

Participation in Subsoil Use Auctions: Law and Practice

By Marc Polonsky, Partner, and Sergei Stepanov, Associate, White & Case

Recently, it has become common practice to grant subsoil use rights based on auction results. The Ministry of Natural Resources considers that this reduces the adverse impact of bureaucratic whim and corruption, making the licensing mechanism more transparent. Marc Polonsky and Sergei Stepanov of White & Case discuss certain practical aspects of participation in auctions.

In 2004, the Subsoil Law¹ was amended with regard to the issuance of licenses. While previous decisions to issue production licenses for most onshore fields were made by federal executive authorities jointly with the relevant regional executive authority, now, according to the amended law, such licenses are issued based on a decision of the tender or auction commission.²

Currently, the federal authority responsible for the management of subsoil resources is the Federal Agency for Subsoil Use. The interests of regional authorities are addressed by the inclusion of representatives of regional executive authorities in tender or auction commissions.³

Subsoil use licensing regulations⁴ were adopted in 1992 and have not been amended since that time. They contain a number of provisions which are not wholly consistent with the Subsoil Law. However, the regulations are still in force as a whole; those provisions that do not contradict the law also govern the granting of subsoil use rights.

In order to improve the subsoil use licensing system, in 2002 the Ministry of Natural Resources (MNR) issued guidelines on holding tenders and auctions for subsoil use rights.⁵ Certain provisions in these Guidelines are inconsistent with the current version of the Subsoil Law and apply only to the extent that they do not contradict this law.

The Guidelines clarify a number of issues concerning the grant of subsoil use rights. In particular, they provide that the organization of tenders and auctions is the responsibility of the MNR and its territorial agencies. This includes preparing documents in connection with tenders and auctions, providing geological and other data on the subsoil areas put up for auction, timely publication of information on forthcoming tenders or auctions in the mass media, and ensuring that the terms of tenders and auc-

tions are complied with when preparing the relevant license.⁶ (As noted above, according to the Regulation on the Federal Agency for Subsoil Use, issues related to the organization of licensing for subsoil use are within the jurisdiction of the Federal Agency for Subsoil Use and its territorial bodies.)⁷

Auction Commission

The initial stages of an auction organization process – such as the initial decision to hold the auction, the establishment of the auction commission, and the determining of the procedure, terms and conditions for the auction – take place beyond the view of its potential participants.⁸ Potential auction participants obtain information about the auction from announcements published in Russia-wide and regional mass media.⁹ Information about subsoil areas put up for auction may be published in the MNR's newsletter, "Economic and Legal Aspects of Subsoil Use in Russia"¹⁰ (on 1 January 2005 renamed "Subsoil Use in Russia") where forthcoming auctions are announced and their terms described.

Auction Participants

Recently, there has been much discussion in the press about the narrowing of the categories of persons that will be able to participate in auctions in the future. In this situation, it is important to examine the relevant regulations to make sure that the entity in question is (in accordance with the terms of the auction) eligible to participate.

The Licensing Regulations provide that only Russian Federation entities may participate in tenders and auctions.¹¹ This provision contradicts the Subsoil Law and, therefore, should not be applied to bidders and subsoil users (except, perhaps, where the extraction

¹ Law "On Subsoil" No. 2395-1 dated 21 February 1992 ("Subsoil Law").

² Article 10.1.5 of the Subsoil Law

³ Article 13.1 of the Subsoil Law

⁴ Regulations "On the Procedure for Issuance of Subsoil Use Licenses" (as approved by Decision of the Supreme Court of the Russian Federation No. 3314-1 dated 15 July 1992) ("Licensing Regulations")

⁵ Methodological Guidelines for the Preparation of Terms of and on the Procedure for Holding, Tenders and Auctions for the Rights to Use Subsoil Areas (approved by Order of the Ministry of Natural Resources No. 457-r dated 14 November 2002) ("Guidelines").

⁶ Article 1.3 of the Guidelines.

⁷ Article 5.3.4, Regulation "On the Federal Agency for Subsoil Use" approved by Decision of the Russian Federation Government No. 293 dated 17 June 2004 ("Regulation On the Federal Agency for Subsoil Use").

⁸ Article 13.1 of the Subsoil Law.

⁹ *Id.*

¹⁰ Article 7.1 of the Guidelines.

of radioactive materials is involved). The Subsoil Law states that subsoil use rights may be granted to persons that engage in entrepreneurial activities, including members of simple partnerships, foreign citizens, and legal entities, unless federal law provides for restrictions on the granting of subsoil use rights.¹² In other words, the Subsoil Law clearly stipulates that restrictions may be established by federal law only. Furthermore, the Licensing Regulations themselves provide that license holders may include legal entities and individuals from other countries¹³, clearly indicating that license holders may include foreign legal entities. (In practice, the instances where a license is held directly by a foreign company are very rare in Russia.)

Timing

Timing is an important aspect of auction participation. The auction announcement should clearly specify the deadlines for the submission of documents and the making of deposits, and the date of the auction itself. In practice, we are aware of instances where the auction terms referred to two different dates for the auction. If such confusing contradictions arise, official clarification should be sought from the authority that made the decision to hold the auction.

Decision to Issue a License

As mentioned above, licenses should be issued based on a decision of the auction commission. However, in practice, decisions on the issuance of licenses are made by the Federal Agency for Subsoil Use or its territorial body (rather than by the auction commission). It may be that such decisions are made on the basis of the powers contained in the Regulation on the Federal Agency for Subsoil Use, which provides that the Agency shall make decisions on the granting of subsoil areas use rights in the manner prescribed by Russian Federation laws.¹⁴

The Subsoil Law clearly states that the Agency has the right to make decisions to grant short-term subsoil use rights (of up to one year).¹⁵ While in relation to auctions the Subsoil Law stipulates that licenses should be issued on the basis of the auction commission's decision,¹⁶ in practice the auction commissions merely record the auction results (rather than making a decision to issue the license). The Subsoil Law indicates that such decisions

should be made on the basis of the results of the tender or auction,¹⁷ while the approval of the results by the Agency is a pure formality.

There are no clear guidelines for making a decision to approve (or not to approve) the results of an auction. Since the law prescribes that licenses shall be issued on the basis of the auction commission's decision, such a decision does not need to be additionally approved.

Payment Terms

Attention should be paid to the payment terms described in the auction materials. In practice, we have come across cases where the auction terms contained no such information. All such inaccuracies or uncertainties should be officially clarified by the authority that made the decision to hold the auction.

Granting of Rights

Care needs to be taken to ensure that all rights are duly granted. The Subsoil Law provides that subsoil use licenses shall be issued with the prior consent of the land resources management body or the owner of the relevant land plot.¹⁸ Taking into account the substantial scale (in general) of the land allotted for subsoil use, it is important to make sure that the local authorities are the only owner of the land. The existence of other owners of the land allotted for subsoil use would create a risk of difficulties with field development in the future.

When a production license is issued, the preliminary boundaries of the mining allotment (as approved by the state mine inspectorate) must be registered.¹⁹ (Currently, the Federal Service for Ecological, Technological and Nuclear Monitoring carries out the functions of the state mine inspectorate.)²⁰ The absence of such approval may in the future cause complications with financing or the sale of the company, as the relevant financing institution or acquirer will consider the absence of such approvals a risk. Accordingly, the auction winner should ensure that the required approvals are obtained promptly.

Hope for New Legislation

We understand the difficulties faced by public officials in relation to holding an auction: the relevant legislation contains inconsistent or contradictory provisions. In practice, auctions are not always held in accordance with the procedures clearly prescribed by law. We can only hope that, with the adoption of the amended Subsoil Law, the auction procedure will be clearly defined in the law and its implementing regulations, and, accordingly, that the law and practice of auctions will coincide. This will serve the interests of all parties (the state and auction participants), ensuring better protection for auction participants and making more stable the mechanism for holding auctions. □

¹¹ Article 10.5 of the Licensing Regulations.

¹² Article 9 of the Subsoil Law.

¹³ Article 9.1 of the Licensing Regulations.

¹⁴ Article 5.3.6 of the Regulation on the Federal Agency for Subsoil Use.

¹⁵ Article 10 of the Subsoil Use; Procedure for Consideration of Applications for Subsoil Area Use Rights for a Short-Period of Time (up to one year) (approved by the MNR's Order No. 22 dated 16 February 2005).

¹⁶ Article 13.1, clause 5, of the Subsoil Law.

¹⁷ *Id.*

¹⁸ Article 11 of the Subsoil Law.

¹⁹ Article 7 of the Subsoil Law; Article 1.3 of the Instruction "On the Procedure for Mining Allotment for the Purpose of Oil and Gas Field Development" (approved by Decision of Gostekhnadzor No. 28 dated 11 September 1996).

²⁰ Regulation "On the Federal Service for Ecological, Technological and Nuclear Monitoring" (approved by Decision of the Russian Federation Government No. 401 dated 30 June 2004).