

The Oil and Gas Industry in the Netherlands 2007

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Argos Group B.V.
Hoefsmidstraat 40
3194 AA Rotterdam
P.O. Box 129
3190 AC Rotterdam
The Netherlands

Telephone: +31 - (0)10 - 295 47 70
Telefax: +31 - (0)10 - 295 47 71
E-mail: groep@argos.nl
Internet: www.argos.nl

The Dutch Way

The scene on- and offshore the Netherlands is changing, exposing opportunities that remain in the E&P sector.

It is typical of the Dutch to remain so quiet and modest that it is often forgotten that the Netherlands is a major energy-producing country. Its diminutive size and no-nonsense approach rarely make waves, but Holland is Europe's second-largest producer of natural gas and the ninth-largest in the world with estimated reserves of between 50- and 60 trillion cubic feet. The country contributes 30% of the European Union's total gas production.

Despite the term "Dutch disease" being coined to illustrate the potential damage a bonanza of natural resources can have on a healthy economy, reflecting the situation in Holland in the 1960s, today Holland is, as it almost always was, a healthy and open economy, outperforming its neighbors and leading the way in terms of economic reform.

The bonanza began with the discovery of gas onshore in 1959 at Groningen Field, the biggest in the world at the time, estimated to contain 3 trillion cubic meters of gas. NAM (the Dutch petroleum company) was, as its name suggests, actually drilling for oil and disappointed to find gas. Nevertheless, the advent of the popularity of gas has consoled it and made for many very profitable years of exploitation of the massive field—a partnership of the Dutch government, Royal Dutch Shell and ExxonMobil.

Gas has become the most important mineral fuel produced in the Netherlands. Oil reserves are very small, estimated at between 100- and 200 million barrels. Both onshore and offshore gas has been easily accessible and is found at low depths, encouraging 20 years of extensive activity which began to slow in the 1990s. Net finding costs are considerably lower than international averages: US\$0.50 per barrel of oil equivalent (BOE) on the Dutch Shelf.

And, low lifting costs hover at around US\$6 per BOE. A dense grid of pipelines and platforms has been built and the Small Field Policy has ensured that, despite the abundance of gas in Groningen Field, marginal fields were developed, while Groningen has been used to effectively guarantee a consistent supply.

Today exploration activity has slowed again, but major potential remains. More than 70 discoveries, adding 1.6 billion BOE to Holland's reserves, have been made during the past decade. The availability of an extensive infrastructure allows for short lead times and considerable cost savings, while generous off-take terms mean investments can be quickly recouped.

Nevertheless, the infrastructure is aging and within 20 years the majority of it must be retired. Thus, the Dutch are keen to ensure that the exploitation of marginal fields is undertaken before this window of opportunity closes. The majors, which formerly dominated the Dutch scene, must make way for nimbler independents. This report will look at the changing scene on- and offshore the Netherlands and expose opportunities that remain.

The Dutch service sector is flourishing, meanwhile, with about 400 companies involved in supplying goods and services to the hydrocarbons industry, between them employing just over 20,000

This special report was prepared by London-based Global Business Reports. The authors are Nicholas de Weydenthal and Bilge Cuhadar. More information on the firm is available at GBReports.com. Cover photos courtesy Keppel Verolme

Useful Contacts

- The Ministry of Economic Affairs, Directorate for Energy and Telecoms
Phone: +31 703798911
www.minez.nl
- The Netherlands Oil and Gas Exploration and Producers Association (NOGEPa)
Phone: +31 703478871
www.nogepa.nl
- Association of Dutch Suppliers in the Oil and Gas Industry
Phone: +31 793411981
www.iro.nl

people. Many of these companies are world-class and 70% of the business of Dutch oil and gas suppliers is generated through exports, with the U.K. and Norway as main markets but also a considerable presence in more exotic locations, such as Kazakhstan.

2006 has been a bumper year for Dutch service companies and prospects for 2007 are even better. A high oil price and companies looking further and further afield to exploit reserves require evermore intricate solutions and Dutch service companies are among the world's most innovative. A recent wave of mergers, joint ventures and partnerships has broadened their scope. This report will analyze their potential.

The business environment and legal framework found in Holland are excellent, to the extent that the Netherlands often plays an important role in the holding structure of international energy groups due to an attractive holding regime and extensive treaty network. Its internal energy market has been completely liberalized since 2003 in accordance with EU regulations.

E&P both on- and offshore has been carefully guided by the state to ensure the best possible use of the country's reserves and adequate incentives are provided to encourage sustainable and reliable exploitation by companies involved. The government is currently keen to attract smaller, more flexible players to ensure that remaining small pockets of gas are not overlooked while infrastructure is still in place.

As yet, there is no equivalent to the fallow-field initiative as is found in the U.K. However, this is expected to change as the Dutch government encourages the majors to make room for smaller fish by vacating fields in their portfolios that they are not exploiting. This study examines the legal environment and assesses remaining opportunities for oil and gas in Holland.

With an ever-growing demand in Europe for natural gas, Holland is determined to become an energy hub for northwestern Europe, using not only its significant remaining gas reserves, but the country's unparalleled refining capacity, its the world-class Rotterdam port (where LNG terminals are under construction) and its geographical position within the EU. This position offers the Netherlands vast potential to profit from harmonization of EU-wide gas infrastructure under way, and thus benefit from economies of scale currently not available in the small country.

But perhaps its single-most important asset is the basic Dutch good sense and the experience that the Dutch have gathered during the past 50 years in the energy industry. While reserves on- and offshore will decline, with applied Dutch resourcefulness, the industry may not. □

To the Last Drop

Holland has been dominated by the majors, but as fields become depleted, they're moving on, setting the stage for smaller independents to take over.

Despite being the No. 2 gas producer in Europe, the Netherlands does not display the same opulence equated with small nations of the Persian Gulf. The Dutch are reputed for their frugality, and the management of their oil and gas reserves exemplifies that.

Gas production in the Netherlands began with a bang—in 1959, oil prospectors for NAM (the Dutch petroleum company) hit the onshore Groningen gas field, which was then believed to be the largest in the world. This field alone contains two-thirds of the Netherlands' proven reserves. While being a bit put out to discover gas, rather than oil, in time, NAM and its partners, Royal Dutch Shell and ExxonMobil, have learned to appreciate their discovery just as Europe's energy consumers have learned to appreciate the clean and efficient fuel that is gas.

The "Small Fields Policy" was introduced by the Dutch government in 1973 to ensure that exploration activities were carried out both on- and offshore, despite the huge reserves that were discovered at Groningen, and also ensuring that the latter was not too rapidly depleted. Groningen has acted as a "swing" producer, balancing supply and demand and thus ensuring a consistent supply of gas and its homogenous quality. The Small Fields Policy's incentives included a guaranteed take-off for gas at a good price from Gasterra, the state-owned (again, with Royal Dutch Shell and ExxonMobil) gas-trading and -distribution company.

This sent the majors scouring the Dutch Continental Shelf (NLCS) for further discoveries and more than 200 small fields are currently operational. A huge grid of pipelines and platforms was installed and a sophisticated service sector sprang up along the Dutch coast. The Netherlands' oil and gas boom was well under way and production attained annual levels at around 2.8 trillion cubic feet (Tcf) through much of the 1970s and 1980s.

Today, though in a mature phase, Dutch fields continue to produce around 2.6 Tcf of gas per year, about two-thirds of which are produced onshore (mainly from Groningen). This represents a decline from a peak of 3.5 Tcf in 1976, but nevertheless, careful management means NAM estimates these production rates can be maintained for another 25 years. However, much of this will depend on the current restructuring the sector is experiencing.

For the past 40 years E&P both on- and offshore Holland has been dominated by the majors, with NAM and its partners at the forefront and BP Plc and Total SA also active. But as fields become depleted, their appetite for the Dutch Continental Shelf is waning as they concentrate on more bountiful reserves elsewhere in the world. This should set the stage for smaller independents to take over, and this is precisely what the Dutch government would like to see happening. Yet this is not taking place as fast as it would like.

New discoveries are becoming rarer and estimates of Holland's gas reserves are now shrinking. Only seven offshore wells were drilled in 2003, compared with an annual average of 13 during 1998-2002. In the past, reserve reductions from production were offset by discoveries of new resources. This is no longer the case. Gas production from marginal fields therefore looks set to fall.

Nevertheless, Total's Total E&P Nederland, the No. 2 producer after NAM, remains committed to the area if the right environment can be established. Christian Guerrite, managing

director of the Total unit, is eager "to see some incentives to improve the mining climate for very difficult and very marginal projects via the oil and gas taxation environment to facilitate the development of our projects."

As only a part of Total's global portfolio, operations in the Netherlands are often overlooked in favor of other areas of the globe with more favorable environments. This complaint is a constant refrain from many upstream players in the Netherlands. Compared with other markets, and the U.K. in particular, the environment is just not friendly enough and this is hindering the immediate development of marginal reserves, E&P executives say.

This problem is offset to some extent by advantages. Most noticeable is pre-existing infrastructure. Drilling extended-reach wells from an existing platform can render otherwise uneconomical reserves viable, something in which Total has great experience. Guerrite explains, "If you discover a gas field in the Netherlands with 35 billion cubic feet of reserves, you are happy. But to be able to produce this gas efficiently and economically, it is very useful to have existing installations in the neighborhood.

"On a stand-alone basis, the economies would be too low to validate it, even at the high levels of gas prices that we are currently experiencing."

Rob Atsma, chairman of Energie Beheer Nederland (EBN), agrees, "Existing infrastructure can be used to develop smaller fields not viable to develop on a stand-alone basis and thus can prolong the lifetime of existing fields."

EBN is an independent E&P company owned entirely by the Dutch government and established to represent its interest in mining ventures. In order to lower the financial threshold that exploration activities represent, particularly offshore, would-be prospectors partner with EBN, which covers up to 40% of E&P costs in return for the same share of eventual revenue. EBN also brings its knowledge and resources to the partnership. Such co-operation can greatly facilitate the entry of smaller-size players to the Dutch market.

Yet the majors remain less inclined to squeeze out the last drop, with or without the help of EBN. BP, after more than 40 years in the Netherlands, is in the process of divesting its assets in the area. Many see this as a positive move as opposed to companies (and NAM, in particular) that sit on their assets waiting for such a time that they may become viable.

This attitude frustrates those eager to take advantage of the window of opportunity that the current aging operating infrastructure affords and it will be closed once this is largely retired from service 10 to 20 years from now. The lack of a formal fallow-field initiative equivalent to that in practice in the U.K. North Sea is also much-lamented, E&P players comment, particularly among the mid-tier players in whose hands the future of Dutch gas E&P activity depends.

John Gerstenlauer, managing director of Wintershall, says, "Why are people just sitting on their blocks and not doing any work on them?"

There is a need for the likes of NAM and Total to let go of many of their offshore assets or the government to somehow encourage them to do so. Wintershall is an aggressive player in Dutch waters, noticing that discovery rates are significantly higher than the industry average, and is looking to increase its

oil and gas production 50% within this decade. Thus, the company is constantly investing in developing new discoveries and extending the life or scope of existing fields.

During the past five years, Wintershall has invested around EU\$350 million in this part of the North Sea. In 2002, it acquired Clyde Netherlands, thus doubling its reserves and production base in the Netherlands and becoming the third-largest gas producer in the country, oper-

has found more oil and gas accumulations in the vicinity.

Placing a multilateral horizontal well between the oil/water and gas/water contacts is key to the development of this reservoir. Hustoft says Petro-Canada has a strategy to grow in concentric circles from De Ruyter Field, on the basis of this knowledge. He forecasts a production lifetime of approximately six to eight years.

With concentric growth, the De Ruyter platform would consequently turn

new acreage, but the mining climate needs to be more attractive.”

Nevertheless certain facts remain that explain the presence on the Dutch Continental Shelf of the likes of Treffers. Overheads are relatively low, though gradually increasing as prospectors are forced further offshore, upstream companies can count on an excellent infrastructure and world-class service providers, the political regime is stable, and operations are close to one of the world's largest markets.



Big Lift's Happy Buccaneer and Jumbo Fair Partners' Seaway Polar, Acergy, are receiving crane maintenance and upgrades by Huisman-Itrac at Wilton harbor, Schiedam, the Netherlands.

ating 25 offshore platforms.

In 2005, it took part in five completed appraisal wells and five production wells. This year alone, Wintershall intends to drill another 12 on the Dutch Continental Shelf.

Petro-Canada is also welcomed new blood to the shelf, taking over Hanze Field in 2002 and restarting De Ruyter Field in 2006, adding 28 billion barrels equivalent of reserves to the Dutch sector. Looking for gas but finding oil was a big surprise for Petro-Canada. Development studies were stopped in 1999, when oil prices were at a record low. At that point, De Ruyter was viewed as sub-economic and remained inactive until Petro-Canada took the reins following its acquisition of Veba.

Reidar Hustoft, Petro-Canada's country manager, saw this as a marginal project, with an oil price at the time of US\$20 to US\$30, but was still confident about its development. With constant evaluation, mapping and 3-D surveys, the operator

into a processing hub. Petro-Canada thought ahead and left space to tie in future risers, with five spare well slots in addition to the three in use.

Nevertheless, these examples fail to buck the trend and not enough new players are prepared to join the fray. U.S.-based ATP Oil & Gas Corp. is typical of many as they wait expectantly for the government to force the incumbent majors to free reserves. Rob Happe, ATP general manager, expects, "As soon as commodity prices come down, the operators will leave, opening the door for ATP."

Tax legislation is also to blame, especially following the revocation of the "Depreciation at Will" law, which had allowed considerable tax breaks on investments. Jan Treffers, president and general manager of Gaz de France Production Nederland, one of the most dynamic companies active on the Dutch shelf, says, "There are still undiscovered oil and gas reserves and we are willing to work on

Opportunities abound in areas such as underground gas storage and there is no doubt that fallow fields will soon become available, and at a good price. There is a lot, however, that the government could do to increase E&P activity, even though such measures are unlikely to be sufficient to buck the trend of depleting reserves.

The above-mentioned need for a fallow-field policy is certainly an area to be improved, legal red tape needs to be cut and applications processes for new plots shortened. Also, many would like to see environmental standards, particularly onshore, relaxed.

At this transitional moment, much remains unclear. However, expect the uncertainty to be addressed in a typically no-nonsense Dutch manner and, despite the fears of many, it is very unlikely that the thrifty Dutch will not eventually concede sufficient incentives to E&P companies so that their valuable energy resources are effectively mined down to the very last drop. □

Dutch Engineering

The Netherlands boasts a complete array of world-class suppliers and services to the oil and gas industry, and aims to further expand its position.

Living in a small country, much of which is made up of land reclaimed from the sea, the Dutch certainly know how to make the best use of what they have. Dutch oil and gas service companies have demonstrated such resourcefulness for many years, operating in small and marginal fields, encouraged by the Small Fields Policy adopted by the Dutch government.

The Netherlands boasts a complete array of world-class suppliers and services to the oil and gas industry, and the town of Den Helder, having prevailed over the local competition IJmuiden, now rivals both Aberdeen in Scotland and Stavanger in Norway as an “offshore capital” for the North Sea hydrocarbons industry. Rotterdam’s port and naval construction facilities are unrivaled anywhere in Europe.

With decades of experience in engineering, solid finances, a healthy no-nonsense approach to business, and an extensive track record for innovation, Dutch firms make excellent partners, whether refitting a tug in the dry docks of Rotterdam or supplying a rig in the South China Sea.

One of the most significant advantages the Dutch deploy is a

skill for realizing low-cost solutions that suit both the marginal fields of the Dutch Continental Shelf and the thrifty instincts of the people. Balance Point Control (BPC) has developed its BPD 300, which exemplifies such an approach. Combining the best features of a hydraulic workover unit and a conventional rig, the newly patented BPD 300 reduces mud costs, clean-up costs and well downtime.

The data acquisition system of the BPD 300 will also reduce the number of people involved in high-risk areas of the equipment. Every part of the system is designed to be container-friendly, which means moving it will take about four to five days, whereas moving an ordinary rig can take up to 10 days. Bert Platje, BPC general manager, believes, “This system will help new entrants coming into marginal markets, such as the North Sea, where there are many opportunities, in terms of the still recoverable reserves in place.”

In a similar vein, combining cost-effectiveness and safety, Pascal Ferier, general manager at KCI Oil and Gas Engineers (part of Wood Group), boasts the advantages offered by its de-



The BBL pipeline is being built between the Netherlands and the U.K. (Photo courtesy of Gasunie.)

sign for self-installing platforms. "Conventional platforms with jackets and topsides cost millions to install and are just not feasible for marginal-field developments, such as in the North Sea," he says.

"Self-installing solutions are much more convenient. For transportation, self-installing platforms need only three or four tugboats and no heavy-lift vessels. The beauty comes after three to five years: When you are finished at one location, you do a reverse installation and move to another location."

Keesjan Cordia, managing director of Workfox, which manages and operates accommodation and multi-support vessels, points out that most of the existing platforms in the North Sea are more than 30 years old and so far only 50% have undergone maintenance. Effective maintenance and optimizing rigs for maximum utilization have become significant issues.

Workfox has been awarded long-term contracts with majors such as Royal Dutch Shell and Total SA for its innovative Seafox, a multi-purpose supply vessel that also includes accommodation units. Workfox is now working on *Seafox 5*, a first-in-the-world multi-purpose unit able to provide accommodation and regular maintenance, as well as light drilling, which will be the most efficient and cost-effective unit in the North Sea, Cordia says. Workfox is currently looking outside of the Netherlands for another small company in the same line of business to partner with.

Cutting costs while still abiding by some of the most stringent safety procedures worldwide that are applied in the North Sea and even stricter environmental regulations when operating onshore are characteristic of Dutch know-how.

Partnerships

The level-headed Dutch attitude towards business has opened the door to many partnerships that have allowed smaller service providers to club together and offer total solutions or simply benefit from synergies that can both reduce costs and improve performance.

Joep Athmer, director of offshore at Van Oord Offshore, says, "Partnering means to facilitate a proactive approach to problem solving as a project team rather than adopting a reactive, adversarial approach commonly associated with the more traditional forms of contract."

Together with the Environment Agency and Halcrow Group Ltd., Van Oord has been a partner in procurement, design and construction. "Partnering has helped create a win-win situation whereby the contractor is allowed to make a reasonable return and the client benefits from an enhanced solution."

Van Oord is known the world over for being the world's largest dredging contractor. Having completed ultra-prestigious projects in Dubai, such as Palm Jumeirah, and across the globe, and able



World Wide Managers for offshore accommodation and construction vessels

Workfox is the leading management company for Accommodation/ support Jack-up Operators in the world. In addition to providing temporary accommodation, catering and housekeeping services for hook-up and maintenance activities, the managed fleet is able to support the following operations:

- Platform breakdown repair
- Platform installation and abandonment
- Structural inspection
- Electrical power supply
- Pipeline inspection/maintenance
- Well testing
- Well workover/hydraulic workover/snubbing
- Well intervention (coiled tubing/stimulation/slickline)
- Well data acquisition (electric wireline)
- Diving/ROV operations
- Shallow water drilling
- Conductor pile driving
- Single pile platform installation
- Offshore wind turbine installation

Workfox operates from bases in both the United Kingdom and the Netherlands and has an experienced and dedicated organisational structure that includes:

- General management
- Operations
- Engineering
- Safety management
- Quality management
- Logistics and purchasing



The Netherlands

Workfox BV, P O Box 783, 2130 AT Hoofddorp, The Netherlands
 Tel: +31 (0) 23 556 3131 Fax: +31 (0) 23 556 3135 E-mail: info@workfox.com

United Kingdom

Workfox UK Limited, James Watt Close, Gapton Hall Industrial Estate
 Great Yarmouth, Norfolk, NR31 0NX, United Kingdom
 Tel: +44 (0) 1493 440711 Fax: +44 (0) 1493 655513 E-mail: sdm@workfox.co.uk

Website: www.workfox.com

to boast of winning the biggest contract awarded to a single contractor (EU\$2.5 billion), Van Oord is also making noise offshore, working on a project for ExxonMobil in Sakhalin where it has been trenching and laying pipes in shallow waters.

Besides being the market leader in shallow-water pipe-laying, Van Oord wants to push its deepwater rock-dumping agenda as well as establish a wider presence in the Gulf of Mexico.

Bob Rietveld and Jeroen Lusthof offered more of the same spirit of camaraderie when they pooled together more than 25 years of experience in harsh environments to found Vlaardingen-based Sea of Solutions five years ago. Working on the next generation of double-deck multi-purpose pipe-laying vessels, they have since joined forces with IMT Marine Consultants from the UK and Dutch WorldWide Marine to create Offshore Ship Designers. They will now be able to provide the whole range of vessels, from tugs and supply ships to maintenance and drilling vessels.

According to Rietveld, demand is so high at the moment that he is trying to find a new way to put vessels into the market on a regular basis without suffering from long lead times and rejecting new orders. Flexibility is key and the merger could provide it.

Partner par excellence in the Netherlands must be Phil Burgess, chief executive officer of Talburg Oil and Gas Consultants. Recently, Talburg joined forces with Single Source Multiple Solutions (SSMS-Group) to create synergies and share expertise between the North Sea and the Middle East. Burgess has pooled together a group of companies from the Netherlands, the U.K. and Italy to start epicONE. The group includes an engineering firm, a fabricator, a subsea constructor, a marine installer, and a project manager to bring low-cost solutions to clients.

"With this unique concept of independent companies, the risk is substantially lowered and overheads are significantly reduced," Burgess says. The members complement each other and have already started doing conceptual studies for independent E&P companies as well as for BP Plc in the North Sea.

The business environment in the Netherlands is such that the Dutch have bucked the trend of manufacturing processes moving east by enticing Singapore-based Keppel Offshore and Marine to the Netherlands via the 2002 acquisition of the historic Verolme shipyard, which spans more than 54 hectares in Rotterdam and is said to be Europe's largest. This is despite high labor costs. The company now repairs and converts some of the world's largest semisubmersibles there.

In the summer of 2006, two of the world's more novel floating production platforms arrived in Rotterdam for modification work. First to arrive was the Sevan Stabilised Platform SSP *Piranema*, which has been contracted to work for Petrobras under an 11-year charter, starting in late 2006. Keppel Verolme performed the outfitting work. The second to arrive was Petro-Canada's *Terra Nova* FPSO.

The yard's strategic location, facilities, experience, resource availability, project management and safety track record all were factors in the contract award. Harold Linssen, managing director at Keppel Verolme, claims that creative flexibility within the whole Keppel group has been able to keep the "company ahead of its competitors."

Foreign companies are made very welcome in the Netherlands, whether they choose to operate via an agent, set up a joint venture or aim at an acquisition. Halliburton partnered in 1976 with a major Dutch construction company to form Cebo International, a provider of infrastructure in the form of minerals, cement and bentonite for the drilling industry in the North Sea.

"Being half-American as a company has helped open doors," says Paul Schouten, managing director, and, "brings opportunities to move internationally." Last month Greek company S&B Industrial Minerals acquired 50% of the company from its Dutch owners while Halliburton has maintained its half-share.

To diversify geographically is on the agenda of many Dutch companies. Some 70% of Dutch service-company business is generated outside the Netherlands. Their engineering prowess, sensitivity to cost and business acumen make Dutch companies



Marcel P. Kramer, chairman and CEO, NV Nederlandse Gasunie

partners of choice in any environment.

Sander Posthumus, marketing manager of Badotherm, a top-quality process instrumentation manufacturer, underlines the potential. "We want to capitalize globally on the excellent contacts we have here in the Netherlands in regards to the oil and gas industry. Clients like Shell require a number of suppliers that can deliver globally with the same quality, same prices, and want to work with someone they can really rely and build on. That is how we can help them."

For the benefit of the North American market Badotherm is currently opening a joint venture in the U.S.

Opportunities galore

2006 was a fabulous year for the oil and gas supply and service industry worldwide, and the majority of those commenting reckon any supplier not busy now must be doing something seriously wrong. All expect 2007 to be another great year. As international E&P companies continue to divest noncore operations, opportunities for experts in an array of services abound.

This trend has not yet caught up with non-major operators in the North Sea, such as Wintershall and Gaz de France, which prefer to keep the expertise in-house. Meanwhile, majors like Royal Dutch Shell may choose to subcontract, depending on the project.

PanTerra Geoconsultants, based near Amsterdam, is looking beyond the North Sea at places like the Middle East, the Caspian or Siberia where it can offer a new layer of services and higher-level work, which would give the company the ability to do fully integrated projects. Greg van de Bilt, managing director, says he plans to take on some of the operators' work, since he trusts that with PanTerra's specialization and knowledge base it has better techniques to improve well performance.

Such is current demand, spurred by high oil prices, that one of the major concerns is shortages of equipment. Demand for tugs, for example, simply cannot be met. All the shipyards constructing tugs are fully booked and there is a three- to 3.5-year waiting time.

Fairmount Marine, a Dutch specialist in ocean towage and the transportation of heavy lifts across the globe, has few competitors on a worldwide scale. The company wisely invested in a new fleet before oil prices went up. Henk van den Berg, president of Fairmount, says, "We are completely booked out, but we are planning possible acquisitions of vessels for the future." Fair-

***“If the plans currently being discussed materialize, then LNG in Holland could certainly become a very sizeable business.*”**

mount is strengthening its position at the top of the heavy-lift transportation market through strategic partnerships with the likes of Fukada Salvage, Semco and Louis Dreyfus Armateurs.

With such a broad and international scope, the gradual depletion of Dutch hydrocarbon reserves need not sound the death toll for the Dutch oil and gas sector. New and grand opportunities herald. One such is liquefied natural gas (LNG). The construction of three LNG terminals (two in Rotterdam, one in Emmshaven) is currently being discussed, with associated storage facilities underground. The aim is not merely to supply the regional market, but to develop the Netherlands as an international hub for LNG, including the possibility of supplying the North American market.

Local companies grasp this opportunity. Gutteling, a manufacturer of com-

posite hoses, has just invented and certified the first ship-to-ship composite hose for the transfer of LNG at the request of American client Exmar, which owns liquefied petroleum gas (LPG) and LNG ships. Peter Gutteling, the managing director, believes LNG is the future. If the plans currently being discussed materialize, then LNG in Holland could certainly become a very sizeable business.

Even greater in scale are possibilities for the Netherlands to become the hub of a pan-European Union gas network that is gradually emerging as EU members pass measures to liberalize their energy markets. A memo of understanding signed between Gasunie, the company that owns the Dutch gas transmission network, and Gazprom, the Russian giant, October 5, 2006, hints at the Dutch ambition. With a completely liberated energy sector since 2003, excellent facilities, and years of ex-

pertise in gas marketing, the Dutch are Gazprom's logical partners.

Marcel Kramer, chairman of the executive board and chief executive officer of Gasunie, says, “We have a tradition of being at the crossroads of Northwest Europe and we have a tradition of fulfilling our role towards other markets.” As the European Union gradually harmonizes its gas-distribution network, the opportunities are huge.

Meanwhile the Dutch are busy preparing to convert depleted gas fields into vast underground gas-storage facilities in anticipation of the pivotal role they expect to play.

Biofuels are not being ignored either as the Dutch prepare for the future. Argos Oil, which started as a fuel wholesaler 22 years ago, has developed into a multilateral energy provider. Present in business segments that include bunkering, logistics, storage, wholesale and retail, Argos is now looking at biofuels and is the Netherlands' leading biofuels producer.

Its plans are pan-European as Peter Goedvolk, managing director at Argos, explains. “We want to be a versatile energy supplier with ambitions of becoming a mini-major one day present throughout Europe.”

Coming from a land that has literally pushed back the sea, Dutch resourcefulness and ambition can go a long way. □



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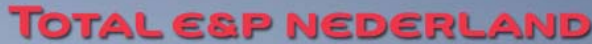
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in the Netherlands**



The Dutch Fiscal Regime

The depreciation-at-will incentive to develop Dutch oil and gas resources has been rescinded, but new policy is likely to be developed in its place to encourage activity.

The Dutch government has for years encouraged the production of natural gas from its North Sea continental shelf. It has been doing this through the Small Fields Policy, aimed at conserving the reserves in the huge Groningen gas field, which was discovered in 1959, and maximizing offshore gas production from marginal fields.

The benefits of this policy consist not only in the increased volume of gas produced offshore, but also in prolonging the capability of Groningen Field to act as a swing producer. Another key component of the policy is the guaranteed off-take of offshore gas by Gasterra (formerly Gasunie Trade and Supply).

Since the early 1990s, however, a declining pattern in exploration activity has been observed, while the annual production rates have stabilized. In response to these developments, the Dutch government has taken several measures to improve conditions for the gas industry. Most significant was the introduction of depreciation-at-will (DAW) in 1995. This measure gave gas firms the opportunity to postpone tax payments, raising the profitability of investment projects. The Dutch government abolished this fiscal facility when revising its tax plan in 2003.

A fierce debate ensued. It is important to note the tax and fiscal regime present in the Netherlands to subsequently under-

stand the position of the government. In theory, two factors determine the design of tax systems regarding mining activities: the existence of economic rents due to natural circumstances and the presence of market failure. The former explains why mining activities should be taxed relatively strongly, while the latter could account for higher or lower levels of taxation.

Economic rents generated by the mining industry follow mainly from the scarcity of its resources and partly from the costs involved in their extraction. These rents belong to the owner of the resources, in this case, the state. To receive these, the resources must be discovered and exploited.

If private firms execute these activities, they require compensation for their costs and remuneration for the risks undertaken. This implies that taxation of the resource rents must, on the one hand, leave sufficient incentives for private firms to engage in E&P and, on the other hand, recuperate an appropriate part of the rents to the state.

In general, profits from oil and gas production are subject to three types of fiscal charges: royalty, corporate income tax and petroleum taxes. Most European countries, including the Netherlands, Norway and the U.K., have a concessionary system. In such a system, private firms have exclusive rights to ex-

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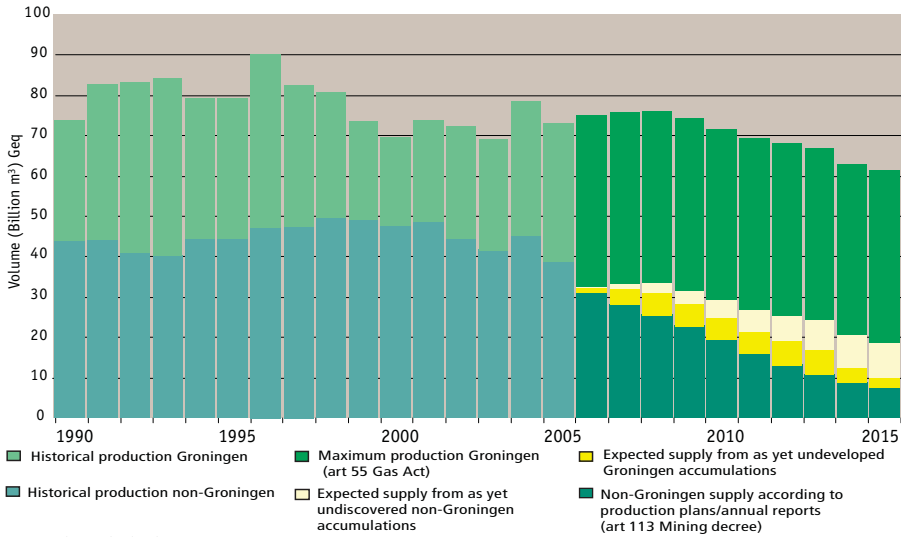
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Gas-Production Forecast, Netherlands



Source: The Netherlands O&G E&P Association

Production declines from existing fields and producers' few plans for finding and developing new sources of gas have the Netherlands' gas-output future on a downward slope.

plore and produce at their own risk and expense. In the Netherlands, oil and gas E&P is carried out via a partnership between the state and private firms.

The state is represented by Energie Beheer Nederland (EBN), which bears 40% of production and exploration costs, and in turn receives 40% of profits from oil and gas production ventures. In the Netherlands, royalties have to be paid on onshore fields only. Only one fiscal regime is applied to offshore and onshore production. This regime holds for all firms, domestic or foreign, active on the Dutch shelf.

The regime imposes a 50% tax to new exploration licenses after a deduction of 10% for uplift costs. The profit share refers to the profits of the company after the deduction of EBN's participation. This implies that the government receives 40% of the profit from EBN's participation and 50% of the profit of the private firms, making the total government share in the profit 70%.

The Dutch corporate tax was set at 25.5% on January 1, 2007, down from 34.5%, and is credible against the state profit-share, implying that any change in the corporate tax structure does not affect the total tax take. Before abolition of depreciation-at-will, exploration costs could be charged as an expense and be written off immediately. Capital expenditures can no longer be depreciated at will.

DAW enabled firms to treat investments in platforms and pipes as expenses in the determination of taxable income. Without it, investments have to be entered on the tax form on a unit-of-production basis or on a straight-line basis. The immediate impact of DAW, compared with other regimes, was postponement of tax payments, which gave an interest advantage to firms.

In contrast, the government bore an interest disadvantage as it received tax pay-

ments later. If firms raise the level of investments, the net impact of DAW on the government budget could be positive due to a higher level of gas production and, hence, increased tax earnings. The key question in the debate on DAW is, therefore, to what extent interest losses due to postponed tax earnings are compensated for by an increased tax base.

Christian Gueritte, managing director of Total E&P Nederland, says, "It [DAW] had a very good effect in promoting new developments because tax-wise it provided very good leverage in terms of potential rate of return for the operators and it didn't change much in terms of overall revenues for the tax authorities."

For many outside investors, the withdrawal of DAW has reduced the Netherlands' attractiveness. It can be seen as a possible deterrent to new entry for independents, and the removal of DAW is regarded by many as a reason for the significant decrease in offshore drilling.

Less drilling will lead to a lower level of depletion of offshore gas fields, a decline in resource rents the government receives and a loss of economic activity. This is something the Dutch ministry of economic affairs is hard-pressed to avoid. But the problem is two-sided: the ministry has to reach consensus, not only with operators but also with the finance ministry. It is psychologically difficult to lobby the finance ministry for a tax break with commodity prices at today's levels and oil companies announcing record-breaking profits.

Pieter Jongerius and Yvette Peters of the directorate-general for energy at the Dutch economic-affairs ministry, believe that, although all projects benefited from DAW, only a part of the projects really needed this facility. "Depending on the choice of the financial criterion, 60% to 70% of all projects which are profitable with the DAW also appear to be prof-



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itable without it," Jongerius says.

So it is clear that other, non-financial, factors, such as pre-drilling activities (geological research, interpretation of data), environmental and licensing procedures, and insufficient access to profitable prospects by new firms will determine the magnitude of offshore activities in the near future. Improving financial conditions by implementing DAW would, therefore, not affect that magnitude.

However, a financial, tax-break incentive for smaller projects could. Reducing the tax burden on marginal projects without relieving the tax burden on larger projects would have positive effects on gas activities and the government budget. Gueritte stresses, "The government does not want to do it for all the projects, including the existing projects. They don't want to give the free ride to all the players. Now we are discussing the application of an incentive for just specific projects."

The question also remains whether the government should take other measures regarding offshore gas activities such as, for example, a fallow-field initiative. Looking at past relationships between oil prices and offshore activity, it is expected that exploration and development drilling will increase in the near future. A large number of projects appear to be profitable, even if relatively strong finan-

"The government is working on a solution that would bring together a fallow-field initiative modeled on the U.K.'s, with a modified depreciation-at-will incentive...."

cial criteria are used.

A major factor influencing offshore activity seems to be market structure. Many of the firms currently active on the Dutch Shelf apply rather high financial criteria in their investment decisions due to insufficient competition in the upstream market. To encourage offshore activities in the medium term, policy measures could be directed at increasing competition. Options to do so include improving licensing procedures and increasing the

transparency of the market to attract new players.

Experiences in other countries could offer useful lessons. The U.K., for instance, has introduced several measures to attract new players to the North Sea. These include the fallow-field initiative, which encourages activity on acreage that has had no activity for a number of years, and a measure facilitating access to existing infrastructure.

The government is working on a solution that would bring together a fallow-field initiative modeled on the U.K.'s, with a modified depreciation-at-will incentive specifically for marginal and difficult projects to avoid free-riding. The economic-affairs ministry has demonstrated its flexibility in interpreting the current law in place in favor of a fallow-field policy, even though no formal law is in place.

Jongerius adds, "Additional research is needed to assess the cost-effectiveness of several options to encourage investments at the Continental Shelf. In that further research, attention should also be given to the benefits of the 'small fields' policy. Only then is it possible to determine the optimal design of government policy regarding the exploitation of the domestic natural gas resources."

Or simply put, expect further incentives from the government soon. □



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Parkstraat 20, 2514 JK The Hague, The Netherlands
Tel: +31 (0)70 3062384 Fax: +31 (0)70 3062386

Single source multiple solutions Saudi LLC
P.O. Box 696, AL-Khobar 31952, Kingdom of Saudi Arabia Tel: +966 3 897-2220

Single Source Materials Solutions Kuwait LLC
P.O. Box 43012, Hawalli 32045, Kuwait Tel: +965 2652260 / 2651121

Magtech LLC
P.O. Box 38332, Dubai United Arab Emirates Tel: +9714 3408535

Single Source Materials Solutions
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Xytech BV
Parkstraat 20, 2514JK The Hague, The Netherlands Tel: +31 (0)70 319 5252

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