and Kalundborg in Denmark, a 10 per cent holding in the Dutch Pernis refinery, and the Tjeldbergodden methanol plant in western Norway.

Statoil's business unit for NGL¹ trades LPG², ethane, petrochemical naphtha and condensate in international markets. The company also operates some 1 800 service stations in eight north European countries. In addition, it sells traditional oil products, natural gas and renewable energy in the Nordic region. Statoil ranks as the leading Scandinavian company for retail marketing and sales to big customers.

¹ Natural gas liquids comprise butane, ethane, isobutane and propane.

² Liquefied petroleum gases comprise propane and butane or a mix of these gases when they have been liquefied by cooling or increasing their pressure.

4. Norsk Hydro ASA

4.1 *Developments in recent years*

Norske Hydro ASA (Hydro) was founded in 1905 as a private company. Hydropower development at the beginning of the 20th century laid the basis for industrial growth in Norway and for Hydro's business concept, which was the production of nitrogen fertiliser. An important stage in building the modern company was the commitment to aluminium, which was adopted in 1963 with the creation of Alnor. Hydro also became involved with the oil and gas activity in 1963, and participated in the first commercial discovery on the NCS in 1969. At the beginning of 21st century, the three cornerstones of Hydro's business were accordingly oil and gas, aluminium production and fertiliser.

The government became a major shareholder in Hydro when the shares in German hands were confiscated by the Norwegian state in 1945. This holding was expanded in 1971, giving the government a majority interest in the company. See Proposition no 63 (1970-1971) to the Storting, Recommendation no 110 to the Storting and the Storting resolution of 9 February 1971. Acquisition of a majority shareholding was motivated primarily by oil policy perspectives. After the government had owned 51 per cent of the shares in the company for many years, its holding was reduced to 43.8 per cent in 1999 as the result of a capital expansion which formed part of the acquisition of Saga Petroleum. See Proposition no 81 (1998-1999) to the Storting, Recommendation no 234 to the Storting and the Storting resolution of 17 June 1999.

Hydro presented its Focus on the Future strategy in the autumn of 1999. This has formed the basis for its dispositions in recent years. The principal element was a concentration on the three core areas. With its base in Norway, the company would seek global positions in oil and energy, aluminium and agriculture. Businesses which fell outside these core areas would be divested. The takeover of Saga Petroleum ASA earlier in the same year was the largest acquisition in Hydro's history and increased its oil production by 40 per cent. In 2002, the company's petroleum business was further strengthened through the purchase of interests in eight oil and gas fields on the NCS from the government (the SDFI). Hydro also acquired all the shares in Spinnaker Exploration Company in 2005. This gave access to production and exploration acreage in the Gulf of Mexico.

In order to strengthen its position in aluminium, Hydro moved in 2002 to acquire VAW Aluminium AG, a large integrated aluminium company, and Technal, a supplier of aluminium solutions to the construction industry.

The Hydro board resolved in the summer of 2003 to establish its agricultural division as an independent Norwegian-based company listed on the Oslo Stock Exchange. Reference is made in this context to Proposition no 33 (2003-2004) to the Storting, Recommendation no 97 to the Storting and the Storting resolution of 18 December 2003. The decision to secure a listing for the agricultural division as a separate company resulted from a review of Hydro's business with the aim of creating the largest possible shareholder value. The agricultural division, later Yara International ASA, already ranked at that time as one of the world's leading fertiliser companies. It was concluded that value creation and growth would best be achieved by giving this business increased financial freedom of action and direct access to the capital market. Yara International was demerged from Hydro and listed on the stock market in March 2004.

Hydro's business has subsequently comprised two core areas: Oil & Energy and Aluminium. Both these business areas have expanded strongly in recent years. The company has over 33 000 employees and has more than doubled its operating profit since 2004. One factor underlying this growth has been the increase in raw material prices. That rise has contributed in turn to strong cash earnings, and means that the company occupies a strong financial position today. Hydro's head office is in Oslo, and the company has operations in almost 40 countries. The Hydro share is listed on several stock exchanges, including those in Oslo and New York.

Stable growth in profits has been achieved by Hydro in recent years. The company reported its strongest results in 2006, when net profit increased by 11 per cent from 2005 to NOK 17.4 billion. Operating profit rose by 13 per cent to NOK 52.2 billion. Higher prices for oil, gas and aluminium, combined with efficient operation, helped to lift profits to a record level in 2006.

Hydro's share price has risen by 253 per cent since 2002. This development largely reflects higher raw material prices.

The share price at 20 March 2007 was NOK 191.25. It was NOK 156.25 at 15 December 2006 (closing price on the last trading day before the merger was announced).

Hydro's share capital at nominal value is NOK 4 708 426 965, divided between 1 286 455 455 shares with a nominal value of NOK 3.66 each. The government has a 43.8 per cent holding. At a share price of about NOK 191, Hydro has an overall stock market value of roughly NOK 245.7 billion. The government's share of this is just over NOK 107.7 billion.

Return and dividend

Hydro's return on average capital employed was 14.9 per cent at 31 December 2006, compared with 16.6 per cent a year earlier.

The company's dividend policy is based on three key factors:

- the average dividend will total 30 per cent of profit over several years
- as far as possible, annual dividend per share will be unchanged or show a nominal rise
- during periods when earnings are high, buying back and striking off shares will supplement ordinary dividend payments.

The figure *Hydro dividend* (see separate pdf file) presents historical dividend since 2001 in kroner per share and as a percentage of profit. On average over the past five years, Hydro has delivered about 32 per cent of its consolidated net profit as dividend.

The proposed dividend for 2006 is NOK 5 per share, compared with NOK 4.40 per share the year before. Dividend was substantially lower in the years before 2004. The new level primarily reflects the high oil price and the corresponding improvement in results.

4.2 Business areas

Hydro organises its operations in the following business areas: Oil & Energy, Aluminium, and Other Businesses.

Oil & Energy

Hydro is a substantial producer of oil and gas in Norway and an important supplier of natural gas to Europe. Its Oil & Energy business area is divided into units for exploration and production, which embraces exploration for and production of oil and gas in Norway and internationally, and energy and oil marketing, which embraces the marketing

of the company's oil and gas production, electricity output in Norway, and the service station business in Sweden. In addition comes the technology and projects organisation, which is responsible for the company's development projects.

Responsible for 11 fields, Hydro is the second largest operator on the NCS. The company's average equity production in 2006 was 573 000 boe/d. Its production target for 2007 is 605 000 boe/d. Hydro expects its oil and gas output to reach 700 000 boe/d by 2010. About 90 per cent the company's production in 2006 derived from the NCS. At 31 December 2006, Hydro's proven and expected reserves in sanctioned oil and gas projects were estimated at 1.2 billion boe. This represents a total resource base of 3.9 billion boe.

The NCS is Hydro's main base, but the company also produces oil and gas in Angola, Canada, the Gulf of Mexico, Russia and Libya. In addition come activities in Brazil, Iran and Denmark. Half of Hydro's oil and gas exploration activities are pursued outside Norway. At 31 December 2006, operations outside Norway contributed 56 200 boe/d to a total production of 573 000 boe/d.

Hydro pursues extensive operations relating to transport of and trading with gas and electricity in Europe.

In addition, the company generates a considerable amount of electricity. This currently forms part of the oil and energy business, but will remain with Hydro after the merger between Statoil and Hydro's petroleum business. Hydro's holding in Naturkraft, which is responsible for the gas-fired power station at Kårstø, and its wind power output will be transferred to the merged company.

Aluminium

Hydro is the world's third largest listed aluminium company, with operations in every continent. In January 2006, it divided the aluminium business into two separate areas – Aluminium Metal (metal production) and Aluminium Products (further processing). The first of these areas, which represents the company's upstream business, embraces production of primary metal, resmelting, and production of alloys and blocks for rolling and extrusion. Hydro is working to strengthen its position in aluminium oxide, an important raw material for producing primary aluminium. The aim is to expand output of primary aluminium by 10 per cent up to 2010. Investment in a new metal works in Qatar, efficiency improvements, and upgrading of existing works are elements in the company's strategy for the future.

The company's downstream business is organised in Aluminium Products, which embraces automotive components, extrusions (extruded products/profiles) and rolled products. Restructurings have been initiated within this business area to improve profitability.

Demand for aluminium on a world basis is expected to grow by four per cent annually until 2020. Rising costs for energy and raw materials represent a challenge for the whole industry, but have been more than offset in recent years by higher aluminium prices. Hydro expects to produce about 1.73 million tonnes of primary aluminium in 2007 and two million tonnes in 2010. More than NOK 3 billion was invested in the aluminium business during 2006.

Other Businesses

Other Businesses embraces Hydro's activities outside the two core areas, and includes the Hydro Polymers, Hydro IS Partner, Hydro Production Partner, and Hydro Industrial and Business Parks companies. This business area has just over 3 000 employees.

Hydro IS Partner, an IT business with 650 employees, will be transferred to the merged company.

Hydro Polymers, which is the largest of these businesses, produces polyvinyl chloride (PVC) with about 1 200 employees in Norway, Sweden and the UK. PVC is a versatile plastic raw material much used in such sectors as the construction industry. Hydro Polymers has some 300 employees in Norway. It has 65 per cent of the Nordic market and 42 per cent of the British. After a focus on renewal and efficiency improvements over the past couple of years, Hydro announced in the autumn of 2006 that Hydro Polymers is being considered for listing as a separate company on the Oslo Stock Exchange or for sale.

5. Further details about the merger

Hydro and Statoil concluded an integration agreement on 18 December 2006 concerning the merger of Hydro's petroleum business with Statoil. Following the announcement of the integration agreement, the companies have negotiated a merger plan.

Put briefly, the merger will be implemented through the transfer to Statoil of Hydro's total oil and gas business and its activities in wind energy, shares in Naturkraft AS and Hydro IS Partner AS, and interests in Hydro Canada Inc – hereafter called Hydro's petroleum business. As compensation, shareholders in Hydro will receive shares in Statoil. The exchange ratio is described in more detail below. The Statoil shares due to be allocated to Hydro's shareholders as compensation will be issued through a capital increase pursuant to chapter 10 of the Norwegian Act on Public Limited Companies. According to the merger plan, 70 per cent of Hydro's net value will be transferred to Statoil and incorporated in the merged company.

5.1 The transaction model

The board of directors of Hydro and the board of Statoil discussed and signed a plan for demerging Norsk Hydro ASA as part of the merger of Hydro's petroleum business with Statoil ASA on 12 and 13 March 2007 respectively. This plan, also called the merger plan, will be submitted to the general meetings of the companies for approval. The merger plan is appended as appendix 2.

In terms of company law, the merger will be accomplished by demerging Hydro's petroleum business from the Hydro group and transferring it to Statoil as the acquiring company. The legal aspects of the demerger and transfer are regulated by chapter 14 of the Act on Public Limited Companies.

The merger plan builds on the integration agreement concluded by the two companies on 18 December 2006. In addition to the merger plan, the boards of the companies have each prepared a detailed written report on the merger. The merger plan and its appendices were published on 13-14 March through stock exchange announcements and press releases. These were also appended to the draft prospectus submitted to the US Securities and Exchange Commission (SEC) on 20 March 2007 because both companies are listed on the New York Stock Exchange. An expanded stock exchange announcement (the draft prospectus) was sent to the Oslo Stock Exchange on the same day. Hydro has also issued an expanded stock exchange announcement which deals with the company's operations after the demerger of the petroleum business.

When the draft prospectus has been approved by the SEC, the companies will send all the relevant documentation to their shareholders at least one month before the extraordinary general meetings. The boards have recommended that the shareholders of the companies vote for the merger plan. Plans call for extraordinary general meetings of the two companies to be held in late June/early July 2007. The merger is likely to be implemented during the third quarter of 2007.

Ahead of its consideration by the general meetings, the merger plan with appendices will be presented to the workforces, their union officials and the corporate assemblies of both companies. Pursuant to the provisions of the Norwegian Working Environment Act, union officials have the right to discuss these proposals. A recommendation from the respective corporate assemblies will form part of the documentation provided ahead of each general meeting. The same applies to comments received from employees.

The merger plan must be approved at the general meetings by at least two-thirds of both the votes cast and the share capital represented at each meeting. The merger plan will be presented to the general meetings. Their authority is confined to approving or rejecting the merger plan. By voting for the merger plan, an implicit decision is also taken in favour of all the conditions included in the merger plan, such as the exchange ratio, the articles of association, changes to the capital and so forth. This approach accords with the provisions of the Act on Public Limited Companies. The government shareholding is 70.9 per cent in Statoil and 43.8 per cent in Hydro. At Statoil's extraordinary general meeting, the merger resolution will be approved if the government votes in favour. At Hydro's extraordinary general meeting, the demerger and merger decisions will depend on support from other shareholders in addition to the government unless the government's shares account for at least two-thirds of the share capital represented at the general meeting.

According to the merger plan, its implementation is subject to the proviso that no conditions, changes, events or developments which significantly change the basis for the merger occurring ahead of approval by the respective general meetings. Subject to agreement by the boards, the merger plan can be amended until the point when they are approved by the general meetings. Changes must be treated as a new plan and, among other things, made known to employees, union officials and the corporate assemblies, reported to the Norwegian Register of Business Enterprises, and circulated to shareholders with the legally-required one month's notice before consideration by the general meetings.

Once the general meetings have approved the merger plan, the plan specifies that implementation is conditional on the merged company securing the approvals from government authorities required to implement the merger and that these approvals do not contain terms which would have a significant detrimental effect on the merged company. This condition applies unless the boards of Hydro and Statoil determine that the effect of possible missing approvals or possible terms for approvals would not be significantly detrimental to either of the companies when account is taken of compensation which might be agreed in this context.

5.2 Compensation

According to the merger plan, Hydro shareholders will receive 0.8622 shares in the merged company for every share they hold in Hydro as compensation for the transfer of the petroleum business. They will also retain their shares in the continued Hydro. This means that the shareholders in Statoil and Hydro will own 67.3 and 32.7 per cent respectively of the shares in the company. This proposed exchange ratio is a result of negotiations over the value of the petroleum businesses of Statoil and Hydro respectively, and based on advice obtained from the companies' financial advisors.

5.3 Government holding in the merged company

When Statoil was listed on the stock market in 2001, the Storting resolved that the government's shareholding would not fall below two-thirds. More details are provided in Proposition no 36 (2000-2001) to the Storting on the ownership of Statoil and future management of the SDFI, which was presented by the Stoltenberg I government. This opened the way for new shareholders to own up to one-third of the value of the company. Following the listing in 2001, the government retained 81.7 per cent of the shares in the company. Further sales to institutional investors and private individuals were implemented under the Bondevik II government in July 2004 and February 2005. The

government currently owns 70.9 per cent of the shares in Statoil. In the autumn of 2006, the government presented Report no 13 (2006-2007) to the Storting on an active and long-term ownership, in which the government proposed that the shareholding in Statoil would be retained.

Under the merger plan, the government will have a shareholding of about 62.5 per cent in the merged company. In accordance with the Storting's decision in 2001 that the government holding in Statoil should be at least 67 per cent, and with White Paper no 13 (2006-2007), the government intends to increase the state shareholding in the merged company would be increased over time from 62.5 per cent to 67 per cent, see draft resolutions III and IV. A government shareholding of 67 per cent will help to ensure that the intentions on state ownership specified when the decision to list Statoil was taken are also maintained for the merged company. The government's intention is that shares in the merged company will be purchased in the market over time.

A proposition to the Odelsting will be presented concerning amendments to the Act on the Government Pension Fund. Section 3 of the Act specifies that revenues from the sale of shares in Statoil fall to the Government Pension Fund – Global. However, no mention is made of the purchase of shares. A symmetrical treatment of the purchase and sale of shares in the definition of the fund's revenues accordingly requires an amendment to the Act. Such a proposition must be presented after the transaction has been approved by the extraordinary general meetings of the companies.

5.4 Articles of association

Statoil will be the acquiring company. The articles of association of the merged company will be based on Statoil's existing articles, but necessary amendments will be made. These amendments relate particularly to the company's name, its share capital, and formulations concerning the board and corporate assembly. Minor technical and linguistic modifications have also been made. Draft articles of association for StatoilHydro are appended (Appendix D).

Name

The company's name will be StatoilHydro ASA. The companies have agreed that the board of the merged company will develop proposals for a new name and logo which will symbolise the company's business strategy, values base and vision, and which will differ from the present company name. A proposed new name will be submitted to the annual general meeting of StatoilHydro for approval in 2008.

A change of name and logo will not prevent the use of Statoil's existing name and logo in connection with the merged company's energy and retail business cluster to the extent that this is considered appropriate.

Business office

The two boards have proposed in the merger plan that the company's business office will be in Stavanger. Corporate functions will be located in both Stavanger and Oslo, and the chief executive will have offices in both places. The most important commercial functions and business areas will be operated from Stavanger, Oslo, Bergen and Trondheim.

Board of directors and corporate assembly

The company's board of directors will have 10 members. These directors, including the chair and deputy chair, will be elected by the corporate assembly. The merger plan assumes that Eivind Reiten will be elected as chair and that there will be seven shareholder-elected directors. Statoil's nomination committee will recommend four of the directors, and Hydro's nomination committee the remaining two shareholder-elected directors. The elected directors will serve until the annual general meeting in 2010. The company will have a corporate assembly of 18 members plus alternates, of whom 12 members and four alternates are elected by the general meeting. The remaining members and alternates will be elected by and from among the company's employees under regulations adopted pursuant to the provisions of the Act on Public Limited Companies concerning the right of employees to representation on the board and in the corporate assembly of limited companies. According to the merger plan, efforts will be made to allocate employee representation in the corporate assembly and on the board between personnel with a background from Statoil and Hydro respectively, in a ratio which reflects the principle of equal treatment. Statoil's nomination committee will recommend seven members of the corporate assembly, while Hydro's nomination committee will recommend five. Members elected will serve until the annual general meeting in 2010.

Marketing and sale of petroleum

Since the State's Direct Financial Interest (SDFI) was established in 1985, Statoil has been responsible for handling the overall marketing and sale of the government's oil and gas volumes together with its own volumes. This arrangement was maintained and enshrined in Statoil's articles of association in connection with the listing of the company in 2001. The company's general meeting can adopt instructions for such marketing and sale by a simple majority. The provision in Statoil's articles of association which makes it responsible for handling the marketing and sale of the government's petroleum will be retained for the merged company. The government gives great weight to the continuation of this arrangement after the merger. Oil and gas volumes belonging to Statoil and Hydro will be treated equally and sold together with the government's petroleum in accordance with the company's articles of association and the marketing and sales instruction. Like Statoil, Hydro produces crude oil, natural gas liquids and natural gas. A large proportion of these products will typically be priced in relation to publicly-available prices/quotations. That applies particularly to oil products, but also to part of the NGL/natural gas products.

Until the dissolution of the Gas Negotiating Committee (GFU)³ and the establishment of company-based sales on 1 June 2001, the long-term gas sales portfolios of Statoil and Hydro comprised contracts with the same customers and with the same sales terms and prices. These contracts accounted in 2001 for the bulk of the portfolios of gas sale contracts held by both Statoil and Hydro. The Ministry of Petroleum and Energy has no reason to believe that this position is significantly different today. Given the nature of these long-term contracts, developments in them are expected to have been the outcome of general market

³ The Gas Negotiating Committee was established by the government in 1987 as an integrated resource management body. It negotiated all sales contracts for natural gas from the NCS.

trends and the application of mechanisms in the contracts which take account of developments in the relevant markets for on-going price adjustments and certain price redeterminations. The Ministry of Petroleum and Energy accordingly has no reason to believe that the allocation of value between the SDFI's gas and the merged company's gas under the marketing and sales instruction will change to any extent after the merger.

5.5 Other considerations

Statoil and Hydro must secure approval from the US Federal Trade Commission (FTC) or the antitrust division of the US Department of Justice (DOJ), which both have the authority to review the transaction in relation to applicable competition legislation.

In addition, the European Commission will consider the competition law aspects of the merger between Statoil and Hydro's petroleum business in light of the role played by these companies in Europe's oil and gas market. The merger could also involve requirements for notification or approval in other countries in which the companies have operations.

As mentioned above, Hydro is operator for and a licensee in a number of fields on the NCS. Any transfer requires the consent of the Ministry of Petroleum and Energy pursuant to section 10-12 of the Petroleum Activities Act, which specifies that the assignment of shareholdings and other ownership shares which may provide decisive control of a licensee possessing a participating interest in a licence may not take place without the approval of the Ministry. The consent of the Ministry of Finance to the merger is required pursuant to section 10 of the Petroleum Taxation Act, which specifies that transfers or assignments as specified in section 10–12 of the Petroleum Activities Act may not take place without the Ministry having consented to the tax effects.

6. Description of the merged company

StatoilHydro ASA will be a Norwegian-based oil and gas company with substantial international operations. Its object will be to conduct exploration for and production, transport, processing and marketing of petroleum and derivative products as well as other forms of business.

After the transaction, StatoilHydro will have about 31 000 employees and a presence in almost 40 countries.

The company's production and development portfolio will be strengthened, both on the NCS and internationally. Based on the sum of the targets set separately by Statoil and Hydro for 2007, it is expected to have an overall output of 1.9 million boe per day in 2007, including 1.6 million boe per day from Norway. StatoilHydro's proven oil and gas reserves are estimated at 6.1 billion boe.

The company will have an estimated market value approaching that of the large, but not the largest, listed oil and gas companies. See the figure *StatoilHydro's market value compared to other leading companies per 27.03.07* (see separate pdf file).

Stavanger will be StatoilHydro's business office as well as its geographical centre of gravity. Three of its business areas will be led from Stavanger, where the bulk of its corporate functions will be located.

The company's business areas will be Exploration & Production Norway, International Exploration & Production, Natural Gas, Manufacturing & Marketing, Technology & New Energy and Projects. In addition come accounting and finance and the company's corporate centre with staff, support and service functions.

6.1 Business areas

Exploration & Production Norway

Operations in Norway will remain the most important area for the merged company. It will maintain and continue to develop centres of expertise at a number of locations in Norway. Sixty-eight per cent of its proven reserves will be on the NCS. See the figure *StatoilHydro's activity by country* (see separate pdf file). The company will control more than a third of remaining proven resources on the NCS. From 2007, it will operate about 80 per cent of production.

The Exploration & Production Norway business area will be run from Stavanger and be responsible for safe and efficient operation on the NCS. Substantial resources will be added to this business area from Hydro's oil activities in Oslo, and it will provide the strongest development organisation in StatoilHydro. Operations on the NCS will be divided organisationally into three areas led from Stavanger, Bergen and Stjørdal respectively. A number of underlying units will be located elsewhere. Key parts of the company's operations in the Norwegian and Barents Seas will continue to be run from Harstad and Hammerfest.

International Exploration & Production

This business area will create and continue to develop the company's international growth positions. International Exploration & Production will be led from Oslo and divided into four geographical units run from Stavanger, Oslo and Houston.

StatoilHydro's international commitment will represent a continuation of the current international activities in the companies. Statoil and Hydro have built up operations in a number of countries. They have upstream activities today in Angola, the Gulf of Mexico, Venezuela, Libya, Brazil, Nigeria and Iran. The merged company will achieve operational gains by combining their resources in those countries in which both companies are represented. After the merger, the company's largest international reserves will be in Angola, Algeria and Azerbaijan.

Natural Gas

This business area will be responsible for ensuring efficient operation of the gas infrastructure and maximising the value of the company's gas volumes. It will be run from Stavanger and have activities at Kårstø and Kollsnes as well as international operations.

Manufacturing & Marketing

This business area will be responsible for the company's refineries and global oil trading activity, as well as the service station network and other retailing. The area also embraces the operational industrial plants at Sture, Mongstad and Tjeldbergodden, and at Kalundborg in Denmark.

The business area will be led from Stavanger, with the retail business run from Oslo as at present.

Technology & New Energy

This business area will be the company's centre of technological expertise, and will also be responsible for its work on renewable energy and carbon dioxide management. It will be run from Bergen and have activities in Stavanger, Trondheim and Porsgrunn. R&D activities will be run from Trondheim.

Hydro's involvement in wind power and hydrogen will be transferred to the merged company. Statoil and Hydro have stated that the merged company will give weight to operations related to renewable energy and to carbon capture and storage. Both companies have already devoted considerable efforts to the development and adoption of technology for carbon treatment and deposition. This work will be continued. Where renewable energy is concerned, priority areas will be research, technology development and commercialisation.

Projects

This business area will deliver development projects to the company's global activities. It will be run from Oslo. The management of key units will also sit in Stavanger.

6.2 Other considerations

Dividend policy

StatoilHydro's ambition is to pay a rising ordinary cash dividend measured in kroner per share. It also aims to distribute an annual sum in the order of 45-50 per cent of the consolidated net profit to its shareholders through cash dividend and share buy-backs.

However, the sum of the cash dividend and share buy-backs could be larger or smaller than 45-50 per cent of net profit in individual years, depending on the company's assessment of anticipated cash flow developments, investment plans, financing requirements and appropriate financial flexibility.

Growth and synergies

StatoilHydro has interests in a number of fields and projects which are set to come on stream over the next few years. Ormen Lange, Snøhvit, Statfjord late life, Volve and Skinfaks/Rimfaks IOR are among those due to begin production in 2007. The bulk of additional output in 2008 will come internationally, including the start-up of Agbami (Nigeria) and Tahiti (Gulf of Mexico) and expanded production from new phases of ACG (Azerbaijan).

The company's international output is expected to expand by 9.7 per cent in 2007-12. Its total production growth in this period is expected to exceed that of other major international players, on the basis of the numbers presented in figure *Production growth* (see separate pdf file).

According to the companies, the merger will provide new growth opportunities for the merged company through an improved competitive position internationally, an expanded portfolio and greater organisational and financial capacity. By combining the strengths of both organisations, the merged company will be able to pursue a greater number of opportunities and undertake more tasks. It will also be able to realise cost benefits through more efficient operation and through savings on overlapping functions. Liberated internal resources will be transferred as far as possible to other value-creating activities. In addition, the merger is expected to generate larger revenues than the two companies could manage separately through the introduction of best practice and more efficient use of limited resources for drilling and well operations, improved recovery, integrated operation, management of core areas and international experience.

Based on its own business and analyses by external consultants, Statoil has calculated the expected cost and efficiency gains for the merged company after the merger has been implemented. The cost benefits are estimated at roughly NOK 4 billion per year before tax. This embraces both enhanced efficiency related to exploration activities, development and operations, and savings in administration and business support. Gross cost benefits related to running the activities operated by the company are estimated to be significantly above NOK 4 billion.

Important instruments for achieving savings in operating costs will be reducing the use of external resources and redeploying personnel internally. Part of the synergies will be reflected in future investment. The synergy potential is expected to be realised when the integration process has finally been completed around 2009-10. Possible redundancies will be handled through internal redeployment, natural wastage and other measures announced by Statoil and Hydro on 19 March 2007.

7. Description of the continued business in Norsk Hydro

Hydro will primarily be an integrated aluminium company following the demerger of the petroleum business. However, it will also own substantial power generation capacity. Hydro will be the world's third largest listed aluminium company. In addition to a strong commitment to primary aluminium and metal products, it will continue to build on its leading European position for rolled and extruded aluminium products and building systems. Combined with increased production of metal and the raw material, aluminium oxide, this will provide the main basis for realising the company's growth ambitions in the aluminium business. Hydro's three business areas will be Metal Production, Further Processing and Hydropower.

The continued Hydro would have had an estimated turnover of more than NOK 100 billion in 2006 and a net profit exceeding NOK 6 billion. It would have been among the largest companies on the Oslo Stock Exchange, with about 25 000 employees.

Hydro's aluminium business has made strong progress, with good cash earnings in recent years. The new company is well capitalised and has little debt. This provides it with sufficient financial strength to make the investments required to meet growing international competition.

The Hydro board adopted the dividend policy for the continued company on 12 February 2007. Hydro will maintain its current policy, with a payout averaging 30 per cent of net profit. Buy-back of shares and extraordinary dividend payments will be undertaken in addition to the payment of ordinary dividend during times with strong results. In such circumstances, weight will also be given to the economic conditions faced by the company's businesses and to capital requirements for future growth. Payments to shareholders should reflect Hydro's goal of providing a competitive return to shareholders compared with other investment opportunities in comparable companies.

7.1 Business areas

Metal Production

The Metal Production business area organises Hydro's upstream activities related to aluminium production. This embraces the whole value chain, from ownership interests in bauxite mines to the production of primary aluminium and metal products. This business area will comprise the production of primary metal and remelting of aluminium.

Hydro has stated that it wants to expand its production capacity for primary aluminium by 10 per cent up to 2010. The business area will have about 5 000 employees and a turnover of more than NOK 68 billion. Hydro's total production of primary metal in 2006 was 1.8 million tonnes. It also produced 1.2 million tonnes of remelted or recycled metal. Hydro ranks as the world's fifth largest aluminium producer.

The company's strong position has been achieved via two big acquisitions – the state-owned Årdal og Sunndal Verk in 1986 and VAW Aluminium in 2002. In addition come substantial expansions and modernisations of its own works. Hydro produced primary aluminium at eight wholly-owned and three partly-owned plants in 2006. In addition come a number of remelting works. More than half of Hydro's total output derives from Norway. Its three largest works by production volume are Sunndal, Karmøy and Årdal. Collectively, they produce about 900 000 tonnes of aluminium and have some 2 000 employees.

Because of pollution-related restrictions, Hydro is required to shut down production based on Söderberg technology. In addition to the Høyanger and Stade works, which were closed in 2006, plans call for the Söderberg line at Årdal to be shut down. Hydro has applied for permission to continue production with the Söderberg line at Karmøy until 2009. This has been refused by the Norwegian Pollution Control Authority, but Hydro has appealed against that decision.

Further Processing

The Further Processing business area embraces the Rolled Products, Extrusion and Automotive business units. Hydro is one of the major players, and has a 15-20 share of the European market depending on the segment concerned. The company ranks as the industry leader in a number of product areas and markets. That applies in particular to profiles for the construction industry and lithographic aluminium products.

Rolled products are the result of processes which alter the properties of the material by substantially reducing its thickness. Typical rolled products are foil for use by the packaging industry, plates for the printing industry, panels and bands for the construction, transport and packaging industries, and sheets for use in a number of areas – including aircraft frames, military vehicles and construction components for bridges and buildings. Hydro is Europe's second largest manufacturer in Europe by market share.

Extruded products are produced by pressing heated aluminium through various moulds. The most important applications include frames for windows, doors and facades, automotive and transport components, and parts for machinery, furniture and consumer durables.

Further Processing had operating revenues of almost NOK 50 billion in 2006, and an operating loss of NOK 83 million after substantial write-downs. The company has focused attention on cash earnings, and its 2006 result was an improvement on the year before.

The Further Processing business is being extensively restructured. It has been resolved to dispose of the bulk of the automotive components business. Most of this activity is located in Europe, but bumper production at Raufoss – which employs 700 people – will also be sold as part of this divestment. Hydro otherwise has further processing operations at Holmestrand, Magnor and Karmøy. The company expects the restructuring to be completed during 2007. It has announced through its further processing strategy that the commitment in future will be on rolled and extruded products. In addition, business units such as Precision Tubing will remain in Hydro.

Electricity

Hydro is the second-largest electricity generator in Norway. Power generation will become a separate business area after the demerger. Output derives from 21 power stations and is based in its entirety on hydropower. Hydro generates nine TWh in a year with normal precipitation. This represents roughly eight per cent of the Norway's total output of 119 TWh in a normal year, and corresponds to the electricity consumption of about 350 000 Norwegian households. In addition, Hydro owns 20.9 per cent of SKS Produksjon AS, a company with an annual hydropower output of 1.7 TWh.

Aluminium production is power-intensive, and the ability to generate its own electricity is an important asset for Hydro. The company wishes to continue developing a strong power portfolio in Norway, and to utilise this expertise to some extent abroad. Hydro's electricity output helps to secure power supplies for its operations in Norway, and much of the amount

generated is tied up internally through long-term contracts – primarily for metal production.

A substantial commercial business has been built up in-house in Hydro for the management of its electricity portfolio. The company is also a major player in Nord Pool, the Nordic power exchange.

Hydro's power business had a turnover of roughly NOK 6.2 billion in 2006, when total output was 8.3 TWh.

Polymers

Hydro Polymers is a wholly-owned subsidiary of Norsk Hydro ASA, and a substantial player in the north European market for the plastic raw material polyvinyl chloride (PVC), the intermediate product vinylchloride monomer (VCM), chlorine and caustic soda. This company has 65 and 42 per cent of the Nordic and UK markets respectively. In December 2006, Hydro announced that Hydro Polymers was under consideration for listing as a separate company on the Oslo Stock Exchange or for sale. This process is expected to be completed during the spring of 2007.

The company has production operations in Norway, Sweden and the UK. In Norway, Hydro Polymers produces chlorine and VCM at the Rafnes complex in Bamble local authority, while PVC is produced by a plant at Herøya in Porsgrunn. The company has some 1 200 employees, including 315 in Norway. It showed an operating profit of just over NOK 1 billion in 2006.

8. Assessment of effects for the activity on the NCS

In this chapter, the Ministry of Petroleum and Energy assesses, as the administrator of Norway's petroleum resources, the possible effects of the merger for oil and gas activities on the NCS.

The Ministry has received a number of comments and views concerning the effects which the merger might have on the Norwegian petroleum activity and on the administration of petroleum resources. On 22 February 2007, the Ministry held a consultative hearing with players in the petroleum sector who are affected by the merger in order to illuminate aspects of this issue. The hearing was attended by representatives from licensees other than Statoil and Hydro, the supplies and shipping industries, trade unions and research institutes. The Ministry received a number of contributions during the session which have been taken into account in its assessments.

This chapter begins with an overview of the merged company's position on the NCS. The merger is then assessed in relation to development aspects, the industry structure, the company's position as an operator, and effects for the supplies industry and for research and development. The Ministry of Labour and Social Inclusion has assessed the effects of the merger for health, safety and the environment in the activity, while the Ministry of the Environment has assessed its consequences for the natural environment.

8.1 The merged company on the NCS

The merged company's main activities will be on the NCS.

8.2 Development trends on the NCS and in the industry structure

The NCS has a substantial remaining resource potential. The Norwegian Petroleum Directorate (NPD) estimates that discovered and undiscovered resources total roughly 13 billion standard cubic metres of oil equivalent (scm oe). Only 35 per cent of this has been produced. The remaining *discovered* resources total 5.2 billion scm oe (39 per cent) and the *undiscovered* resources are estimated at 3.4 billion scm oe (26 per cent). It is important to emphasise the considerable uncertainty in these estimates for both remaining and undiscovered resources.

The resource potential is substantial, and it is important that these resources are managed as efficiently as possible. Activity on the NCS is developing in line with the maturing of the resource base. The merger between Statoil and Hydro's petroleum business must be assessed in relation to the challenges and opportunities we face in managing the petroleum resources in the years to come. These challenges relate to the maturing of the NCS, and are not the same as those we have faced during the build-up phase of the activity.

8.2.1 Mature NCS – new challenges

Parts of the NCS are in a mature phase. This is characterised by known geology, a well-developed infrastructure, declining production and rising unit costs. We nevertheless expect that about 45 per cent of the undiscovered resources are located in the mature areas, mainly in the North Sea (see the figure *Undiscovered resources* (see separate pdf file)).

Companies other than the very largest are often those which specialise in the opportunities offered by mature areas, such as tail production or exploration for and development of small deposits. The development in the degree of maturity is

accordingly reflected in the industry structure. Since the late 1990s, the government has facilitated the involvement of new companies which can contribute to developing resources in the mature areas.

This official policy has been successful. Twenty-three companies were licensees in 1997. That figure has increased to 44 today. A specific measure adopted by the authorities in 2000 to increase diversity was the prequalification scheme for companies wishing to become licensees. From the establishment of this scheme until January 2007, 47 companies had taken advantage of the opportunity. Merging Statoil and Hydro's petroleum business will result in a company with a significantly larger portfolio of production licences than the other licensees, but the NCS will retain a multiplicity of licensees.

It takes time for new companies to become established, and we are only now beginning to see the way in which the new players are making a contribution. The picture starting to emerge is that they account for a steadily expanding share of exploration, investment and production activity.

8.2.2 The major oil fields are off plateau – calls for big changes

The figure *Oil production 1980-2025* (see separate pdf file) presents oil production in 1980-2025 from fields on stream and approved for development. During the 1980s and 1990s, a large proportion of the output derived from a limited number of fields, including Statfjord, Gullfaks and Ekofisk. These are now in a mature phase, and many require demanding modifications. The authorities have been concerned with this issue for a number of years. Operations have already been restructured on some fields, while modification work is under way on others. The level of activity on the fields is high, and 70 per cent of investment on the NCS in the period up to 2011 will be made on producing fields. This trend provides a good illustration of the degree of maturity on the NCS. Efficient operation and late-life development on individual fields are needed to ensure good resource management. Substantial gains stand to be made by taking a collective view of several fields and areas. Statoil and Hydro are operators for most of the big fields in mature areas, and the merged company will therefore play an important role in developing them.

The government expects the company to make a continued commitment to improved recovery and efficient operation of these field

8.2.3 More fields – new operators

The figure *The proportion of total Norwegian petroleum production* (see separate pdf file) presents the proportion of total Norwegian petroleum production provided by each field. This shows that the trend is towards more but smaller fields. A requirement accordingly remains for a multiplicity of players in exploration, development and operation. The changes to the industry structure create a good basis for this. While the major international oil companies are present, many new companies have established themselves as licensees since 2000. A number of these newcomers have experience as operators in other countries, and also desire operatorships in Norway. In recent years, such companies as Pertra, Marathon, Talisman and Gaz de France have become operators of fields in production or under development. The experience of the authorities with this type of new operation has so far been good.

Pertra took over the operatorship of Varg from Hydro when the original licensee group wanted to cease production, has further developed the field and has extended its producing life. Output has more than trebled. Talisman acquired Pertra in 2006 and is now

operator of the field. This company became involved on the NCS when it took over the operatorship of Gyda from BP. It has specialised in tail-end production, and is now also operator for the Enoch and Blane fields. These are under development. In addition, Talisman is operator for Yme and has submitted a plan for development and operation of this field to the authorities.

Marathon is another company which has played an important role on the NCS in recent years. It is now in the process of developing the Alvheim area after acquiring participatory interests and operatorships in production licences from Hydro.

Gaz de France farmed into Snøhvit and Njord in 2001, and was prequalified as an operator in 2003. The company also acquired Hydro's participatory interest in Gjøa, and will take over the operatorship of this field from Statoil in the production phase. The plan for development and operation of Gjøa is under consideration by the authorities.

These new companies are important for the development of the NCS. They have so far taken over assignments which the big companies no longer wish to prioritise. In the future, these players will probably acquire jobs from the established companies and develop their own discoveries.

The number of new players which operate producing fields is not large today, but many new players are operators for production licences in the exploration phase. Current forecasts indicate that such companies will be operators for 12 and 18 exploration wells in 2007 and 2008 respectively, compared with just one in 2005 and two in 2006. Talisman, BG Norge and DNO are the companies primarily planning to drill exploration wells in these years, but Pertra, Dong, Lundin, Noreco, Endeavour and Revus also intend to pursue such work. Should discoveries be made, this also means that a greater diversity of operators will emerge over time in the development and production phases.

8.2.4 Development of production

The figure *Total petroleum production* (see separate pdf file) presents historical petroleum production on the NCS up to 2007, and production forecasts up to 2030. The forecasts are based on estimates of recoverable petroleum resources by the Norwegian Petroleum Directorate, and assume that the government and the industry continuously take the decisions necessary for recovering the remaining resources.

Petroleum production is currently at a high level. Output in 2006 totalled 2.8 million barrels of liquid (oil, NGL and condensate) per day and 88 billion scm of gas. Production of saleable petroleum totalled 248 million scm oe in 2006. Oil output will level off in the years to come, but rising gas exports mean that petroleum production is expected to remain at a high level for many years.

Calculations by the Norwegian Petroleum Directorate/Ministry of Petroleum and Energy show that the merged company will control about 30 per cent of proven oil resources and 40 per cent of proven gas resources in 2007. The proportion of oil resources controlled by the merged company will fall to about 20 per cent up to 2020, while its share of the gas resources will only decline to a little under 40 per cent. Taken together, this means that the merged company will control a smaller proportion of the resources over time than it does today. Results from exploration activity are naturally excluded from this forecast, and will affect the distribution.

The smaller companies control a growing proportion of output, as the figure *Petroleum production from the smaller companies* (see separate pdf file) shows. Their production is expected to rise from just under 15 million scm oe to almost 30 million scm oe in 2011. That

corresponds to roughly 500 000 boe/d. By and large, this growth is confined to new players.

8.2.5 Geographical distribution of petroleum resources

The remaining proven resources are divided between 52 fields, 49 discoveries and about 300 projects for improved recovery from existing developments. The figure *Geographical distribution of remaining proven resources* (see separate pdf file) presents the geographical distribution of these resources.

Southernmost NCS

The southernmost part of the NCS, in the North Sea, is a mature area which faces the same challenges as the northern North Sea. A broad array of players are involved in both exploration and production phases in this area, where Statoil and Hydro do not have large participatory interests. ConocoPhillips is operator for Ekofisk and BP for Valhall and Ula. In addition, Total is a licensee with large reserves. Talisman is a new player in the area, and operator for Gyda, Yme, Blane and Enoch. The merger is not expected to affect petroleum operations in the southernmost NCS.

Northern North Sea

The northern North Sea is the region of the NCS with the highest production, both today and for the years to come. This area embraces many of the large fields which are now in a mature phase, such as Statfjord, Gullfaks, Snorre, Oseberg and Troll. Great expertise and a substantial commitment of resources will be required to maintain production for as long as possible from these fields. The merged company will be the operator for most of the fields in this part of the North Sea. It will accordingly have an important role in contributing to good management of resources there. The Ministry expects the merged company to make a commitment to improved recovery and efficient operation in this area.

Statoil and Hydro have participatory interests in many of the same production licences, and the merger will accordingly reduce diversity in certain licences. At the same time, these licences included other licensees with substantial expertise and capacity who can cooperate with and challenge the merged company. The Ministry expects the other licensees to participate actively in the joint ventures and contribute to good resource management.

The largest proportion of undiscovered resources in mature areas is located in the North Sea. This means that the area also attracts exploration activity by a number of players. A multiplicity of players are accordingly involved in the exploration phase throughout the North Sea. The figure *Proportion of exploration investments* (see separate pdf file), shows that a growing number of new companies have been awarded interests in production licences by licensing rounds during recent years, and that they have largely applied for acreage in mature areas. The merger will have little significance for exploration activity in these parts of the NCS.

Over the past three years, the new players have accounted for about 15 per cent of total exploration spending, and they are exploring more in the North Sea than in other regions of the NCS. The merged company will have an important role to play as an infrastructure owner in this part of the North Sea when new discoveries come to be developed. This is covered in more detail in section 8.3.

Norwegian Sea

The merged company will have substantial activity in the Norwegian Sea, but does not have as strong a presence as in the northern North Sea. Both mature and non-mature areas are found in the Norwegian Sea. The merged company will be an important operator in the mature areas on the Halten Bank. The government expects the company to make a commitment to improved recovery and efficient operation in the mature areas of the Norwegian Sea.

A number of discoveries have also been made, which are likely to be developed over the next few years. Major discoveries in the mature areas, such as Victoria, Skarv and Onyx, are operated by companies other than Statoil and Hydro. Total is operator for Victoria, BP for Skarv and Shell for Onyx. Shell will take over the operatorship of Ormen Lange from Hydro when this field moves into the production phase. In the longer term, the industry structure is expected to become more nuanced than it is today.

Large companies which have been active on the NCS for a long time will play an important role in continued exploration activity in the non-mature areas of the Norwegian Sea. Exploration and development in these regions calls for companies with financial strength and broad technological and geological expertise. The biggest companies often want to concentrate on such areas because the probability of making large discoveries is greater. The merged company is likely to be even better equipped to undertake technologically demanding assignments in non-mature areas than are Statoil and Hydro separately. The merger is therefore not expected to have any detrimental impact on the area. The Ministry expects the merged company to maintain a high level of exploration in the Norwegian Sea.

Barents Sea

The Barents Sea is the least mature petroleum province on the NCS. Snøhvit is expected to come on stream towards the end of 2007. Eni has also made a discovery on Goliat, and Hydro on Nucula. The extent to which the estimated resources in the Barents Sea are proven and recovered will depend very much on future exploration activity in these waters. Statoil and Hydro are key players today in exploring the Barents Sea. In addition to Snøhvit, operated by Statoil, the two companies operate eight of the 11 production licences in this area. The Ministry accordingly expects that the merged company will maintain a high level of exploration activity in the Barents Sea, within the framework established by the management plan.

8.2.6 Summary

Further development of the reserve base and production depends on proving and developing new discoveries and on the most efficient possible operation of producing fields. The merged company will have its main business on the NCS and occupy a key position in further development of activities there. It will be an important player both in continued development of the large fields and in exploration of the non-mature areas.

A multiplicity of players is important in the exploration phase, particularly in the mature areas. The industry structure on the NCS comprises both the big, established oil companies and the new players who have arrived since 2000. Diversity is greatest in exploration activity in mature areas. The merger of Statoil and Hydro's petroleum business will therefore have little significance for exploration activity.

The Ministry expects the merged company to make a strong commitment to exploration in the non-mature areas of the NCS.

We also see a more nuanced industry structure for the development of new fields. Such diversity ensures that competition is maintained over the best ideas for exploration, development and operation.

In the production phase, the company will be a major player with substantial participatory interests and a large number of operatorships. That applies particularly to the large fields in the North Sea and parts of the Halten Bank. This is covered in more detail in section 8.3.

8.3 The merged company – influence and roles

The merger means that the two largest operators on the NCS will be united into one big operator.

The Ministry of Petroleum and Energy has considered whether the merged company will acquire too strong a position as an operator on the NCS, and possible measures to compensate for this.

8.3.1 The operator role and alternative assessment organisations

Oil and gas fields are developed and operated by joint ventures between oil companies. Day-to-day management of the field is led by a company which acts as operator on behalf of the other licensees. The operator builds up an organisation to develop, produce and continue development of the field. This means that the operator gets to know most about the field. An operatorship gives the company which holds it the opportunity to build up and reinforce its own specialist teams. Through its capacity for conducting studies and its leadership role, the operator of a field exercises great influence over activities related to development and operation.

The merger means that perhaps the two most important organisations for conducting studies will be unified in a single company. Statoil and Hydro have collaborated with and challenged each other in the joint ventures for the big oil and gas fields. This interaction has been important for developing the fields and for value creation on the NCS. Historically, different assessments made by these two companies in relation to such aspects as production strategies and development and transport solutions have been important. Having access to information from the two companies on alternative development solutions and operating models has also been very valuable for the government.

Through participation in the management committee and various technical sub-committees, the other licensees in a joint venture have an important function in checking and challenging the operator's work and assessments. These alternative assessment organisations, which challenge each other, are important for reaching good decisions on the development and operation of the fields. Previously, this applied primarily to decisions related to the choice of development solution. As a result of the growing number of mature fields, however, decisions related to the choice of production strategy and measures for improved recovery and tail-end production have become increasingly important. The strategic decisions are based on a number of uncertain elements, suppositions and assumptions. This means that the various specialist teams often have different views of what represents the best decisions.

A strong operator with a big capacity for carrying out studies is generally important for securing a good information base. However, complexity, uncertainty and differing information also make it important that the operator is challenged by alternative assessment organisations. Other licensees in the fields, particularly large companies, have

specialists who can challenge the operator's proposed solutions. In addition, small companies can contribute leading-edge expertise in specific technical areas.

The Ministry assumes that the strong specialist teams in Statoil and Hydro will be maintained in the merged company. Discussions between these teams will no longer be pursued in the production licences, but debate over different recovery strategies as well as development and operating solutions and technologies is expected to continue within the merged company.

8.3.2 Sale of participatory interests and transfer of operatorships

A possible means of reducing the merged company's influence would be to require that it disposes of participatory interests and/or transfers operatorships to other players.

In technical terms, the merger between Statoil and Hydro's petroleum business means that Hydro transfers its participatory interests in each production licence to Statoil. These transfers are conditional on the consent of the Ministry, pursuant to section 10-12 of the Petroleum Activities Act. In connection with these consents, the Ministry may set conditions concerning, for instance, the sale of participatory interests and/or transfer of the operatorship for the production licence. Terms of this kind have never been imposed in connection with these consents.

The object of setting such conditions must be that this would contribute to improved resource management and enhanced value creation in the petroleum activity.

Sale of participatory interests

The merged company will control one-third of production on the NCS. This proportion will be declining for oil. However, it will be higher for gas and remain at that level for a long time. This will represent the bulk of the company's revenues for many years to come. Although the company will have substantial participatory interests in producing fields, it will not be completely dominant as a licensee in any field with the exception of Gullfaks, which is discussed in a separate section below.

The object of a possible disposal of participatory interests would be to reduce the merged company's position as a central licensee while also strengthening the other licensees.

A possible sale of participatory interests must be on a substantial scale if it is not only to weaken the merged company's position but also to help strengthen other players. Weakening the company would simultaneously mean weakening the key player on the NCS. With its expertise and capacity, the merged company will play an important role in the future development of Norway's petroleum activity.

Nor will making consent conditional on a sale be a precise instrument in terms of which players are strengthened. A possible outcome, for instance, could be that the participatory interests are purchased by many different companies, and that the sale thereby proves to be of very little value in strengthening individual players who would have a genuine significance for resource management.

All the fields have other licensees, moreover, who can and will influence operation and development of the field. Special voting rules in each production licence provide powerful protection for the minority. This minority protection will be maintained after the merger,

and ensure that players with smaller participatory interests can exercise influence over decisions. The voting rules are covered in more detail in section 8.3.3.

Gullfaks presents a special case, where Statoil currently has a participatory interest of 61 per cent whilst Hydro has nine per cent and Petoro is licensee for the remaining 30 per cent. Statoil is operator for the field. In addition to a high participatory interest, the merger would leave only one licensee which can contribute alternative views and ideas. Having only two licensees on such a large field as Gullfaks is not an ideal position, and that also applies from an HSE perspective. On the other hand, Gullfaks is an old and complex field, where Statoil's high participatory interest has given the company as operator a strong incentive to make a commitment to further development of the field. The Norwegian Petroleum Directorate regards Gullfaks as one of the best-run fields on the NCS. It is doubtful, moreover, whether the company or companies who might acquire participatory interests from the merged company could make a positive contribution to value creation from such a complex field, at least in the short term.

The Ministry has a clear expectation that Petoro will give high priority to work on this field.

On the basis of these assessments, the government has concluded that it would not be relevant to impose conditions for the disposal of participatory interests in connection with the merger.

Transfer of operatorships

Statoil currently operates 68 per cent of production on the NCS. Merging with Hydro's petroleum business would increase this proportion to 80 per cent. In Hydro's field portfolio, Oseberg, Grane and Troll Oil will make the principal contribution to increasing the merged company's operatorships.

The object of requiring a possible transfer of operatorships to other players would be to strengthen alternative operator teams in an effort to maintain the dynamism which Statoil and Hydro have contributed to in the petroleum sector. Significant factors in the interaction between Statoil and Hydro have been that both have the NCS as their main business arena and both have had broad field portfolios. This means that the companies have had a stronger affiliation to the NCS in a long-term perspective, which has influenced the way they behave. If the object of a transfer of operatorships to other companies is to replace Hydro, it would require transfers on a large scale.

To achieve this, the company would need to transfer operatorships from more than one of the big fields: Troll, Statfjord, Gullfaks, Snorre, Oseberg, Åsgard and Snøhvit. Transferring operatorships involves substantial costs and risks. Statoil and Hydro have developed and operated most of the fields in their portfolios, and are accordingly very familiar with their operation. Should another company take over as operator, it might be natural that it took over and retained the Statoil or Hydro operations organisation. In addition, the new operator would have to integrate this operations team in its own organisation.

Implementing such transfers is time-consuming, and poses a risk during a transitional period that the current operator would give this job a lower priority than other operatorships. When the new operator takes over, considerable time could pass before it has acquired sufficient knowledge of the field to be able to continue its development on a good basis. Such change processes also present a risk from an HSE perspective. See section 8.4. A transfer process could result in the organisation devoting substantial resources to the actual transfer, while the field is not operated or developed in a long-term

perspective for several years. This could result in lower production, a failure to pursue measures for improved oil recovery and higher operating costs, which could have consequences for total value creation over the field's producing life. These costs and risk elements must be weighed against possible gains attainable from a greater diversity of operators.

We have gained experience on the NCS with operator transfers for a number of fields in recent years. In connection with Hydro's acquisition of Saga Petroleum in 1999, an agreement was concluded that Statoil would take over as operator for Snorre and Visund with effect from 1 January 2003. Plenty of time was allocated for this transfer, and substantial resources were devoted to ensuring a smooth transition. Statoil took over Hydro's operations team and integrated it in its own organisation.

Despite careful planning of the operator transfer and the allocation of time for the transition, major challenges have arisen from an HSE perspective in operating these fields. This demonstrates that such decisions must be taken on the basis of thorough impact assessments, with HSE considerations not least taken into account.

Two fields in the development phase have divided operatorships. Ormen Lange is being developed by Hydro and will be produced by Shell, while Gjøa is being developed by Statoil for production by Gaz de France. A transitional period lasting for several years is also required in these cases to ensure a good transition from one operator to another.

Any transfer of operatorships must be weighed against the consideration that Statoil and Hydro are currently good and competent operators on the NCS. The merger will strengthen the company's expertise in exploration, development and operation. It will also have the capacity to handle many demanding development and production assignments simultaneously. The big fields will represent the core of its business, and the Ministry assumes that the merged company will have a strong self-interest in developing and operating the fields as well as possible.

This position is also expected to persist in the future. The Ministry accordingly takes the view that requiring the transfer of operatorships to other companies on one or more of the big fields would not contribute to improving resource management.

Statoil and Hydro are also operators today for a number of small fields, and for fields which are not part of areas containing several fields with the same operator. The Ministry has considered a more restricted transfer of operatorships for such producing fields to other players. This will have little effect on the merged company's portfolio or its position as the leading operator on the NCS. A transfer of Veslefrikk, Brage and Heidrun to other operators, for instance, would only reduce the proportion of production operated by the company from 80 to 76 per cent. The transfers would give other players operator assignments and strengthen their operator organisations, but only to a limited extent. We would again face costs and risk associated with the transfers, if not on the same scale as with the big fields.

The merged company will also be a very competent operator for these fields, providing they receive sufficient attention. The company has signalled a continued commitment to small fields and tail-end production through the formation of a separate operations organisation related to the activity in Bergen. The government expects that the merged company will also make a commitment to developing these fields in accordance with good resource management.

On this basis, the government has concluded that it would not be relevant to impose conditions for a transfer of operatorships in connection with the merger.

8.3.3 A big operator – compensatory factors

Two factors in particular suggest that the merged company will have little opportunity to exploit its position as operator in a way which causes a loss of petroleum resources and reduces value creation on the NCS:

- A multiplicity of players, the licensing system and voting rules in the production licences will help to some extent to ensure that alternative views on exploration, development and operation are studied and assessed.
- The merged company's operatorships lie to a great extent in areas of the NCS with substantial opportunities and challenges related to efficient operation and area optimisation – the merger will thereby provide opportunities for enhanced value creation from these areas.

It is also important that the Ministry of Petroleum and Energy and the Norwegian Petroleum Directorate as resource manager monitor activities by the merged company and assess how the company fulfils its operator role.

The factors mentioned above are discussed in more detail below.

Joint operating agreements and voting rules

The operator plays a very important role in the joint ventures. But it cannot execute projects without the support of other licensees. The balance between the operator and the other licensees is regulated by the joint operating agreement and the voting rules in the licence. The voting rules are structured in such a way that licensees with smaller interests in the licence carry a substantial voting weight. Decisions in the joint venture require that a specified number of licensees with a specified proportion of the participatory interests must approve a given proposal. It is important that diversity finds expression in the development of differing technical assessments in the joint ventures. Licensees with smaller participatory interests must also have incentives to participate with technical proposals in the joint ventures, not least because the voting rules ensure genuine participation in decision-making processes.

When changes are made in the number of licensees or the size of their participatory interests, the licensees are required to consider whether the voting rules need to be amended. New voting rules are conditional on Ministry approval.

Statoil and Hydro are jointly present in about 90 production licences, the Gassled joint venture for the gas transport system on the NCS, and certain other pipeline joint ventures. The voting rules in all these ventures must be reviewed and possibly amended as a result of the merger. When amending the voting rules in an existing licence, the fundamental principle is that new provisions must be framed in such a way that the effect on the voting weight of the individual licensee is minimised.

In addition to the voting rules, a new joint operating agreement has been formulated for the petroleum activity. This will facilitate a more active involvement by licensees in the work of the operator. The joint operating agreement regulates activity in the licence and the way costs are allocated between licensees. The new agreement, which will be identical for every production licence, has replaced all previous collaboration and accounting agreements with effect from 1 January 2007.

This will mean that licensees are involved to a greater extent than before in the operator's work, in part through detailed requirements on governance and clear rules for budgeting and cost management. The Ministry of Petroleum and Energy expects the new joint operating agreement to mean that cooperation between operator and licensees

will become closer and more transparent than before, and that costs relating to the activity will be better managed and monitored than at present.

The new joint operating agreement will accordingly give alternative assessment organisations a stronger position for monitoring the operator's work in the joint venture.

Emergence of more assessment organisations

The Ministry of Petroleum and Energy has pursued a licensing policy for many years which has resulted in Statoil and Hydro holding a substantially smaller proportion of operatorships and participatory interests than in the 1980s and 1990s. As outlined in section 8.2.3, a number of new players have arrived on the NCS. The oil and gas activity in these waters is progressing towards a greater diversity of players in the exploration, development and – eventually – production phases. The Ministry expects that existing operator organisations will continue to develop over time, while new organisations are built up. New companies have acquired growing importance the most recent licensing rounds. In the 2006 awards in predetermined areas (APA), Statoil secured 13 per cent and Hydro five per cent of operatorships, whilst other companies received 79 per cent. Statoil received 23 per cent of operatorships in the 19th round, Hydro 15 per cent and other operators 62 per cent. Developments in the industry structure are leading to a greater diversity of participants with different ideas, who can challenge the operators in the joint ventures. In the longer term, these operator organisations could represent strong partners, challengers and competitors to the merged company.

Many operator companies have made discoveries or are exploring promising prospects in the Norwegian Sea, the province with the largest remaining undiscovered resources. In addition to Statoil and Hydro, these include Eni, BP, Total and Shell. It is accordingly reasonable to expect that this area will have a far more varied operator picture than the northern North Sea. Shell's takeover of the operatorship on Ormen Lange for the production phase is also of significance.

At the southernmost end of the NCS, ConocoPhillips is operator for the Ekofisk area and BP for Valhall, Ula and Tambar. The merged company has a very minor presence in this area.

In the Barents Sea, on the other hand, the merged company has a very strong presence in a number of production licences. Snøhvit represents the first field development in the far north. The merged company will have substantial activity in coming years, with Snøhvit phase 2 and a possible development of Nucula. Eni is operator for Goliat. The future development pattern and operator picture in the far north depends on discoveries which have still to be made. The Ministry finds it reassuring that the merged company gives a high priority to the far north. Statoil and Hydro have traditions for giving weight to regional spin-offs and for developing the expertise of local industry through supplier development programmes.

The merged company is operator for a number of fields in the northern North Sea. Most of these fields are in a declining phase. Additional resources are required to maintain production. In recent years, smaller companies have also shown great interest in exploring close to the big producing fields. Should discoveries be made, an appropriate development solution would be to produce and process these resources on existing fields. Pressure will accordingly be applied by the new players to secure access to processing capacity on these fields. This will be positive in terms of diversity and the need for alternative assessment organisations. The Ministry of Petroleum and Energy and the Norwegian Petroleum Directorate will keep a close eye on developments.

Given this picture, the Ministry expects that players other than the merged company will participate actively in the joint ventures and thereby help to ensure that good development and production solutions are developed across the whole NCS.

Government regulation of the industry

The merger means that the two most important organisations for conducting studies will be unified, and thereby reduce the government's access to information.

Such information is essential if the Ministry of Petroleum and Energy and the Norwegian Petroleum Directorate are to apply their regulatory powers in a way which ensures good resource management. The authorities supervise operation of the oil and gas fields through a continuous dialogue with operators and licensees. This dialogue is extremely important for ensuring that the Ministry is informed about industry developments on the NCS.

The Ministry of Petroleum and Energy and the Norwegian Petroleum Directorate initiated work in 2005 on developing a new system for regulatory follow-up of producing fields. Applied for the first time in 2006, the performance indicator analysis for fields (Piaf) system is to be implemented on an annual basis.

This initiative was prompted by the government's desire for closer and more systematic supervision of the way operators and licensees work on developing resources in and around producing fields. That includes improving recovery, phasing in additional resources and enhancing operational efficiency. The operator of each field continuously pursues a large number of projects to operate and develop the field. The purpose of Piaf is to ensure that the government has a better and more systematic overview of developments with regard to resource growth, recovery, operating costs, investment, various issues hindering development of the field and possible potential for improvement.

Piaf involves benchmarking the development of a field against developments on other fields, and ranking fields in relation to each other. This ranking allows the government to set priorities for allocating resources to field and area supervision. Similarly, Piaf provides an overview of which fields are making better progress than others, and which could represent best industry practice in some areas.

The merger will make Piaf an even more important tool in government regulation of the activity.

During the development phase, the government can stipulate in connection with its consideration of the plan for development and operation (PDO) that further assessments should be carried out on alternative development concepts, tie-ins to other fields or other solutions for landing oil and gas. Generally speaking, it is advantageous if the authorities can influence development projects at an early stage in the assessment process. New development projects or projects on producing fields pass through various decision stages in the joint ventures. It is important for the joint ventures and the government that alternative solutions are assessed at an early stage in a new project. Information from alternative assessment organisations is essential if the government is to regulate such projects in a good way. The merger could mean that the authorities, to a greater extent than before, must identify and take the initiative on assessing such alternative solutions.

The issue of annual production permits represents one of the government's most important regulatory instruments in the production phase. Through these permits, the authorities can influence the recovery strategy where necessary and appropriate. That is not least important for fields where a difficult balance must be struck between oil and gas production. Troll provides an example of a field where the authorities, to achieve

good resource management, want to restrict gas offtake in order to facilitate long-term profitable oil production. Information from alternative technical teams will again be essential for exercising regulatory responsibility in a good way.

An operatorship provides great opportunities for influencing local spin-offs on land from developments and receiving terminals. In cooperation with other ministries concerned, the Ministry is reviewing the impact assessment system – including guidelines on plans for development and operation – in order to evaluate how spin-offs in the regions can be incorporated in this planning system.

The merger highlights the importance of the resource management authorities possessing the expertise and capacity to regulate the industry. To a greater extent than before, the authorities must acquire their own information and challenge the merged company as an agenda-setter for important decisions in the activity.

Petoro AS

The merger also affects Petoro AS, which manages the State's Direct Financial Interest (SDFI) in the petroleum business on behalf of the government. In Proposition no 36 (2000-2001) to the Storting on the ownership of Statoil and future management of the SDFI and Recommendation no 198 (2000-2001) to the Storting, it was resolved that Petoro would fulfil this duty without a level of expertise corresponding to the traditional oil companies. The company does not apply on its own behalf for new licences, but manages the state's direct participatory interests in those joint ventures in which the government has such holdings at any given time. Petoro is not awarded operatorships. In practice, a ceiling of 60 people has been set on its establishment.

Petoro carries out its own technical assessments in a limited number of priority areas. In addition, it cooperates with Statoil, Hydro and other licensees in order to get studies carried out and to assess alternative proposals for solutions which can be presented to the joint venture. On issues which are central for the SDFI, and where the other companies do not have the same interests as Petoro or choose not to apply resources, Petoro will need to give greater consideration after the merger to whether it should carry out independent analyses, present alternative proposals, pursue quality assurance of the operator's work and do its own work on selected strategic issues.

8.3.4 The merged company – a strengthened operator

The challenges faced by the industry in mature regions relate to efficient operation and area optimisation. A common area operator with substantial participatory interests will have incentives to coordinate activities and operate the fields as efficiently as possible. In some areas of the NCS, the merger will yield such effects.

The figure *Reserves by operatorship* (see separate pdf file) shows that the position of the merged company as an operator of producing fields will be particularly strong in the northern North Sea and on the Halten Bank in the Norwegian Sea. The company has a very limited presence in the southernmost NCS. An assessment of the merged company's position as the operator for fields in the production phase is provided below.

Improved recovery and efficient operation

Many of the big Norwegian oil and gas fields are now in the tail-end production phase. This is characterised by declining output and rising costs per unit produced. At the same time, the potential for improved recovery remains high on such fields as Statfjord, Gullfaks,

Oseberg and Snorre.

Key challenges in the tail-end production phase include improved recovery and efficient operation. By international standards, the recovery factor for a number of fields on the NCS is very high. A substantial potential nevertheless exists for improving recovery from these fields. It is accordingly important that the operators and licensees for these fields have incentives and expertise to make a commitment to further development. The recovery factor can be increased, for instance, by drilling new wells, by injecting water, gas or carbon dioxide, or by other methods. This is very demanding technologically, and makes big demands on the operator. Another challenge is that the infrastructure is dimensioned for a substantially larger production than at present, which calls for extensive maintenance and upgrading work. Moreover, the infrastructure faces restrictions in terms of its producing life. That makes it necessary to maintain a high pressure on developing the field. This in turn calls for the operator and licensees to work continuously on improving recovery, phasing in additional resources and implementing measures to enhance efficiency.

The merged company will increase its participatory interests in the big fields in the northern North Sea, and an important part of its production will derive from them for many years to come. The company will therefore have a strong self-interest in making a continued commitment to improved recovery and efficient operation on these fields. It will also have the expertise and capacity required for continued development of the fields.

The Ministry expects that the merged company will make a commitment to improved recovery and efficient operation of fields in the production phase.

Area optimisation

Many of the large oil and gas fields now in the tail production phase are located in the same geographically confined areas. In many cases, these have been developed on the basis of a single large field, as with Ekofisk, Oseberg, Sleipner and Troll. In addition, the established infrastructure in the Tampen area (including such fields as Statfjord, Gullfaks and Snorre) and on the Halten Bank (with Heidrun, Draugen and Åsgard) also forms such areas. Compared with less mature parts of the NCS, coordination and economies of scale are more important in these areas for ensuring good management of petroleum resources.

An area operator has strong incentives to optimise development of the area in order to generate the highest possible value creation. This is achieved by exploiting the infrastructure and operating the fields as efficiently as possible. Several areas already exist today with area operators. These include ConocoPhillips in the Ekofisk area, Hydro in the Oseberg area and Statoil for all the fields in the Tampen area.

Substantial economies of scale can be achieved in the petroleum activity, including coordination of helicopter transport, supply vessels, base services, field management, reservoir management, administration, and project planning and execution for several fields in the same area. Other gains can be secured, for instance, from coordinating the use of drilling rigs, well maintenance services and exploration activities near existing infrastructure. Area operators can also continue developing the infrastructure to a greater extent – by replacing old platforms with new ones, for instance, and by coordinating power supplies and transport solutions for oil and gas.

The merger will strengthen the area operator in such regions as Tampen and Oseberg through larger participatory interests. Giving the company a greater degree of balance in its participatory interests in an area will help to strengthen it. At the same time, these fields have other licensees which can challenge the operator. The Ministry takes the view that this

lays the basis for operating the fields efficiently and in accordance with good resource management,

A multiplicity of players are involved during the exploration phase in mature areas. This is also the case in areas which border the producing fields operated by the merged company. Players other than Statoil and Hydro are also very interested in exploring for and developing new discoveries. These can often be produced cost-effectively from existing infrastructure. Ensuring good utilisation of spare processing and transport capacity in existing infrastructure is accordingly important.

The Ministry of Petroleum and Energy issued a regulation on 1 January 2006 concerning third-party use of installations. This regulation is intended to secure efficient use of established facilities and to prevent players who own such infrastructure from imposing unreasonably high fees for using them. In this way, the regulation ensures that players have stronger incentives to explore for and develop new fields close to existing infrastructure.

8.3.5 The gas transport system

Virtually all Norwegian gas is transported through a 7 800-kilometre network of pipelines. In close collaboration with the industry, the Ministry of Petroleum and Energy has made substantial improvements to the gas transport activity over recent years. A unified organisation for ownership, operation and use provides more efficient utilisation of the transport system and reduces operating costs. Ownership of the bulk of the system is vested in the Gassled joint venture. The merged company will have a 31.4 per cent participatory interest in Gassled. Gassco is the operator for Gassled in order to ensure independent and equal treatment of natural gas owners and shippers when operating the gas transport system and in its continued development.

To secure efficient use of pipelines and other gas transport facilities, the return on these installations is regulated by the government. The Ministry of Petroleum and Energy issued regulations in 2002 which specify the main principles for access to the transport system. The Ministry delegated the authority to pursue capacity management of the transport system to Gassco as the neutral operator. Owners of the transport system must book capacity through Gassco on equal terms with other shippers.

The owners finance Gassled's daily operation and accordingly approve the transport system's budgets. An assessment should be made of whether Gassco's operating costs for system operation, capacity administration and infrastructure development should be covered by the transport tariff without these costs being submitted to the owners of the transport system. Budgeting and follow-up of these operating costs will then be managed by the Gassco board and audited by the users.

It is important that capacity allocations and subsequent trading in such rights are conducted in a way which promotes efficient utilisation of resources. The Ministry of Petroleum and Energy monitors the market for transport capacity and assesses adjustments to the regulations. The regulations specify, for example, that the Ministry will evaluate the special advantages enjoyed by the owners of the transport system when booking capacity. This will be done by 1 January 2008. In addition, the Ministry is working on an assessment of other aspects of the regulations for the gas transport system, including processes for expanding system capacity, financing future removal costs and incorporating installations covered by the regulations.

On behalf of the transport system's owners, Gassco has awarded contracts for providing technical services – primarily to Statoil. The merged company will deliver such services for

the great bulk of the transport system. It will perform daily operating functions and be responsible for maintenance in order to secure the technical integrity of the installations. The merged company must tailor its quality and contract management to Gassco's requirements. Gassco has the overall responsibility and the authority to issue instructions, while the merged company will have a purely operational role in a sub-contractor relationship. It is important that the services provided by the new company to Gassco in this context are organised under a unified management.

Gassco AS

Gassco AS was created in 2001 and serves as operator for the gas transport system. A strengthening of its organisation will be considered in relation to its role as an agenda-setter and challenger to the merged company. The specific strengthening of expertise should be assessed in relation to Gassco's principal duties and directed at those functions where a strengthening would have the biggest effect. This assessment will include building up a stronger technical function in Gassco, which is better able to specify the premises for good operation and further development of the gas transport systems. That applies particularly to the facilities at Kårstø and Kollsnes.

Costs associated with Gassco's operations are charged to the users of the system through the transport tariff. No appropriations are accordingly required over the central government budget.

8.4 Health, safety and the environment (HSE)

In the view of the Ministry of Labour and Social Inclusion and the Ministry of the Environment, the actual merger between Statoil and Hydro would basically have no legal consequences in the HSE area, since the new company would retain all its obligations. However, further assessment of these aspects would be needed when monitoring the merger process because the business will become a new large company.

The authorities will pay special attention to the integration process in the two companies in order to monitor and ensure that it does not weaken the level of HSE in the business. The authorities will also need to be aware that the merged company's large portfolio and obligations will be significant for the level of HSE on the NCS.

Experience acquired by the authorities from earlier mergers/unifications shows that major change and restructuring processes are critical activities both in the implementation phase and well into the phase of new operation. Incident figures from annual risk reports on the NCS show, for instance, that three of the seven installations with the highest number of gas leaks per annum over the latest three-year period had changed operator at least once in the production phase. The authorities accordingly expect both companies to maintain a high level of HSE in the process they are now entering. Statoil and Hydro are both players with powerful resources who give weight to a high level of HSE in their operations. As a result, the companies are also expected to conduct detailed impact assessments for all critical activities and processes with a view to achieving good synergies in and maintenance of HSE. It is also important that the two companies follow up their respective obligations to ensure that HSE conditions are managed in a fully adequate manner during the period before they become a single enterprise.

In their supervisory work, the authorities will also give weight to understanding of risk, organisational and possible staffing changes, planning and HSE culture. The integration process will accordingly call for an increased supervisory commitment by the Petroleum

Safety Authority Norway in both the short and long terms. Similarly, the environmental authorities will have to supervise the merged company more closely.

Industry structure on the NCS

Achieving a more diversified and nuanced player composition on the NCS has been a goal for the Norwegian authorities since 1997. One observation made by the Petroleum Safety Authority Norway from its supervision of the licensees is that many new players display an interest in contributing to the production licences in which they have interests. Their reported experience was that the big operators in the joint ventures respond differently to such initiatives, from being dismissive to taking an accommodating view and welcoming such initiatives from the licensees.

The merger of Statoil and Hydro will significantly change the industry structure on the NCS.

Combined with the fact that the industry structure in general is changing, this raises a number of issues for the Petroleum Safety Authority Norway. It could mean that the agency must focus greater attention on the way operators and licensees work in the production licences. Consideration must be given, for instance, to whether more resources are needed for monitoring the way licensees supervise the operator through their compliance responsibility, and how they fulfil their own duties. This means that the Petroleum Safety Authority Norway must consider new methods and tools for its regulatory activity.

Merging Statoil and Hydro's petroleum business will create a single very large operator. This means in part that the competition which has existed between two Norwegian players, and which has provided a dynamic element because they have challenged each other, will disappear. That must be replaced by the application of other instruments. The merger could also mean that the authorities must identify, take the initiative on and assess alternative solutions to a greater extent than before. As a result, the Petroleum Safety Authority Norway and the Norwegian Pollution Control Authority will need to extend their own expertise to meet a large player of this kind with a high level of competence and great influence.

The role which has been played by Statoil and Hydro as prime movers for technology development, involvement in developing norms and standards, R&D, representation in overarching institutions, company-union-government collaboration and so forth must also be preserved. This will be discussed in more detail below.

Statoil and Hydro both possess a critical body of expertise in the form of key experts on whom they depend to develop and drive forward new projects which may also need to be pioneering in technological terms. It is important for the Norwegian petroleum sector that such critical resources are available for projects on the NCS. Basic principles must also be observed by new players concerning compliance responsibility and follow-up of own duties, playing an active role in field operation and contributing to the development of a good HSE culture and company-union-government collaboration.

The compliance responsibility is enshrined in the Petroleum Activities Act, and is exercised in part through the joint ventures. This duty is also given more precise form in the HSE regulations. The latter place great emphasis on the responsibility for HSE in operations which rests on the individual decision-taker. In addition, a special duty to supervise the overall activity – known as the compliance responsibility – rests on the operator and licensees.

Participation and tripartite collaboration

In addition to legally-required safety and environmental work pursuant to the Norwegian Working Environment Act, a “tripartite” company-union-government collaboration has been developed in the petroleum activity. This now represents a cornerstone in efforts to establish and continue developing a high level of HSE. In particular, the basis has been laid for facilitating broad participation by companies, unions and government in further development of the regulations.

The tripartite concept has its roots in a Nordic tradition of government administration which builds on the view that participation and responsibility create a stronger commitment among everyone involved. The Norwegian companies must be said to be closer to such thinking than the foreign ones, and are in many respects important bearers of such values. It is assumed that the merger will not change the balance of power between licensees in a way which undermines these administrative ideals.

A variety of interest groupings on the employee side find expression in a relatively large number of unions. The employer side also has several overarching organisations, with the Norwegian Oil Industry Association (OLF) as the most central player. The OLF has developed a role beyond that of the traditional employer/negotiating organisation, and today serves as a developer in relation to the industry. From the government’s viewpoint, this developer role must be regarded as positive because it contributes to enhancing the level of HSE. Statoil and Hydro are the operators which have made the biggest contribution to this work. The government expects that these efforts will be continued after the merger.

Standardisation work

One goal in developing the regulations for petroleum operations on the NCS has been to facilitate better use of recognised industry standards. Much reference is made to such standards as recommended norms in the guidelines to the regulations. The operator can opt to apply these, or to document in another way that the chosen solutions meet the regulatory requirements.

Statoil and Hydro have both been active and highly important participants in standardisation work. From their respective standpoints, they have influenced the development of standards in the direction which they have regarded as best practice. The dialogue and dynamic in the competitive position in which they have found themselves have contributed to finding good solutions agreeable to everyone involved in this work. The authorities expect the merged company to maintain this commitment to standardisation work.

R&D

Active and purposeful R&D is an important element in overall efforts to reduce the level of risk in the petroleum activity on the NCS. Both Statoil and Hydro have played very central roles in technology development for these waters by sponsoring R&D projects organised by the authorities and research institutes and through their own efforts. This R&D activity has been very important for the development of the companies’ own critical body of expertise for important projects. The government expects the merged company to maintain a high level of R&D related to safety and the environment.

Summary

The merger could have a number of different consequences for the HSE authorities. A major challenge looks like being the approach taken the Petroleum Safety Authority Norway to supervising the players. The merged company will be a large and demanding player with very good expertise in all phases of the industry. It is expected to be

able to maintain and continue its commitment within the existing structure in the HSE area.

It seems likely that a large number of differentiated small companies which have their interests spread over special areas and production licences, such as mature fields and tail production, will cluster around this player. Experience indicates that these companies vary in their interest in being represented in a tripartite context, standardisation work, development of regulations, an R&D commitment and participating in key institutions involved in developing the level of HSE.

From an HSE perspective, there will accordingly be a need for the Petroleum Safety Authority Norway to review its instruments and working methods and to consider whether these are sufficient for supervising HSE in the industry in a fully adequate manner.

8.5 The natural environment

The government expects the merged company to maintain a high level of environmental protection both during and after the merger process. However, the Norwegian Pollution Control Authority (SFT) has found from its experience of earlier supervisory activities relating to operator changes and mergers that the natural environment is not always given the necessary attention and priority. As a result, the SFT will prioritise work in both short and long terms on supervising and following up the merged company.

As two big players on the NCS, Statoil and Hydro have made a substantial contribution to reducing emissions/discharges from and the environmental impact of the petroleum activity. Contributions in this area include varying goals and strategies pursued by the companies, different choices of technical and organisational solutions and the use of different suppliers and research institutes.

Particular mention can be made of the fact that Statoil and Hydro have made a strong contribution as two separate players to the development of environmental technology, monitoring methodology and emergency response to acute pollution. As two companies with different suppliers, they have also put extra pressure on progress with the work of substituting environmentally harmful chemicals.

The merger will have consequences for the SFT's regulatory role. The merged company will be a big player on the NCS. Competition between the two large national players, which has previously yielded good results in the environmental area, will disappear. That could slow down the pace of continued improvements in the environmental area. To combat this, it is important that the SFT itself has sufficient capacity to be a prime mover in developing new and improved technology and solutions, to keep abreast of the development of new environmental technologies, and to ensure that such solutions are adopted to reduce discharges to the sea and emissions to the air. The SFT must maintain a broader direct dialogue with such groups as suppliers and research teams than it does today, and will also have an increased need for studies and assessments to be carried out on its own behalf.

8.6 Effects of the merger on the supplies industry

The petroleum-related supplies sector is an important industry for Norway. Supplier companies are found in all the country's counties. More than 80 000 people are employed in the Norwegian petroleum industry. The supplies sector has a turnover of NOK 80-90 billion in Norway and almost NOK 50 billion abroad (exports and sales through foreign subsidiaries). A large proportion of the technology development in the petroleum industry takes place in the supplies sector. Norwegian suppliers are world leaders in a number of technology areas, such as seismic surveying, subsea solutions and multiphase

transport. The interaction between oil companies, research institutes and the supplies industry is regarded as an important requirement for expertise development in the Norwegian petroleum sector. A good dialogue between the authorities and the various players has also contributed to progress with technology and expertise.

The trend in the supplies sector over the past decade has been towards acquisitions and the formation of larger units. The 20 largest companies account for well over 80 per cent of turnover in Norway's petroleum-oriented industry. However, the sector also embraces many small and medium-sized enterprises as well as a wide range of newly-established companies.

Diversity among operators on the NCS has stimulated diversity in the supplies sector. Competition between the various suppliers has contributed to the development and testing of various technological solutions. Retaining a competitive and innovative supplies industry is important for value creation on the NCS.

The supplies industry has increased its international turnover over the past decade. The ability to internationalise and its scope are an expression of the competitiveness of the Norwegian-based supplies sector. Growing international sales have coincided with rising activity on the NCS. This indicates that Norway's supplies sector has the capacity and competitiveness to win contracts simultaneously both abroad and on the NCS. It is important that the supplies industry brings its knowledge and expertise back to the NCS to safeguard value creation.

The merged company and the supplies industry

The merged company will be the largest operator on the NCS. It will also be the most important customer for the Norwegian-based supplies sector – particularly in relation to producing fields. Questions of procurement, choice of contract strategy and selection of suppliers are decided by the whole joint venture. The operator nevertheless exercises great influence over the choice of both contract strategy and suppliers. As a result, the merged company's decisions concerning contract strategy and selection of suppliers will be very important for the industry.

It is generally easier to maintain diversity and competitiveness in a market with a multiplicity of players and customers. The supplies industry has expressed concern that the merged company will become a dominant operator and that this could be detrimental to the opportunities for suppliers to compete. The supplies industry could become too dependent on maintaining good relations with a dominant player with great negotiating strength. It has been noted that one possible detrimental consequence of the merger could be fewer suppliers over time and reduced diversity in commercial and technological solutions.

However, the merged company is expected to have a strong interest in encouraging continued broad competition and diversity among suppliers. Competition and diversity will be crucial for the company's ability to secure the best technology and the most efficient solutions. The NCS will be the merged company's most important resource base for a long time to come. It accordingly has strong incentives to maintain a good interaction with the supplies industry. A good instrument could be supplier development programmes of the kind which have proved positive in the Snøhvit development, for instance.

A greater diversity of players and more operator companies could counter possible detrimental consequences of the merger. The new industry structure could help to maintain diversity in the supplies industry. While it is true that the merged company will be operator for two-thirds of the producing fields, the largest discoveries which remain to be developed or are in the planning phase are operated – as noted above – by companies other than the merged company. For the industry as a whole, the development stage is at least as

important as the production phase. The fact that other oil companies will strengthen their position on the NCS in the longer term will help to counter possible detrimental consequences of the merger for the supplies industry.

Since the supplies sector is not homogenous, drawing general conclusions about the way it will be affected by the merger is difficult. The effect will be different for different parts of the industry. Rig and drilling contractors, for instance, serve an international market. In the market for maintenance and modification services, on the other hand, a local presence for the supplier is more important.

The Norwegian-based supplies industry has a high level of competitiveness and adaptability. The NCS is part of an international market, and will remain an important market for Norwegian-based suppliers for a long time to come. Developments in the general level of petroleum industry activity are likely to be more significant for the supplies sector than the Statoil-Hydro merger as such.

An increase in the merged company's international portfolio could create good opportunities for the continued internationalisation of the Norwegian-based supplies industry. However, this picture could change if the merged company secures a number of international operatorships.

Summary

The merged company will exercise great influence over the Norwegian-based supplies industry – particularly in the production phase. It is expected to be conscious of the responsibility associated with this position. The consequence is that the merged company must stimulate broad competition and diversity among suppliers in order to continue securing good solutions in terms of technology and efficiency in the future.

In order to be able to assess the possible effects of the merger on the supplies industry, the government will strengthen its dialogue with this sector and with the oil companies on such issues as contract strategy, procurement policies, rights to new technology and the commitment to research. It will be important to pay particular attention to the position of the small and medium-sized supplier companies. The government will also support and further develop arenas which contribute to diversity in the supplies industry. Such networks must contribute to a good and early flow of information between oil companies and suppliers, and between suppliers and sub-contractors. This could be accomplished, for instance, through industry associations, supplier networks and meeting places such as Konkraft.

8.7 Effects for research and development

Research and development (R&D) are important for value creation on the NCS. The challenges related to such activities as exploration, improved recovery, rising costs and the environment mean that the need for new technology is growing. Norwegian suppliers and research communities are leaders in a number of technological areas, not least as a result of broad and long-term cooperation with Norwegian oil companies. With their extensive development activities, the Norwegian companies have occupied a central place in technological progress. Statoil's projects on Snøhvit and Åsgard and Hydro's Troll Oil and Ormen Lange developments are good examples of forward-looking field developments where Norwegian-developed technology and solutions occupy a key place. Both companies now have major operator responsibilities in mature areas of the NCS. Their R&D commitment to reduce the level of costs and improved recovery will therefore be very important for future value creation in these areas.

The oil companies depend on good cooperation with the supply industry and research communities. Statoil and Hydro each pursue extensive research collaboration with various suppliers, research institutes and universities. A substantial proportion of technology development takes place today in the supplies industry and among research institutes and universities. Continuing to secure good development opportunities for ideas and technological solutions in this part of the industry is accordingly important for value creation and competitiveness.

A substantial part of the R&D effort is partially funded by operator companies on the NCS, which in turn have a large share of their R&D expenses covered through the production licences which they operate. Statoil and Hydro devoted just over NOK 1.5 billion between them to R&D in 2006. The bulk of this spending was covered through the production licences. About half the research funds spent by these companies are devoted to the purchase of services from research institutes and universities.

It follows from the presentation above that the merger between Statoil and Hydro will give the new company a very central position in R&D and the application of technology on the NCS.

The merged company and R&D

The experience gained by the Ministry of Petroleum and Energy with two competing Norwegian operator organisations is that these take differing views of their technological opportunities and exploit the expertise of the industry differently. One effect of the merger could accordingly be that the merged company assesses a smaller range of technological opportunities in exploration, development and operation than the two companies did separately before the merger.

In that respect, the merger could represent a challenge for petroleum research in Norway and particularly for R&D activities at Norwegian universities and research institutes. Norwegian research communities have expressed concern that the company might opt to secure the benefit of the merger in the form of reduced research activities. They also fear that diversity will be reduced because the new company will choose to integrate and concentrate its R&D activities. The researchers note that such a strategy would have a detrimental effect on resource utilisation on the NCS, because reduced diversity would mean fewer creative technological and operational solutions. Such a development could also weaken the international competitiveness of the Norwegian petroleum industry.

The object of the merger is to strengthen opportunities for international success. Possession of unique knowledge and technology represents a very important competitive advantage in the competition over access to resource developments in other countries. It will accordingly be in the merged company's self-interest to maintain a high level of R&D. Since the new company will have the bulk of its business in Norway, it is natural that the larger part of its R&D activities will be directed at opportunities on the NCS. This is particularly true because the bulk of the funds for R&D work will derive from production licences on the NCS. The Ministry of Petroleum and Energy accordingly expects that the company will maintain a high level of R&D activity.

The Ministry also expects that the merged company, with its increased international involvement, will enhance the opportunities for Norwegian research communities and Norway's supplies industry to develop and demonstrate new technology tailored to challenges on the continental shelves of other countries. The merger will therefore mean increased opportunities for Norwegian petroleum-related research activities.

It is nevertheless the case that the merger could present a challenge in the longer term to the level and diversity of R&D activities directed at enhancing value creation on the NCS. This is partly because the merged company is expected to increase its focus on opportunities and challenges related to developing the petroleum resources of other countries, and because the company's role on the NCS will eventually decline.

The Ministry of Petroleum and Energy has established an important interactive arena through its OG 21 (Oil and Gas in the 21st Century) research strategy initiative, which brings together the most important players in the oil companies, the supplies industry and research to collaborate on developing a national R&D strategy. This arena contributes to maintaining technological diversity in technology development. The OG 21 strategy has recommended which areas and technologies should be given priority in order to safeguard future value creation on the NCS.

Our achievement with OG 21 is to unite the industry over the most important challenges and tasks to be addressed in the immediate future and the long term, and over which roles the industry and the government should play in contributing to enhanced value creation on the NCS. Extensive work has been done by a number of companies and research institutes to identify the status of and gaps in knowledge and technology within a selection of technology areas, including exploration, improved recovery, environmental protection and subsea development. OG 21 will be an important arena for boosting the collective research commitment in the petroleum sector, and for contributing to continued diversity in technology development. Increased involvement by foreign oil companies in technology development will be a natural part of this. An expanded commitment by international oil companies will mean more competition and thereby help to maintain the diversity of petroleum-related R&D in Norway.

Summary

Both Statoil and Hydro play an important role in petroleum-related research and development (R&D). The bulk of their R&D is financed by the joint ventures for the fields operated by the companies. Combined with the significance of new technology for the company's competitive position, this should indicate that the company will maintain the level of its R&D commitment. However, the merger could lead to a reduction in diversity and less creative solutions – particularly on producing fields.

Because such an effect of the merger is possible, it will be important to continue developing and strengthening the broad R&D collaboration established in the petroleum industry through OG 21. The Ministry of Petroleum and Energy gives weight to monitoring R&D activities by the merged company in order to ensure that this work is adequately directed at challenges on the NCS.

9. Assessments

9.1 Assessment of the industrial basis for the merger

Merging Statoil and Hydro's petroleum operations creates new conditions and opportunities for the business both in Norway and abroad. The background for the proposal to open up for more owners in Statoil by listing the company on the stock market is outlined in Storting proposition no 36 (2000-2001) *Ownership of Statoil and Future Management of the SDFI*. This proposition noted in part that a steadily increasing proportion of Statoil's investment and value creation would relate to the international commitment. Internationalisation was seen as a central and essential strategy for ensuring continued growth and value creation as the Norwegian continental shelf (NCS) matured and the level of activity declined. It was also noted that the petroleum sector had undergone substantial changes, leading to rapid developments and tougher competition in the industry. Rapid and continuous adaptation to changing circumstances was seen as crucial to success. In order for Statoil to participate adequately in the restructuring of the industry, the assumption underlying the Storting's consideration of the matter was that Statoil would be given the opportunity to conclude ownership-based strategic alliances with others – by using its own shares as a means of settlement, for instance.

The government shares the view of the two boards that changes in international frame conditions have substantially altered the competitive position of Statoil and Hydro and that greater international weight is required. The merged enterprise will be a strongly-based energy company, competitive both nationally and internationally.

Global competition is demanding. Stronger and more active national oil companies, the consolidation of a number of companies and an increased shortage of physical and intellectual resources have collectively helped to present the oil companies with a new set of conditions governing efficient exploration for and production of oil and gas. Larger entities with greater financial strength and stronger negotiating positions have made it difficult for smaller companies to gain access to new resources through exploration, purchases or swaps.

In a number of cases, nation states have given priority to recovering the resources themselves rather than permitting access to the international oil companies. At the same time, a number of national oil companies are operating in markets outside their national boundaries in order to secure access to required energy sources as part of efforts to meet the energy requirements of their home countries. National oil companies have often proved ready to pay more than international players are willing and able to do. This contributes to strong competition over access to scarce resources on a world basis, either through exploration or through purchases/swaps.

The most important consideration for oil companies today is to increase their reserves and resource base. This can be done in several ways, including organic growth through exploration for resources, acquiring other oil and gas companies or farming into producing fields. A financially-strong company can take more risk. By developing new technology, it is possible to tap resources which were previously commercially unrecoverable. The government takes the view that the merged company would be better able to increase its reserves than Statoil or Hydro separately.

The government would point out that the merged company will remain Norwegian-based. Its biggest assets will be related to the activity in Norway, where 68 per cent

of its reserves lie. Challenges and new assignments in Norway will continue to develop the company, but it will also need new opportunities internationally in order to make further progress. The company's commitment internationally will provide knowledge and expertise which can contribute in its turn to further development of the activity in Norway. As a single unit, the merged company will have greater capacity to pursue a larger number of more complex operations than either of the existing companies separately.

In the government's view, the proposed merger will lay the basis for substantial growth by the company. At the same time, transactions of this kind involve an element of uncertainty. The success of the merger will depend in part on the company's ability to take effective advantage of growth opportunities and to achieve efficiency improvements, synergies, cost savings and other gains. A successful merger will also depend on the company's ability to unify two strong corporate cultures and expertise communities. Gains from the merger could be countered by reduced operating revenues as a result of changes in product prices, changed frame conditions for the oil and gas business, risks and uncertainties relating to its projects, unexpected challenges and costs related to the integration of the two companies, and conditions related to competition in the industry and other risk factors. However, these are risks with which the companies would also have to live as independent entities. In the government's view, a merged company would be more strongly placed to meet such business risks.

9.2 Assessment of effects on the NCS

The merger will integrate the two biggest players on the NCS into one large entity. It will control more than a third of remaining proven reserves, account for a third of production and be operator of two-thirds of the fields on stream. The company will have substantial holdings in the major oil and gas fields.

During the exploration phase, we currently have a multiplicity of players – particularly in mature areas. We need diversity in this phase in order to give scope for alternative views of exploration opportunities. The merged company will be an important player in the non-mature areas of the Norwegian and Barents Seas, but these areas will also attract great interest from the international companies. The merger will have limited significance for exploration activity.

Statoil and Hydro write in their merger prospectus that they envisage that the merger “will strengthen the merged company's ability to explore for, develop and produce oil and gas in technically challenging frontier regions of the NCS such as the Barents Sea”. The merged company will have a very high level of expertise for exploring non-mature areas of the NCS, and thereby be well placed to make a continued commitment to these waters. The authorities expect the merged company to make a strong commitment to exploration in non-mature areas of the NCS. StatoilHydro has every opportunity to become a stronger and more active exploration company than the two companies have been separately.

A central role has been played by Statoil and Hydro in the development of Norway's oil and gas fields. The merger means the loss of an important development team in terms of providing alternative proposals. The company will be a substantial participant in the development phase, but the trend will again be towards a larger number of players. The four largest discoveries currently being planned for development are operated by players other than Statoil and Hydro.

The production phase calls for companies which take a long-term view of production,

continue to develop the fields, and view fields in a broad context. A significant proportion of production in the years to come will derive from fields already on stream. The merged company will have a strong position in the production phase as operator of the big fields in the northern part of the North Sea, including Statfjord, Gullfaks, Snorre, Oseberg and Troll. It will have the expertise and resources to continue developing these fields. It will be very much in the company's own interest to operate fields and areas efficiently, in accordance with good management of the petroleum resources.

The merger prospectus states that the merger could "increase efficiency of operations and improve utilisation of resources, which, in turn, is expected to improve operations and extend the lifetime of existing fields in production". The NCS is the core area for the merged company. The government expects that the merged company will make a continued commitment to improved recovery and efficient operation of these fields and areas. It also expects the company to maintain a high level of exploration activity.

The merged company will be a substantial operator. It is the operator who is responsible for development and production of the fields and who, through its leadership role and capacity to carry out studies, exerts substantial influence on activities related to a field. The other licensees in the field have an important function in monitoring and challenging the operator. Statoil and Hydro have been key partners and competitors. The merger will put an end to this interaction.

The Ministry of Petroleum and Energy has considered whether the merged company will acquire a too strong position on the NCS, and possible measures to compensate for this.

One possible way to reduce the company's influence is for the authorities to require, in connection with merger, that the company disposes of participatory interests in fields and/or transfers operatorships to other players. The purpose of setting such conditions would be to reduce the company's position as a key licensee and operator, and strengthen other players in an effort to compensate for the role Hydro has played as a licensee and operator in the joint ventures. The Ministry has assessed the possible positive effects of setting such conditions against their cost and risk. It has concluded that such conditions would not contribute to improving resource management and increasing value creation from the petroleum industry.

On the basis of these assessments, the government has concluded that it would not be relevant to impose conditions for the disposal of participatory interests or the transfer of operatorships in connection with the merger.

The government believes that several considerations indicate that the company will operate in a way which enhances value creation on the NCS:

- The merged company will primarily operate fields in the mature areas of the northern North Sea and on the Halten Bank in the Norwegian Sea. The company has a strong self-interest in improving recovery and operating the fields as efficiently as possible, including coordinated operation of several fields in the same area.
- The operator is important for the development of oil and gas fields, but cannot implement projects without the support of the other licensees. The balance of power between the operator and licensees is regulated by such means as the licensing system and voting rules. These have been framed so that the operator is dependent on involving and securing support from other licensees. The voting rules will be adjusted in the production licences concerned.
- A greater diversity of companies means that a number of the new developments will be operated by companies other than the merged company.

Competition between Statoil and Hydro has been an important source of information for the authorities. The merger will reduce the access of the authorities to important information. The government will ensure that the public administration possesses the expertise and capacity required to regulate the petroleum activity in a satisfactory manner.

The merged company must be expected to stimulate broad competition and diversity among suppliers in order to continue securing good solutions in technological and efficiency terms in the future. In order to assess the possible impact of the merger on the supplies industry, the authorities will strengthen their dialogue with the supplies industry and the oil companies on such issues as contract strategy, procurement policy, rights to new technology and commitment to research. Paying particular attention to assessing the position of the small and medium-sized supplier companies will be important. The authorities will also support and further develop arenas which contribute to diversity in the supplies industry. Such networks must contribute to a good and early flow of information between oil companies and suppliers, and between suppliers and their sub-contractors. This could be pursued through industry associations, for instance, supplier networks and meeting places such as Konkraft.

Statoil and Hydro are important players today in research and development (R&D). The bulk of their R&D is financed by the joint ventures for the fields operated by the companies. Combined with the significance of new technology for the company's competitive position, this should indicate that the company has a strong focus on R&D. The company will be better able to pursue large research projects than was the case before. However, the merger could lead to a reduction in diversity and less creative solutions. The government will expect the merged company to maintain its R&D work in Norway on a par with the present level of activity pursued by the two companies separately.

The authorities expect the merged company to be able to maintain and continue its commitment within the existing structure in the area of health, safety and the environment, including aspects relating to the natural environment.

Merging the two largest players on the NCS will have effects which the government must take into account in its overall management of Norway's petroleum resources.

In the time to come, relevant government bodies will assess the need to review their instruments and working methods, and how far these are sufficient for adequate exercise of their jurisdiction over the petroleum activity.

9.3 Assessment of the merger plan

The Ministry of Petroleum and Energy and the Ministry of Trade and Industry have assessed the merger plan presented by the companies.

The companies have proposed that the name of the merged company should be StatoilHydro ASA. They have also agreed that the board of the merged company will develop proposals for a new name and logo. A proposed new name will be submitted to the general meeting of StatoilHydro for approval in 2008. The government believes that the StatoilHydro name conserves the traditions of the two merged companies in a good way and supports the proposed name. The government will take a position on a proposal for a new name as a shareholder at the general meeting.

It has been proposed that the company's business office will be in Stavanger. Corporate functions will be located in both Stavanger and Oslo, and the chief executive will have offices in both places. The most important commercial functions and business areas will be

operated from Stavanger, Oslo, Bergen and Trondheim. The government assumes that the head office will be in Stavanger. This location will maintain Stavanger's strong role and position in the Norwegian oil and gas industry and facilitate further development of the expertise community in the region. At the same time, the government assumes that the company will maintain the strong expertise communities possessed by the two companies at several locations in Norway. It is important that the company facilitates further growth in northern Norway when the level of activity provides a basis for this. The government expects that expanding activity will have industrial effects in the far north, with naturally associated management functions. It is the company itself which determines the organisation and location of its commercial functions and business areas.

The company's board of directors will have 10 members. These directors, including the chair and deputy chair, will be elected by the corporate assembly. It is assumed in the merger plan that Eivind Reiten will be elected chair and that there will be seven shareholder-elected directors. The nomination committee in Statoil will recommend four of these and the nomination committee in Hydro the other two shareholder-elected directors. These directors will serve until the annual general meeting in 2010. The company will have a corporate assembly of 18 members plus alternates, with 12 members and four alternates elected by the general meeting. The nomination committee in Statoil will recommend seven members of the corporate assembly and the nomination committee in Hydro five. These members will serve until the annual general meeting in 2010. The government concurs with this solution.

The Ministry of Petroleum and Energy and the Ministry of Trade and Industry have made use of an external independent financial adviser, Lehman Brothers, to conduct a financial analysis of the merger on behalf of the Ministries.

Lehman Brothers has assessed the exchange ratio with the aid of several recognised valuation methods, including discounted cash flows from future recovery of reserves, comparable pricing in relation to other similar transactions, key figures from other listed companies with similar or corresponding businesses, assessment of historical exchange ratios with and without a valuation of anticipated synergies, comparison with other independent analytical assessments and so forth. Lehman Brothers has also assessed the merger plan and other public documents relating to the matter.

The Lehman Brothers assessment has not produced information which indicates that the government should have objections to the exchange ratio. Lehman Brothers has concluded that the exchange ratio negotiated and supported by the boards is fair from a financial perspective for the government as a shareholder in both Statoil and Hydro.

The object of the government's ownership in StatoilHydro remains unchanged from its ownership of Statoil and Hydro today. In White Paper no 13 (2006-2007) *An Active and Long-term Ownership*, the government noted that the state should have a large shareholding in Statoil and Hydro in order to safeguard industrial expertise and jobs. Keeping head office functions and R&D assignments in Norway is regarded as important. In accordance with the Storting's decision in 2001 that the government holding in Statoil should be at least 67 per cent, and with White Paper no 13, the government intends that the state shareholding in the merged company will be increased over time from 62.5 per cent to 67 per cent. A 67 per cent shareholding will help to ensure that the intentions in the decision to list Statoil are also maintained for the merged company.

9.4 Assessment of Hydro's continued business

In its assessment of the continued business, the government has based its evaluation on the figures prepared by Norsk Hydro ASA in connection with the demerger of its petroleum business.

As the largest shareholder in Hydro, the government has wished to be sure that the company is sustainable and can develop on its own without the petroleum business. It has been assumed that the demerger will free up value for the shareholders of Hydro while also laying a good foundation for further development of the remainder of the company. The continued company must have sufficient financial strength to implement the investment required to meet growing international competition and the capital adequacy to withstand a recession.

Hydro's aluminium business has been strengthened in recent years. The company will now be established with low debt. The government accordingly considers that the demerger of the oil and gas business will not undermine Hydro's opportunities to realise its strategies for the aluminium business. The company will be a big player in the aluminium market. In the government's view, Hydro will have sufficient size and financial strength to continue developing as an independent company. The government's adviser has provided an assessment of the "new" Hydro's financial and industrial position which supports this assessment.

In White Paper no 13 (2006-2007) *An Active and Long-term Ownership*, the government noted that the state should have a high shareholding in Hydro in order to safeguard industrial expertise, further processing, jobs and the management of major Norwegian natural resources. This object for the government's ownership remains unchanged. Norsk Hydro ASA has a strong foundation for continuing the development of its business as a focused aluminium and power company.

The transaction will not have significant consequences for Hydro's employees. No downsizing has been notified other than the strategic changes in the organisation which had already been announced before the merger with Statoil was made known. The demerger is expected to strengthen the aluminium business, which will help when viewed in isolation to safeguard these jobs. As owner, the government will have expectations that the business can continue to be developed in Norway, including further processing, and that the expertise community built up by Hydro will be preserved.

The government wants the continued company to have a solid Norwegian foundation in order to safeguard industrial expertise, further processing, jobs and management of natural resources as described in the ownership White Paper. It is also important to maintain head office functions and R&D assignments in Norway. The government will maintain the government's existing shareholding in Norsk Hydro ASA after the demerger, and thereby sustain the stable ownership which the company has enjoyed.

In the government's view, the transaction adequately protects the continued business in Hydro and the company will continue as a financially-sound enterprise concentrated on the aluminium market.

9.5 Overall assessment and recommendation

Merging Statoil and Hydro's petroleum activity opens substantial industrial perspectives both in Norway and internationally. In the growing global competition over oil

and gas resources, a merged StatoilHydro will be far better equipped financially, technologically and organisationally than the two companies separately.

The merged company will continue to have its core business in Norway, and will have a strong self-interest in further developing this. However, the merger does mean the unification of two important communities for conducting studies in the petroleum sector. This will be countered in part by a multiplicity of players, particularly in the exploration and development phase, who will help to maintain competition. It is also necessary to ensure that the authorities can retain a broad perspective on the management of the oil and gas resources.

The government supports the plans of the two companies for a merger, while simultaneously setting great expectations for the company as the leading player on the NCS. The company must be expected to encourage continued diversity and competition between suppliers and research communities. A number of unsolved assignments exist in the Norwegian petroleum activity. StatoilHydro will have a special place in helping to find good solutions in the future.

9.6 Mandates

It is recommended that the Ministry of Trade and Industry be mandated to vote at the extraordinary general meeting of Norske Hydro ASA in favour of the proposal to demerge the petroleum business as a step towards the merger of Hydro's petroleum business with Statoil by and large on the terms detailed in this proposition, see draft resolution I.

It is recommended that the Ministry of Petroleum and Energy be mandated to vote at the extraordinary general meeting of Statoil ASA in favour of the board's motion to merge Statoil and Hydro's petroleum business by and large on the terms detailed in this proposition, see draft resolution II. By voting for the merger plan, an implicit decision is also taken in favour of all the conditions included in the merger plan, such as the exchange ratio, the articles of association and changes to the capital.

It is recommended that the Storting consents to the state shareholding in the merged company being 67 per cent in the longer term, see draft resolution III. A 67 per cent government shareholding will help to ensure that the intentions specified for state ownership in connection with the decision to list Statoil are maintained for the merged company.

It is recommended that the Ministry of Petroleum and Energy be mandated to expense the purchase of shares in the merged company without appropriation under chap 1811 StatoilHydro ASA, item 96 Share purchase, see draft resolution IV. A continuation of the mandate will be proposed in the relevant budget documents until the government's holding in the merged company reaches 67 per cent.