

**Report to the Danish Parliament
on the North Sea**

**Minister for Economic and Business Affairs
Denmark
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1. Introduction

On 20 February 2003, during the interpellation debate over the taxation of the oil and gas resources in the North Sea, the Danish Parliament adopted the following text (V 54):

“The Danish Parliament calls on the Government to submit, by 1 October 2003, a report to the Danish Parliament outlining the possibilities of – in an economic and balanced way – ensuring that the State gains a larger share of the values in connection with the present and future exploitation of the oil and gas resources in the North Sea.

In this connection, it is assumed that talks will at the same time be undertaken with the holders of the licence that expire in 2012 with a view to a possible extension.”

This report follows up on decision no. V 54. The report describes the historical distribution of values between the Danish State and the licensees and accounts for the expectations from the future oil and gas production in the Danish sector of the North Sea. Finally, it presents the results of the Government’s talks with A.P. Møller - Mærsk regarding an extension of the Sole Concession rights for the exploration and production of oil and gas in the North Sea, which expires in 2012.

The oil and gas activities in the Danish sector of the North Sea have developed far more positively than originally anticipated in the early 1960s. This is primarily due to skilful efforts from the companies involved in exploration and production in the North Sea.

At the same time, the oil and gas activities contribute positively to the Danish balance of payment and create jobs and industrial development. Since 1997, Denmark has been self-sufficient in energy, primarily on account of the oil and gas production in the North Sea.

The Government wants to lay the groundwork for optimum exploitation of the remaining oil and gas resources in the North Sea. Therefore, a stable and long-term framework for the future development must be set up to ensure that the Danish society will benefit as much as possible from the values in the North Sea.

A.P. Møller - Mærsk and the partners of the Danish Underground Consortium (DUC) are responsible for most of the activities in the Danish sector of the North Sea. This report will therefore mainly focus on matters related to A.P. Møller - Mærsk’s Sole Concession, even though the report as a starting point concerns the entire Danish sector of the North Sea.

2. Oil and gas activities in the Danish sector of the North Sea¹

The development of the oil and gas activities in the North Sea has by far exceeded expectations made in 1962 when the Sole Concession for the exploration and production of hydrocarbons etc. was granted to A.P. Møller for a period of 50 years. When activities to find oil and gas were started in the 1960s, knowledge of the actual prospect of finding oil and gas in Denmark was scarce. Oil was first discovered in 1966, and oil production commenced in 1972.

¹ Appendix 1 describes the present Danish legislative and financial framework of the activities in the North Sea.

So far, most of the oil discovered in Denmark has been discovered in very dense strata of limestone. When production from these strata began, only very small quantities of the oil found in the strata were expected to be recoverable. For example, 20 years ago, it was estimated that approx. 6 per cent of the oil in the Dan Field could be recovered. Since then, new production methods (water injection and horizontal wells) have been developed enabling recovery of more and more of the oil found in the dense strata of limestone. It is now estimated that approx. 26 per cent of the oil in the Dan Field can be recovered. The same trend applies to the other Danish oil fields.

This has been instrumental in ensuring that companies other than the DUC partners continue to be interested in participating in the oil and gas activities. Today, 25 oil companies have a licence to explore and recover oil and gas in the Danish sector of the North Sea. Ten of these companies have initiated production and sale of oil and gas. DUC, presently composed of Shell (46 %), Texaco (15 %) and A.P. Møller - Mærsk (39 %), is clearly the largest producer. In 2002, DUC accounted for 82 per cent of the total Danish oil production and 92 per cent of the gas production. The remaining part of the oil and gas production came primarily from fields operated by the state-owned company DONG and Amerada Hess.

State revenue from oil and gas activities under the Sole Concession has so far mainly come from corporate taxes. Of the total revenue of almost DKK 80 billion (2003 prices) generated during the period from 1962-2003, 55 per cent originated from corporate taxes, 31 per cent from royalties, 13 per cent from oil pipeline tariffs and 1 per cent from hydrocarbon taxes.

From 2000, state revenue from Danish oil and gas production in the North Sea has increased significantly, mainly as a result of a positive production development combined with high oil prices. During the past three years, annual revenue from taxes and fees has amounted to approx. DKK 10 billion, cf. Table 1.

Table 1: State revenue from the North Sea – 1998-2002 (2003 prices)

| DKK million | 1998 | 1999 | 2000 | 2001 | 2002* |
|--------------------------------------|--------------|--------------|--------------|---------------|---------------|
| Hydrocarbon tax | 0 | 0 | 0 | 0 | 67 |
| Corporate tax | 1,940 | 2,303 | 6,657 | 6,578 | 6,957 |
| Royalties | 1,237 | 944 | 1,244 | 2,356 | 2,160 |
| Oil pipeline tariff/compensatory fee | 349 | 685 | 1,512 | 1,168 | 952 |
| Total | 3,526 | 3,933 | 9,413 | 10,101 | 10,136 |
| Share of DUC partners | 100% | 97% | 96% | 93% | 93% |

*Figures are not final.

Note: Budget accruals concept (payment year)

Stating exactly how beneficial the North Sea oil and gas activities have been to A.P. Møller - Mærsk is difficult. To calculate this, assumptions concerning the actual value of the assets, etc. must be made. If relatively conservative assumptions concerning the value of the company's assets are made, A.P. Møller - Mærsk has in the period 1962-2003 achieved an annual average nominal yield of 16 per cent after tax². During the period, yields have fluctuated significantly. In the first years, there was almost no

² Appendix 2 details the assumptions forming the basis of the profitability analyses. See also the background memorandum by the Danish Ministry of Economic and Business Affairs "Profitability analyses of oil and gas activities in the Danish sector of the North Sea 1962-2003", which will be submitted to the Energy Policy Committee of the Danish Parliament in the near future.

return on the investments. In contrast to this, A.P. Møller - Mærsk has, especially in recent years, achieved very high yields from their North Sea activities.

The terms applying to A.P. Møller - Mærsk are to a large extent governed by the 1981 Contract and the Sole Concession from 1962. According to the protocol of the Sole Concession, talks of a possible extension and the related conditions must be initiated well in advance of the expiry of the Concession. If the parties cannot agree on an extension of the Concession, the Danish State is entitled to take over the existing installations in the North Sea at a price laid down by arbitration in case of dispute. If the State does not want to use the installations, because it does not want to continue recovery after 2012, removal of these can be required.

In addition to DUC, several other companies also currently operate in the Danish sector of the North Sea, as mentioned above. These companies have won rights to oil and gas exploration and recovery through calls for tenders.

Since 1984, five calls for tenders have been issued. In 1997, a so-called "Open Door Procedure" was also introduced for the less attractive Danish areas. Outside the calls for tenders, the Open Door Procedure allows oil companies to apply for licences during an annual opening period from 2 January to 30 September. These new licences grant companies 30-year production licences.

The companies with the new licences face somewhat different terms than DUC. Firstly, the investments were made much later. Production from areas outside A.P. Møller - Mærsk's Sole Concession was not initiated until 1998. Secondly, other licence terms apply to the new licences in several areas, e.g. as regards state participation. The State, for instance, participates in all recent licences through DONG Efterforskning & Produktion A/S, a subsidiary of the entirely state-owned DONG A/S, and in this way gains a share of the oil and gas reserves.

In future, oil and gas companies will also be interested in participating in exploration and recovery activities in the North Sea if the financial terms are reasonable. The fact that many new opportunities to invest in oil recovery are now being offered all over the world also plays a part. This applies, in particular, to the Central Asian countries, which offer far greater potential and far larger fields than the Danish sector of the North Sea.

3. Oil and gas reserves in the Danish sector of the North Sea

There are still valuable oil and gas reserves in the Danish sector of the North Sea. Every year, the Danish Energy Authority publishes an "assessment of reserves", i.e. an assessment of the amount of oil that can be recovered from the known fields with today's technology. According to this assessment, the bulk of the oil and gas reserves is found within the Sole Concession.

The Sole Concession is based on a very long time horizon. Therefore, the Energy Authority's assessment of reserves forms the basis for three production scenarios (low, middle and high) which make various assumptions concerning technological development and new discoveries. The three scenarios are based on a contract solution. This means that the added value generated by concluding a contract, in the form of more efficient production and investment planning, has been included in the projections, cf. Section 5.

The "low scenario" is based on the Energy Authority assessment of reserves that does not include new technology or discoveries.

Historically, these assessments have, however, always underestimated the amount of oil actually produced. This is due to the fact that new discoveries are made and technology is in constant development, cf. Section 2.

The main scenario (the middle scenario) - that formed the basis of the Government's talks with A.P. Møller - Mærsk - takes account of technological development, thus, increasing production by an average of 0.7 per cent annually. This corresponds to an additional production of 125 million m³ oil. At the same time, it is assumed that production from another new, medium-sized oil discovery of 20 million m³ will be initiated around 2012. The total estimated annual average additional production amounts to 1.2 per cent compared with the Energy Authority's latest 20-year forecast for the period 2003-2022. By way of comparison, the period 1990-2003 saw an annual increase in the total oil production from a number of fields within the Sole Concession of approx. 4 per cent in relation to the forecasts of the expected oil production from these fields made in 1990, cf. Appendix 3. According to the middle scenario, the development of new technology and new discoveries are expected to take place at a somewhat slower rate than has been the case during the past 15 years.

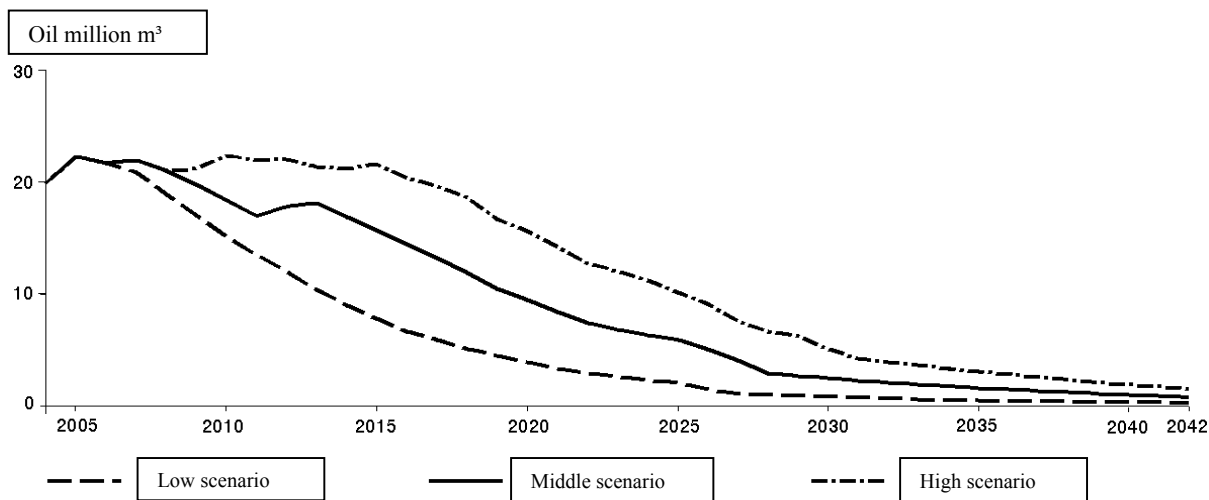
The high production scenario assumes that another medium-sized discovery of 20 million m³ will be made and that faster technological development will take place. This will result in an estimated annual average additional production of 2.1 per cent compared with the Energy Authority's latest 20-year forecast for the period 2003-2022.

The lower rates of increase applied (compared with the historical development) reflect a recognition of the fact that it is becoming increasingly difficult to expand the recovery from the fields in production, just as it is becoming increasingly difficult to make new discoveries concurrently with the continued exploration of the Sole Concession areas.

Moreover, assumptions concerning technological development and new discoveries, the scenarios also include a number of assumptions concerning future investments and operating costs. The assumptions concerning future investments and operating costs are based on historical data and experiences from A.P. Møller - Mærsk's existing fields and other fields outside the Sole Concession. Gradually increasing operating costs per produced oil and gas unit are assumed. Especially towards the end of the period, more water is expected to be recovered together with the oil, which will increase the cost of handling these amounts of water.

Figure 1 shows the expectations of the future oil production illustrated by the three different production scenarios. The total oil production from the areas within A.P. Møller - Mærsk's Sole Concession is expected, according to the middle scenario, to amount to 357 million m³ in the period 2004-2042. Of this, about half will be produced in the period 2004-2012, both years included. By way of comparison, the Danish oil production from 1972, when production was first initiated, to 1 January 2003 totalled 211 million m³.

Figure 1: Official production forecasts for DUC



Production from licensees other than A.P. Møller - Mærsk is assessed to total 43 million m³ oil for the period 2004-2026, of which 32 million m³ oil are expected to be produced in the period 2004-2012. This does not include production from any new licences.

Based on the official middle scenario, the total production value of the remaining oil and gas resources within A.P. Møller - Mærsk's Sole Concession will total DKK 295 billion in the period 2004-2042 at an exchange rate of 6.95 DKK/USD and an oil price of USD 22.4 per barrel from 2004-2010 (from 2011, incrementing by USD 0.4 annually). The future production value is stated in present value. This means that allowance is made for inflation and the possibility of an alternative application of the resources through a return on investment of 6 per cent.

4. State share of values from A.P. Møller - Mærsk's Sole Concession

From 1962 to 2003, A. P. Møller - Mærsk's Sole Concession generated a production value of DKK 309 billion and a total profit of DKK 166 billion (2003 prices). Of this, the Danish State received DKK 78 billion spread over almost the entire period. The state share of the profit has varied significantly during the years. On average, the historical distribution has been 47 per cent to the State and 53 per cent to DUC. In recent years, the state share of the profit has, however, been 40 per cent, cf. Table 2.

Table 2 - 2000-2003 profit from the Sole Concession

| DKK billion (2003 prices) | 2000 | 2001 | 2002 | 2003 | Annual avg. 2000-2003 |
|---------------------------|-------|-------|-------|-------|-----------------------|
| State profit | 9.6 | 8.9 | 9.4 | 7.9 | 9.0 |
| DUC profit | 15.8 | 12.4 | 11.5 | 13.6 | 13.3 |
| Total profit | 25.4 | 21.4 | 20.9 | 21.5 | 22.3 |
| Distribution State:DUC | 38:62 | 42:58 | 45:55 | 37:63 | 40:60 |

As regards new licences, international comparisons indicate that the Danish State's share of values from the North Sea with the present rules is above the level in the United Kingdom, but significantly below the levels in Norway and the Netherlands³.

The oil and gas accumulations in the Danish sector of the North Sea represent significant socio-economic values. It is crucial that the Danish State, which owns the accumulations, is guaranteed a considerably larger share of these values in future. This is supported by the following:

- Today, the knowledge of the resources in the Danish sector of the North Sea has been improved compared with the knowledge available when the Sole Concession was granted in 1962, which speaks for a lower risk premium to the involved companies in future.
- Even in recent years, which have seen high production and profit from the North Sea, the State has received no appreciable hydrocarbon tax. A tighter tax system that provides the State with a larger share of the values is therefore called for.
- Compared with Norway and the Netherlands, Denmark has received a smaller state share of the profit from non-renewable oil and gas resources.

Moreover, a number of external framework conditions have changed considerably since the oil and gas activities in the North Sea commenced. Corporate tax has, for instance, been lowered several times over the years without any increases in other taxes and fees on hydrocarbon activities. The interest rate and inflation levels are also significantly lower today than in the early 1980s, which has increased the actual value of the special hydrocarbon allowance.

However, to ensure that society also in future will benefit from the Danish oil and gas resources, it is crucial to have competent companies carry out the exploration and recovery activities in the North Sea. It must still be attractive for the companies to explore and produce in the Danish sector of the North Sea. As part of this, a stable and reasonable financial framework will be created for future North Sea activities. This will create a basis that will allow the companies to adopt long-term strategies and invest with confidence that there are stable conditions for exploration and recovery of oil and gas in Denmark.

5. The contract with A.P. Møller - Mærsk

To follow up on decision no. V 54 of 20 February 2003, the Government undertook talks with A.P. Møller - Mærsk on the possibilities of extending the Sole Concession, which expires in 2012. These talks were based on the Danish Parliament's decision concerning an increase of the Danish State's share of the values related to present and future exploitation of the oil and gas resources in the North Sea.

On 29 September 2003, the Minister for Economic and Business Affairs and the licensees (A.P. Møller - Mærsk A/S and Mærskolie og Gas AS) concluded a contract on the specific terms of extending the Sole Concession by 30 years until 8 July 2042 inclusive, cf. Appendix 5.

³ These assessments are based on model calculations of fields. In the UK, the taxation of oil and gas activities is higher for licences granted before 1993.

This contract is contingent on the necessary consent of the Danish Parliament and the Energy Policy Committee of the Danish Parliament and on the adoption of the necessary and implied amendments. The contract also assumes that the new licence will not give rise to objections from the European Commission. A.P. Møller – Mærsk has made reservations as regards approvals by its board.

The contract contains the main elements stated in Box 1:

Box 1: Main elements in contract with A.P. Møller - Mærsk

30-year extension of Sole Concession

A.P. Møller – Mærsk is granted an extension of the Sole Concession for the period from 1 January 2004 to 8 July 2042. According to the contract, the licensees must continue the active exploration work and continuously report to the authorities on plans for future production and closure of fields. In case of disagreement on the scope or content of the work, the dispute must be settled by arbitration.

State participation

From 1 January 2004 to 8 July 2012 inclusive, the licensees and their partners will pay an annual amount to the Danish State corresponding to 20 per cent of the profit before tax and net interest expenses. With effect from 9 July 2012, the State will participate as partner in DUC. The State will take over a share of 20 per cent of the installations (platforms, processing facilities, pipelines, etc.). The State will not pay for this take-over.

Hydrocarbon tax

With effect from financial year 2004, the special investment allowance, cf. the Danish Hydrocarbon Tax Act, will be reduced to 5 per cent in six years instead of 25 per cent in ten years. As regards investments made before 1 January 2004, the annual hydrocarbon allowance will be reduced from 25 per cent to 10 per cent. The allowance will cease when the investment is ten years old. The hydrocarbon tax will be reduced from 70 per cent to 52 per cent. The field tax will be abolished with effect from financial year 2004. Unused field deficits will be stated by the end of financial year 2003 and will be deducted by 2.5 per cent annually for 2004 and 2005, and 6 per cent annually from 2006 to 2016. The remaining 29 per cent cannot be deducted. The special payback rule of the Hydrocarbon Tax Act will be cancelled with effect from 1 January 2004.

Royalties and oil pipeline tax

The provision concerning payment of royalties in Section 10 (1) of the 1962 Concession will be cancelled as of 1 January 2004. The pipeline tax, cf. the 1981 Contract, will be cancelled with effect from 9 July 2012. With effect from 1 January 2004, the pipeline tax will be set off against the hydrocarbon tax rather than the income basis of the hydrocarbon tax or the corporate tax. Unused allowances from one year can be carried forward to the next year.

Removal costs

DUC and the partners will pay all removal costs. As regards taxes, removal costs will be deducted in the year in which they are paid. If the positive hydrocarbon income is not high enough to enable full utilisation of the allowance when production pursuant to the Concession ceases, the State will reimburse the tax value of the unused allowance. However, the amount reimbursed cannot exceed the accumulated hydrocarbon tax payment less earlier reimbursements in connection with removals under the same provisions.

Compensation rules

The DUC partners will be compensated for the effects of amendments to new acts and other rules specifically affecting hydrocarbon producers in the Danish sector of the North Sea. The compensation will be laid down with a view to restoring economic balance between the State and the licensees and their partners and can only amount to the net benefit achieved by the State through this contract. Any dispute about this matter will be solved by arbitration. A detailed contract on the compensation rules will be made. This will not affect the general taxation rules of the State.

Firstly, the contract creates a stable and long-term framework for DUC with financial terms that are considerably tighter than the former. The contract will give DUC the opportunity to concentrate on the activities in the North Sea for many years ahead. At the same time, an operator change in 2012 will be

avoided. This will make the total profit for distribution between the State and DUC even larger. If A.P. Møller -Mærsk's Concession did not continue after 2012, DUC would, during the period until 2012, supposedly not be able to pursue a long-term strategy involving the implementation of new technology and further exploration. In case of an operator change in 2012, new technology might be implemented later in the process, and the licensees might feel inclined to close the most unproductive fields prematurely.

With the contract on continued activities after 2012, the total profit for distribution between the State and DUC is estimated to become more than DKK 20 billion higher than if the contract had not been concluded.

The contract will also provide the State with more insight into the oil and gas activities under the Sole Concession. As part of the annual report on future oil and gas production, DUC must account for their plans for closure of fields as a basis of discussion with the supervising authority, the Danish Energy Authority. In case of dispute about the closure plans, the contract includes an arbitration clause. According to the contract, exploratory work to discover new oil and gas fields must also be continued. From 2012, the State will be a partner in DUC with an ownership share of 20 per cent.

Secondly, the resources in the North Sea will be used in a way that is beneficial to the economy. Therefore, the state revenue must come from distribution of profits and taxation of profits rather than gross taxes. The State will gain a larger share of the profits through profit sharing until 2012 and will then participate in all ongoing and new activities in the period 2012-2042. The abolition of royalties and from 2012 the pipeline tax⁴ will, at the same time, mean the removal of two gross taxes. In practice, the gross taxes are an extra production cost and may thus lead to lower production and exploitation of marginal accumulations. The gross taxes may provoke closure of the fields earlier than what is considered sensible from an economic point of view. Also in other countries, a trend towards abolishing gross taxes.

Despite a tax rate of 70 per cent, the hydrocarbon tax has so far only given a very small yield to the State. This is mainly due to the current rules concerning a hydrocarbon allowance of 250 per cent over a ten-year period. Consequently, the companies have, in practice, only paid very modest amounts in hydrocarbon taxes due to the heavy investments in the North Sea. The reduced hydrocarbon allowance is one of the cornerstones of the contract, which provides the State with an expanded and more solid tax base and thus increased tax receipts. A hydrocarbon allowance of 30 per cent for new investments is also in line with the current rules in Norway.

The changed allowance rules will significantly neutralise current distortion in the present taxation and will thus create a healthier system from an economic point of view. The broader tax base means that the hydrocarbon tax rate can be reduced from 70 per cent to 52 per cent.

Also the abolishment of the field delineation contributes to a more flexible and efficient organisation of production. Field delineation is the rule that prescribes that each field must be treated separately, as regards both taxes and accounts. The field delineation was mainly justified by the very high hydrocarbon allowance that will be reduced drastically as a result of this contract. Compared with the existing rules, abolishing the field delineation will stimulate the incentive to undertake risky

⁴ In reality, the pipeline tax will be abolished with effect from 2004 owing to the set off against the hydrocarbon tax.

investments in both new fields and new technologies. Moreover, the use of horizontal wells may make it more difficult to separate the fields geographically in future.

As part of the abolition, the parties have agreed on a transitional scheme according to which unused field deficits by the end of 2003 will be deducted by 2.5 per cent for 2004 and 2005, and by 6 per cent annually from 2006 to 2016.

The deficits will be carried forward without any interest. According to the contract, companies will renounce 29 per cent of these hitherto unused field deficits. According to the Danish tax authorities, the transitional scheme corresponds reasonably well to the share of these deficits that the companies would have been entitled to use under the current rules.

When the fields are to be closed and the North Sea is to be cleared, this must take place in a good and environmentally correct way. According to the current rules, the companies are entitled to deductions for their costs related to removal of installations, i.e. in practice, the Danish State pays for having the installations removed through lower tax receipts. The main problem with the current rules, apparently, is the fact that the companies cannot utilise the allowance in situations where expenses cannot be set off against positive income, e.g. when a company is closing its final field in the North Sea. This may provide an incentive to close prematurely to benefit from the allowance.

The contract clearly regulates the taxation of removal costs. Costs will be deducted in the year they are paid. If the positive income is not high enough to enable full utilisation of the allowance when production ceases, the State will reimburse the tax value of the unused allowance, however, not more than the hydrocarbon tax paid. In future, the DUC partners must also pay the costs of removing the installations in the North Sea. When the State from 2012 takes over a 20 per cent share of DUC's installations, without any payment, the State will also have to pay 20 per cent of the removal costs.

Thirdly, the compensation rules agreed upon will provide certainty in relation to the financial framework during the contract period. As mentioned, the financial terms have been tightened significantly. The compensation can only make up the net benefit achieved by the State through the new contract. The compensation rules only concern legislation that specifically affects hydrocarbon producers in the Danish sector of the North Sea. Amendments to general Danish or EU legislation, e.g. corporate taxes, the environment, safety or working conditions, etc., will accordingly not be covered by these rules. The specific contents of the compensation rules will appear from a detailed contract that will be prepared and submitted to the Danish Parliament.

Compensation rules are also found in the contracts between DUC and DONG. In this connection, it should be noted that, according to the contract, the DUC partners waive the right to pass on the tighter financial terms to DONG and in this way reduce DONG's profit to the State, which they would otherwise have been able to as regards gas.

6. Financial consequences of the contract

Through the contract, the Danish State will gain a larger share of the values related to the present and future exploitation of oil and gas resources in the North Sea. From 2004 to 2042, the distribution of profit between the State and DUC is estimated to be 61:39 based on specific assumptions as regards production amounts, oil price, etc. This is considered a considerable improvement compared with the average of 47 per cent, which the State has historically received and the 40 per cent the State has received in recent years.

Based on the assumptions made, Table 3 below summarises the financial consequences of the contract between the State and A.P. Møller – Mærsk compared with the historical figures. As regards the entire period 2004-2042, the state proceeds from the areas within the Sole Concession are estimated to total DKK 133 billion (present value) under the contract. The total state proceeds in the period 2004-2012 are estimated to amount to approx. DKK 80 billion (present value).

Table 3 – State proceeds under the contract (in present value)

| DKK billion | Historical 1962 – 2003 | Contract | | | | | |
|--------------------------------------|---------------------------|----------|----------------|---------|----------------|-----------|----------------|
| | *) | 2004-12 | | 2013-42 | | 2004-2042 | |
| | Total | Total | Annual avg. | Total | Annual avg. | Total | Annual avg. |
| | ----- DKK billion ----- | | | | | | |
| Total profit | 166 | 139 | 15.4 | 81 | 2.7 | 220 | 5.6 |
| State revenue | 78 | 80 | 8.9 | 54 | 1.8 | 133 | 3.4 |
| Of this | | | | | | | |
| - Profit sharing/State participation | 0 | 26 | 2.9 | 16 | 0.5 | 43 | 1.1 |
| - Corporate tax | 43 | 32 | 3.5 | 18 | 0.6 | 49 | 1.3 |
| - Royalties | 24 | 0 | 0 | 0 | 0 | 0 | 0 |
| - Pipeline tax | 10 | 7 | 0.8 | 0 | 0 | 7 | 0.2 |
| - Hydrocarbon tax | 1 | 15 | 1.7 | 20 | 0.7 | 35 | 0.9 |
| | ----- per cent ----- | | | | | | |
| Distribution State:DUC | 47:53 | 57:43 | | 66:34 | | 61:39 | |

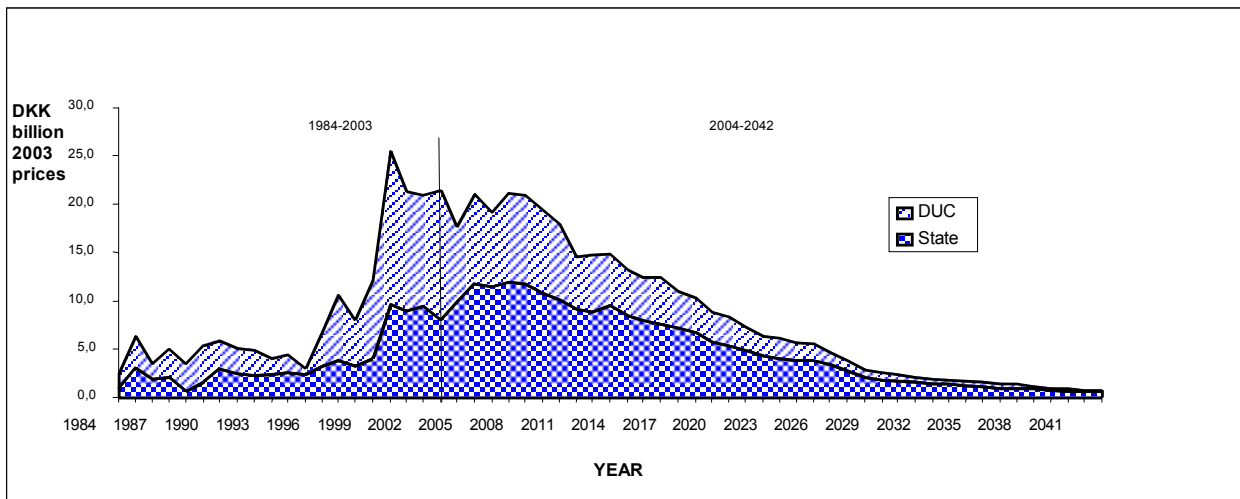
*) 2003 prices

Note: Totals may deviate due to rounding.

With a state share of 61 per cent of the profits from the North Sea in the period 2004-2042, the Danish State's share of the values will, in future, be higher than the state share in the UK and significantly closer to the levels in Norway and the Netherlands. The comparison of the Danish State share with those in Norway and the Netherlands must also consider that fact that especially Norway has much larger fields. Moreover, there are better geological conditions than in Denmark, which make it easier to recover the oil.

Figure 2 shows the development in the total profit for the period 1984-2042. According to the figure, a large profit can be expected from the North Sea oil and gas production, in particular in the period until 2012. After 2020, the profit is expected to be considerably lower as the resources are exhausted and the operating costs of recovering the last oil increase.

Figure 2 - Development in annual profit 1984-2042 (2003 prices)



In Table 3, the proceeds estimates are based on present value. Present-value calculations are most often used in connection with long time horizons when inflation and the fact that the means could have been invested elsewhere, e.g. in Government bonds, must be taken into account, i.e. when something is to be considered an investment. However, present-value calculations do not provide information about the amounts actually received by the State. To get a picture of this, calculations must be based on fixed prices taking only inflation into account.

Table 4 shows the state proceeds in the period 1998-2003 in fixed prices compared with the estimated proceeds in the period 2004-2012 under the contract.

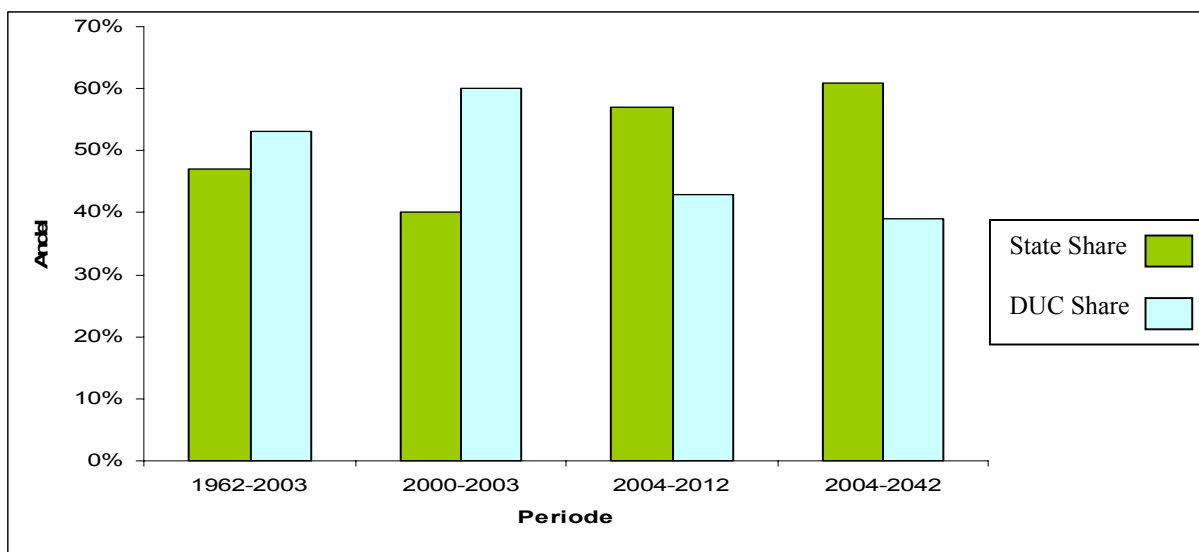
Table 4 - State proceeds - historically and in 2004-2012 under the contract (fixed prices)

| DKK billion (2003 prices) | 1998-2003 Annual avg. | 2004 | 2005 | 2006 | 2007-2012 Annual avg. | 2004-2012 Annual avg. |
|--------------------------------------|-----------------------------|------|------|------|-----------------------------|-----------------------------|
| State revenue: | 7.2 | 9.8 | 11.9 | 11.4 | 10.4 | 10.6 |
| - Profit sharing/State participation | - | 3.6 | 4.0 | 3.9 | 3.3 | 3.5 |
| - Corporate tax | 4.4 | 4.3 | 4.8 | 4.6 | 4.0 | 4.2 |
| - Royalties | 1.8 | 0 | 0 | 0 | 0 | 0 |
| - Pipeline tax | 0.9 | 0.9 | 1.0 | 1.0 | 0.9 | 0.9 |
| - Hydrocarbon tax | 0 | 1.0 | 2.0 | 2.0 | 2.2 | 2.0 |
| Distribution State:DUC (per cent) | 40:60 | | | | | 57:43 |

Figure 4

below shows the historical state share of the profit from the Sole Concession and the expected development of this share over time under the contract.

Figure 4 – Development of the state share of profit



7. Additional state revenue and sensitivity analyses

The value of the contract can be assessed by comparing the state proceeds achieved through the contract with the proceeds achieved if the current rules were to continue until 2012 and an operator was then found through a call for tenders. The terms for the operator after 2012 are assumed to be similar to those applying to new licences. The carryforwards have been made based on the middle scenario for oil and gas production under the Sole Concession, cf. Section 3.

The problem with this type of carryforward is that it is based on income from the hydrocarbon tax, which has generally not generated any revenue. The carryforward does not consider the fact that the present large hydrocarbon allowance of 250 per cent opens up to tax arbitrage in connection with the investments. In practice, this means that the state revenue included in the carryforward with unchanged conditions and an operator change in 2012 overestimates the state proceeds. In the period 2004-2012, DKK 12 billion in hydrocarbon tax receipts are included. According to the tax authorities, these receipts are highly uncertain.

Despite this, calculations indicate that the state proceeds until 2012 will, on average, be DKK 2.4 billion higher, corresponding to additional revenue during the period 2004-2012 of approx. DKK 22 billion, cf. Table 5.

Table 5 - State revenue without and with contract (2003 prices)

| DKK billion (2003 prices) | 2004 | 2005 | 2006 | 2007-2012 Annual avg. | 2004-2012 Total | 2004-2012 Annual avg. |
|-----------------------------------|-------|------|------|-----------------------|-----------------|-----------------------|
| Without contract | 8.7 | 9.8 | 9.6 | 7.6 | 73.5 | 8.2 |
| With contract | 9.8 | 11.9 | 11.4 | 10.4 | 95.6 | 10.6 |
| Additional proceeds from contract | 1.1*) | 2.1 | 1.8 | 2.8 | 22.1 | 2.4 |

*) Stated per earning year. According to contract, both royalties and profit shares will be due in 2004. When using the Budget's accruals concept for actual payments, the additional proceeds for 2004 are estimated to amount to DKK 3.3 billion, cf. Table 6 below.

Note: In the case without a contract, the taxation conditions are assumed to remain unchanged until 2012. The underlying production development is assumed to differ from the case with a contract, as the DUC partners with a contract must be expected to change their recovery rates so that profits would be as high as possible before the expiry of the licence in 2012.

In present value, the additional proceeds to the State from the contract will amount to approx. DKK 18 billion until 2012. In the period 2012-2042, the contract will also yield significant additional proceeds (approx. DKK 13 billion in present value), cf. Appendix 4.

The contract can also be assessed on the basis of historical figures. Appendix 4 contains a calculation of the additional proceeds that the State would have achieved if the contract had been concluded with effect from 2001 rather than 2004. These calculations are based on actual figures for production, profit, investments, taxes paid, etc. Calculations made in present values show that the State would have achieved additional proceeds of DKK 2.3 billion in 2001 and DKK 2.5 billion annually in 2002 and 2003 by entering into the contract with effect from 2001. This equals the results obtained when calculations are based on future figures.

In total, the different comparisons indicate that the size of the additional proceeds to the State with the new contract is fairly stable, both when the contract is tested against positive carryforwards of the State proceeds and actually realised data.

Moreover, a comparison can be made with the expected revenue in the 2004 Finance Bill. Compared with the 2004 Finance Bill, although based on other amounts and oil prices than the contract calculations, the additional proceeds will amount to DKK 3.3 billion in 2004. Provided that the revenue from corporate tax and hydrocarbon tax, etc. does not change in the budget forecasts of the 2004 Finance Bill, the State's additional proceeds will amount to almost the same in the period 2005-2007, cf. Table 6.

Table 6 – State proceeds under the contract compared with the 2004 Finance Bill

| DKK billion (2003 prices) | 2004 | Avg. 2005-2007 |
|---------------------------|------|----------------|
| Contract | 11.2 | 11.5 |
| 2004 Finance Bill | 7.9 | 7.9 |
| Difference | 3.3 | 3.5 |

The 2004 Finance Bill assumes a lower production and higher oil price than the contract calculations. Both assume almost the same dollar rate. From a calculation point of view it is assumed that the state proceeds from DUC will make up 93 per cent of the state revenue from all companies in the North Sea. The statement in the table is moreover based on payment year in line with the principles used in the Finance Bill.

Finally, sensitivity analyses in connection with changed assumptions concerning oil price, dollar rate and production have been conducted (see Table 7). According to the table, the state share of the values within the Sole Concession varies between the low and the high production scenario from 58 per cent to 62 per cent. A 20 per cent positive or negative change in the oil prices or the dollar rate will correspondingly cause the state share vary between 63 and 56 per cent.

Generally, the calculations indicate that the state proceeds and share of the profit may vary if assumptions change. This is due to the fact that the average tax rate increases concurrently with increasing profits due to the composed marginal income tax of 73 per cent laid down in the contract. In contrast to the present tax system based on an even higher official marginal tax rate, the contract establishes efficient and higher taxation. Unlike the present system, the new tax base will be far more stable due to the reduced deduction possibilities.

Table 7 – Sensitivity analyses of state proceeds (state share in parentheses)

| DKK billion (2003 prices) | 2004 | 2005 | 2006 | 2007 | 2008 | Annual avg. 2004- 2012 | 2004- 2012 | 2013- 2042 | 2004- 2042 |
|---|-------------------------------------|-------------|-------------|-------------|-------------|---------------------------------|---------------------------|---------------------|----------------------|
| | ----- DKK billion 2003 prices ----- | | | | | | DKK billion present value | | |
| 1. Contract for State (middle scenario*) | 9.8 | 11.9 | 11.4 | 11.9 | 11.8 | 10.6 (57%) | 80 (57%) | 54 (66%) | 133 (61%) |
| <i>Sensitivity to changed production</i> | | | | | | | | | |
| 2. As 1, but low production scenario | 9.8 | 11.9 | 11.5 | 11.3 | 10.6 | 9.6 (56%) | 73 (56%) | 25 (65%) | 98 (58%) |
| 3. As 1, but high production scenario | 9.8 | 11.9 | 11.2 | 11.9 | 11.6 | 11.4 (58%) | 85 (58%) | 80 (67%) | 165 (62%) |
| <i>Sensitivity to oil prices</i> | | | | | | | | | |
| 4. As 1, but oil price -20% (2004-10: 17.9 USD/barrel) | 6.2 | 7.9 | 7.5 | 8.0 | 8.0 | 7.1 (52%) | 53 (52%) | 40 (64%) | 93 (56%) |
| 5. As 1, but oil price -10% (2004-10: 20.1 USD/barrel) | 8.0 | 9.9 | 9.5 | 9.9 | 9.9 | 8.9 (55%) | 66 (55%) | 47 (65%) | 113 (59%) |
| 6. As 1, but oil price +10% (2004-10: 24.6 USD/barrel) | 11.6 | 13.9 | 13.4 | 13.9 | 13.7 | 12.4 (59%) | 93 (59%) | 61 (67%) | 154 (62%) |
| 7. As 1, but oil price +20% (2004-10: 26.8 USD/barrel) | 13.4 | 15.8 | 15.3 | 15.8 | 15.6 | 14.1 (61%) | 106 (61%) | 68 (67%) | 174 (63%) |

Note: A 10 per cent change in the dollar rate will have the same impact on the state proceeds as a 10 per cent change in the oil price. A 10 per cent higher dollar rate corresponds to a dollar rate of 7.65 (instead of 6.95). Historically, the oil price has fluctuated relatively more than the dollar rate.

*)State middle assumptions, e.g. oil price: 22.355 USD/barrel in 2004-10 and then gradually increasing to 36 USD/barrel in 2042 (2003 prices); dollar rate of 6.95; middle production scenario. At the beginning of October 2003, the oil price exceeded 27 USD/barrel.

Compared with the present rules, the contract generally establishes a more stable tax base, which will provide the State with a higher share of the values in the North Sea, regardless of whether the oil price is high or low, or whether it suddenly proves possible to recover far greater amounts from the North Sea than expected based on the information available today. Stability is particularly important, considering the fact that the production from the North Sea has developed far more positively than expected and considering the often drastic oil price fluctuations.

8. Conclusion

In the opinion of the Government, a good and solid contract has been made with A.P. Møller - Mærsk. In general, the contract offers clear improvements on the current rules. The Government finds that the additional proceeds should be spent on reducing public debt and thus increasing the future scope for action.

In connection with the implementation of the contract between the Minister for Economic and Business Affairs and A.P Møller - Mærsk, the Government will submit a draft resolution and the related draft legislation on amendments to the Hydrocarbon Tax Act and the Underground Act. The contract is intended to enter into force on 1 January 2004.

For the other companies with ongoing licences to explore and recover oil and gas in the Danish sector of the North Sea, the amended legislation will not imply changed conditions because the new terms will only apply to new licences. If other companies request changed terms in line with the contract, the Government would be willing to discuss this.

Appendix 1 - Present Danish legislative and financial framework of the activities in the North Sea

Legislative framework

The exploitation of Denmark's underground is regulated by the Underground Act, which contains provisions concerning the granting of licences for the exploration and recovery of hydrocarbons.

The specific terms of exploration and production are laid down in separate licences (concessions) granted by the State to the companies. As regards DUC, the terms are laid down in the Sole Concession of 8 July 1962 granted to A.P. Møller for a period of 50 years. The terms of the other companies are laid down in separate licences granted by the State in connection with the five calls for tenders that have been issued since 1984. Added to this are the licences granted in connection with the Open Door Procedure introduced in 1997.

A material difference between the Sole Concession and the recent licences is that the recent licences were granted through calls for tender where several companies competed for licences for exploration and recovery in a specific area. Moreover, other rules concerning taxation and state participation apply, cf. below.

The Sole Concession, which originally covered the entire Danish area, has been adjusted several times. The most comprehensive adjustment took place 1981 through a contract between A.P. Møller and the Danish Minister of Energy, which returned large areas to the State. The 1981 Contract was concluded on the basis of a political wish to intensify the activities in the North Sea.

As part of the establishment of the EU's internal energy market, the Concession Directive includes common rules as regards the conditions for granting licences for the exploration and production of hydrocarbons. The areas in the North Sea included in A.P. Møller - Mærsk's Sole Concession are, however, exempted from the tender requirements of the Concession Directive. This means that the State may grant a new licence to A.P. Møller - Mærsk or another operator before the end of 2012 without issuing a call for tenders for the areas included in the Sole Concession. A new licence would, in accordance with EU legislation, have to be granted on the basis of objective and non-discriminatory criteria.

Present taxation and state participation

State revenue from the oil and gas activities in the North Sea comes from five sources:

- Corporate tax
- Hydrocarbon tax
- Oil pipeline tax/compensatory fee
- Royalties (production fees)
- State participation

Corporate tax

Like all other companies, the companies in the North Sea pay a corporate tax of 30 per cent. The corporate tax is stated separately for the hydrocarbon activities in Denmark. This means that any deficits from other activities cannot be deducted before payment of corporate tax on hydrocarbon activities. In this respect, the rules differ somewhat from the usual rules concerning the calculation of

corporate tax according to which deficits from some activities may be set off against profits from others.

Hydrocarbon tax

Hydrocarbon tax is a special tax on income from hydrocarbon activities. The hydrocarbon tax was introduced in 1982 with the aim of taxing windfall profits, for example as a result of high oil prices.

Basically, the base of the hydrocarbon tax is the same as that of the corporate tax, though with three important exceptions. Firstly, the income is stated for each field, meaning that the deficit from one field cannot be set off against the profit from another field. Secondly, the corporate tax paid can be deducted. Thirdly, the companies receive a special hydrocarbon allowance of 25 per cent of their investments. The allowance is granted over ten years, i.e. a total of 250 per cent. The hydrocarbon tax is 70 per cent.

Owing to the hydrocarbon investment allowance, a company that invests DKK 1 billion annually will receive an allowance of DKK 2.5 billion over ten years, or DKK 250 million annually. The DKK 250 million will be deducted prior to calculation of the hydrocarbon tax. To this must be added ordinary depreciation on the investment. In total, the corporate and hydrocarbon tax allowances mean that an investment of 1 DKK releases a tax discount of more than DKK 2 (present value), if the investor should otherwise have paid hydrocarbon tax. For a more detailed analysis, please see “Rapport fra Kulbrinteskatteudvalget” (Report from the Hydrocarbon Tax Committee) by the Danish Ministry of Taxation 2001.

However, the Energy Authority must approve the companies’ work programmes after talks with the licensees.

Oil pipeline tariff and royalties

All oil producers must pay an oil pipeline tax/compensation fee of 5 per cent of the production value of oil after the deduction of transport costs. The pipeline tax rate payable by the DUC companies is laid down in the 1981 Contract between A.P. Møller and the Danish Minister of Energy. The other companies pay a tax in accordance with the provisions of the Oil Pipeline Act.

Under the terms of the Sole Concession, the DUC companies also pay royalties (production fees) of 8.5 per cent of the total value of the oil and gas production after the deduction of transport costs. As regards all other licences, except the very small Lulita Field, royalties are not payable.

The oil pipeline tax and royalties are deductible in the corporate and hydrocarbon tax base.

State participation

Since the first call for tenders in 1984, the Danish State has participated in all new licences, generally with a share of 20 per cent. The State does not participate in A.P. Møller - Mærsk’s Sole Concession.

Appendix 2 - Basis of profitability analyses of the A.P. Møller - Mærsk companies' activities in the Danish sector of the North Sea in the period 1962-2003

The Danish Ministry of Economic and Business Affairs has conducted profitability analyses of the annual cash flows of the A.P. Møller - Mærsk companies. The analyses of the average return for the period 1962-2003 is based on the cash flow stated in a report prepared by the Copenhagen Business School⁵ supplemented with information from the Danish Energy Agency for the years 2002 and 2003.

For 2003, a so-called terminal value is included in the cash flow. This terminal value is equal to the expected value of A. P. Møller - Mærsk's activities in the North Sea. Since this value is not known with certainty, this analysis also calculates the average return for different terminal values. The results of these calculations are found in the following table.

Average rate of return for the period 1962-2003 for different terminal values

| Assumed terminal value (DKK billion) | Expected average return for the period 1962-2003 |
|--------------------------------------|--|
| 0 | 16.2 per cent |
| 10 | 16.4 per cent |
| 14.4 | 16.6 per cent |
| 30 | 16.9 per cent |
| 45 | 17.2 per cent |
| 60 | 17.4 per cent |
| 100 | 18.0 per cent |

Note: The returns are nominal.

Accordingly, the average return of 16 per cent for the period 1962-2003 is specified for a terminal value ranging between DKK 0 to 10 billion.

The 16 per cent return represents the average nominal return achieved by A. P. Møller - Mærsk after tax in the period 1962-2003. This 16 per cent return can be divided into a so-called risk-free return and a risk premium. A risk-free return is a return that is known beforehand when a contract is entered into. An example of risk-free return would be the return on a government bond. A risk premium is a target for the additional return achieved as compensation for the risk imposed on an investor for making a specific investment.

For the period 1962-2003, calculations show that the average risk premium of A. P. Møller - Mærsk was in the range of 5-9 per cent, depending on whether long-term or short-term interest rates are used⁶.

⁵ "Rentabilitetsanalyse af A.P. Møller-selskaberne I den danske del af Nordsøen i perioden 1962-2001" (Profitability analyses of the A.P. Møller companies in the Danish sector of the North Sea in the period 1962-2001), Copenhagen Business School, 2003.

⁶ The average risk-free interest rates have accordingly implicitly fluctuated between 7 and 11 per cent for short-term and long-term interest rates.

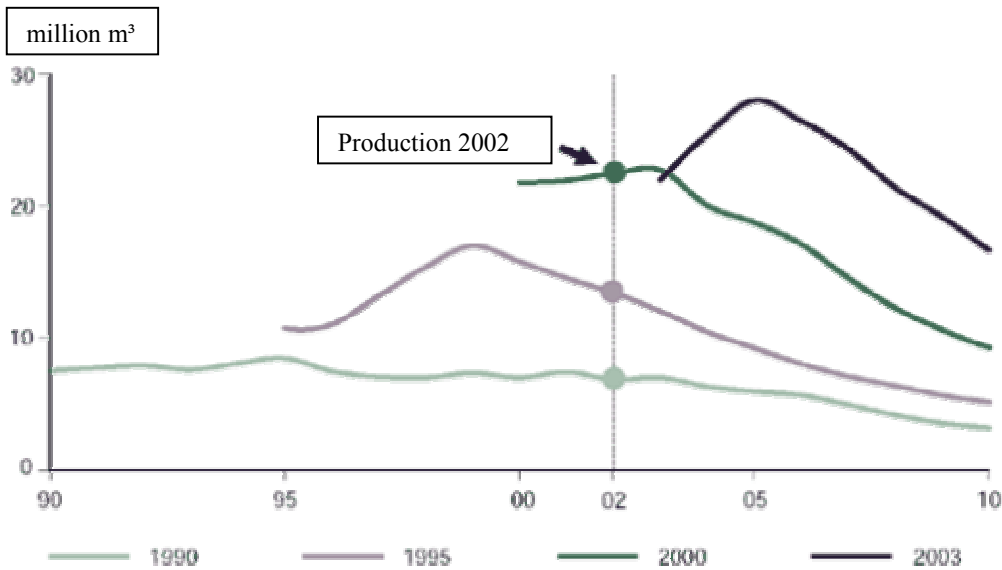
Appendix 3 – Reserves and production forecast

Every year, the Danish Energy Authority calculates the Danish oil and gas reserves and prepares production forecasts on the basis of these calculations. The reserves reflect the amounts of oil and gas that can be recovered by means of known technology from proven accumulations. This definition implies that the reserves may grow because either new accumulations are discovered or new technology is developed which make recovery more efficient. In recent years, Denmark has benefited from both new discoveries and technological development. This positive trend is expected to continue in the next few years.

To illustrate how the reserves and the related production forecasts have grown over the years, the following figure shows the production forecasts for 1990, 1995, 2000 and 2003. The 1990 forecast estimated the 2002 oil production to be 6.8 million m³. The production in 2002 was 21.5 million m³. This means that the actual production was almost three times greater than the estimate from 1990. The 1995 forecast estimated the 2002 oil production to be 13.2 million m³, i.e. 2/3 of the actual production in 2002.

The progress from 1990 to 1995 is attributable to technological development, whereas new discoveries accounted for most of the progress from 1995 to 2000.

Figure 4 – Forecasts for the period 1990-2010



Appendix 4 - Estimated impact on proceeds if the contract had been concluded in 2001

The following shows what a completely identical contract, only valid for a longer period, would have raised if it had been concluded in 2001. This is a hypothetical calculation that disregards the other party's willingness to pay.

The calculation is based on the following assumptions:

- Historical oil prices, dollar rates, production, investments, tax-related accounting figures for 2001 and 2002.
- For 2003, the oil price is estimated at 25 USD/barrel and the dollar rate is at 6.95 DKK/USD.
- From 2004 and onwards, the calculation is based on the oil price of 22.35 USD/barrel forecast by IEA with annual real growth of 0.426 USD/barrel from 2011-2042. The dollar rate is assumed to be 6.95 DKK/USD in each of the following years.
- The current rules are laid down on the basis of a forecast for the total oil production of approx. 302 million m³ for the period 2004-42 with an operator change in 2012. The contract is based on an oil production forecast of approx. 357 million m³ for the same period. The oil production in 2001-03 makes up approx. 52 million m³.

If the contract had been entered into in 2001 rather than 2004, the State would, with great uncertainty and on the basis of the above assumptions, probably have been able to obtain additional proceeds of approx. DKK 10 billion in the period 2001-42. Table 8 provides an overview of the State's total revenue according to the current rules and estimated additional proceeds by concluding the contract in 2001 and 2004, respectively.

Table 8 - State revenue according to current rules and additional proceeds with contract concluded in 2001 and 2004 (DKK billion in present value)

| Year | Current rules | Contract | |
|-----------|---------------------|---|---|
| | Total state revenue | Additional proceeds at conclusion of contract in 2001 | Additional proceeds at conclusion of contract in 2004 |
| 2001-2003 | 25.3 | 7.3 | 0 |
| 2004-2012 | 62.0 | 19.7 | 17.7 |
| 2013-2042 | 40.4 | 14.3 | 13.3 |

Note: According to the current rules, an operator change will take place in 2012. The amounts are stated in present value, i.e. all are discounted with 6 per cent p.a. An amount with a present value of, for example, DKK 2.0 billion will in 2016 become a paid amount of DKK 4.3 billion in current prices.

It should be noted that the additional proceeds are calculated in relation to the current rules yielding hydrocarbon tax. Whether this is at all realistic is very uncertain due to the large hydrocarbon allowances, etc.

It is also important to note that, for the period 2001-03, figures representing historical transactions have been used in connection with investments and taxes, i.e. changes in behaviour that conclusion of the contract in 2001 might have entailed are not taken into account.

Moreover, bringing forward the conclusion of the contract would not only have affected the period 2001-03, but also the proceeds for the following years with an additional total of approx. DKK 3 billion due to the drastically reduced hydrocarbon allowances and the transitional rules concerning field deficits.

In summary, if the contract had been entered into in 2001 rather than 2004, the State would have achieved additional proceeds of approx. DKK 10 billion (present value) for the period 2001-42. According to estimates, these additional proceeds would have been obtained as follows: Approx. DKK 7.5 billion in the period 2001-03, approx. DKK 2 billion in the period 2004-12 and approx. DKK 1 billion in the years immediately following 2012.