Ukraine

New Law Creates Independent Arbitration Tribunals

On May 11, 2004, Ukraine's Parliament passed the Law of Ukraine "On Arbitration Tribunals" (the "Arbitration Law"), which came into effect on June 22, 2004 replacing the Ukrainian Soviet Socialist Republic Regulation "On Arbitration Tribunals," dated July 18,1963. In Ukrainian, the word which translates as "court" in English is also used to describe these newly-created entities. Since these new entities are extra-judicial and private, we have used the word "tribunal," an accepted designation of such panels in other jurisdictions, to avoid confusion with Ukraine's state judicial system.

The Arbitration Law, which regulates arbitration proceedings between Ukrainian residents, provides for the creation of private arbitration tribunals that will operate outside of the state judicial system. This new forum for dispute resolution, which employs a simplified arbitration process, provides an independent alternative to the state system. The Arbitration Law governs the procedure for creating arbitration tribunals, their activity, and the legal requirements for arbitration review.

While the previous law allowed for arbitration tribunals to be created on an ad hoc basis to resolve civil law disputes between natural persons, such tribunals could not be used to resolve business disputes between legal entities. Thus, in disputes with other Ukrainian companies, wholly-owned Ukrainian subsidiaries of foreign companies and Ukrainian joint-venture partners could seek resolution only within Ukraine's state commercial courts, where resolution of disputes could be a long and slow process.

The Arbitration Law, which applies only to issues related to Ukrainian arbitration courts, broadens the scope of such tribunals to include arbitration review among all residents, including Ukrainian legal entities (which may have foreign ownership). Disputes are governed by the Law "On International Commercial Arbitration," dated February 24, 1994, where at least one of the parties is foreign.

Types of Arbitration Tribunals

As envisioned by the Arbitration Law, an arbitration tribunal is a private and independent body, created on the basis of an agreement or decision of the parties for the purpose of settling civil and commercial disputes. The Arbitration Law provides for two types of arbitration tribunals: *continuing arbitration tribunals* and *ad hoc arbitration tribunals.*

Continuing arbitration tribunals may be established within the framework of all-Ukrainian public or employer organizations, banks, stock and commodity markets, self-regulated securities market organizations, trade and industry chambers, or other unions and associations. After registering with the Ministry of Justice, a continuing arbitration tribunal may operate on an ongoing basis to resolve disputes between members of the founding organization. The jurisdiction of a continuing arbitration tribunal is limited to parties and issues arising from the activities and conduct of the establishing organization. Outside parties have no access to a specific continuing arbitration tribunal.

Ad hoc arbitration tribunals may be created as needed by parties to settle specific disputes. Typically, parties to a contract who are unable to refer arbitration to a continuous arbitration tribunal include a provision in the documents governing their relations indicating that an ad hoc arbitration tribunal will be created in the event of a dispute. The Arbitration Law sets forth regulations on the process of forming an ad hoc arbitration tribunal, which are discussed in more detail below.

Jurisdiction

According to the Arbitration Law, an arbitration tribunal may consider disputes under the following conditions: (a) the parties have signed an arbitration agreement or included an arbitration clause in another agreement; and (b) no decision has been issued by a competent court in the dispute between the same parties on the same subject and on the same legal grounds. Arbitration tribunals may not consider disputes regarding the following matters: (a) the validity of legal acts; entering into, amending, terminating or fulfilling commercial contracts related to carrying out state functions; the disclosure of state secrets; (d) family relations, except with regard to marriage contracts; and (e) bankruptcy. In addition, arbitration courts may not consider disputes in which one of the parties is a state or local authority or state company, or

in which at least one of the parties is a non resident. Disputes which, pursuant to law, must be settled by general jurisdiction courts or the Constitutional Court of Ukraine, may not be resolved by arbitration tribunals.

Arbitration Agreement

Parties may submit their disputes to the jurisdiction of an arbitration tribunal by signing an arbitration agreement, either in the form of an arbitration clause in a written contract or as a separate written agreement. An arbitration agreement may also be concluded by an exchange of letters, fax, telegraph or electronic mail. Parties may also include a separate document containing a provision on the arbitration of disputes into a written contract by reference. Failure to comply with the above rules will render an arbitration agreement invalid. An arbitration agreement may specify a particular continuing arbitration tribunal, or simply refer to an ad hoc arbitration tribunal to be created by the parties if necessary.

Appointment of Arbitrators and Formation of an Arbitration Tribunal

The Arbitration Law provides that one or any odd number of arbitrators may review cases for an arbitration court. An arbitrator may not be affiliated with one of the parties of the dispute or otherwise interested in the result of settlement. Parties to a dispute appoint arbitrators; however the consent of all parties is required to appoint arbitrators for a specific dispute. The Arbitration Law provides for special procedures in the event that parties cannot agree on the formation of a tribunal.

In continuing arbitration tribunals, the number and composition of the tribunal is determined in accordance with the tribunal's standard regulations, and arbitrators are appointed and selected from an approved list. In an ad hoc tribunal, the parties may agree on the tribunal's composition at their discretion. If the parties cannot agree on the number of arbitrators for a specific dispute, the arbitration review shall be performed by three arbitrators. The parties and arbitrators in an ad hoc tribunal may enter into a contract in which they stipulate mutual rights and obligations. Arbitrators are entitled to a fee for their services, which must be stipulated in the contract.

Arbitration Review

In compliance with the Arbitration Law, an arbitration tribunal independently decides whether or not it has jurisdiction to review a specific dispute and whether to hold the hearing in private in order to protect commercial or bank secrets. The review should be held in Ukrainian, unless otherwise agreed to by the parties. The arbitration procedure is initiated by issuing and sending a relevant order to the parties. At the start of deliberations, the arbitration tribunal must determine whether an amicable settlement agreement among the parties is possible. Settlement is possible during any stage of the review prior to issuance of the tribunal's decision.

Decision of an Arbitration Tribunal

A decision by a majority of arbitrators (or by a sole arbitrator in a one-man court) is pronounced at a court hearing, executed in writing and signed by all the arbitrators. If the decision is not unanimous, a dissenting opinion may be executed separately by the dissenting arbitrator and attached to the decision.

The parties submitting a dispute to arbitration are bound to execute the decision voluntarily, without any delays or exceptions. A decision of an arbitration tribunal is final and subject to appeal only on grounds of lack of personal or subject matter jurisdiction and/or illegal composition of the tribunal.

Execution of Arbitration Decisions

If no term for execution is established, a decision must be executed immediately. When required by law, a writ of execution must be obtained from a competent body. An application to issue a writ of execution may be filed with a competent court within 3 years from the date of the arbitration decision. A competent court may deny issuance of a writ of execution on limited grounds.

Conclusion

The Arbitration Law provides for the creation of an alternative dispute resolution forum which will likely be very attractive to Ukrainian businesses. Continuing and ad hoc arbitration tribunals should prove more efficient and less susceptible to corruption than judicial dispute resolution, allowing the Ukrainian business community to avoid the delays endemic in Ukrainian commercial courts. This, in turn, should give Ukrainian businesses (and foreign owners) greater confidence when entering into contracts of the ability to quickly and fairly resolve any disputes which may arise.

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Procedure for Auctioning Mineral Exploration Licenses Adopted

On May 26, 2004, Ukraine's Cabinet of Ministers adopted Resolution No. 694 (the "Resolution") approving a procedure for conducting auctions on the sale of special licenses to explore for mineral resources within the boundaries of Ukraine, its continental shelf and exclusive economic zone. To curtail previous practices of favoritism and to ensure that licenses are issued on a competitive basis, the Resolution requires licenses to be granted exclusively by auction. The Resolution provides a detailed procedure by which the State Committee on Mineral Resources of Ukraine (the "Committee") will hold auctions and issue licenses to Ukrainian and foreign legal entities and individuals, specifying actions the Committee must take in announcing, planning and conducting auctions, as well as application requirements and participation requirements for potential buyers.

Procedure for Conducting an Auction

According to the Resolution, the Committee must announce a sale of licenses in the official newspaper of the Cabinet of Ministers. This announcement should include descriptive data on: (a) location of the mineral resources parcel; (b) initial asking price for the license; (c) date and place of the auction; (d) deadline for submitting proposals; (e) address to which proposals should be delivered; (f) cost to receive an information packet on the license for sale (containing geological data on the mineral resources parcel, qualification requirements for potential buyers, terms and conditions of using the parcel, and a draft agreement on the use of the parcel); (g) fee for participating in the auction; (h) contact details of the person in charge of accepting proposals; and (i) a contact phone number for inquiries.

Qualification Requirements for Buyers

Not all potential buyers are allowed to participate in an auction. The Resolution provides qualification requirements which must be met by potential participants in any auction. In addition, the Committee may establish specific qualification requirements which must be met for a particular license. The Committee may reject applicants who do not comply with the qualification requirements.

In general, the Resolution specifies that a potential buyer must demonstrate appropriate staffing, technical capabilities, and unencumbered exploration equipment, as well as the absence of any outstanding tax debts and liquidation or bankruptcy proceedings, in order to qualify for participation in an auction.

Upon reviewing the submissions of all interested parties, the Committee must inform applicants of their acceptance to the auction at least five days before the auction is held. Each participant is required to sign a preliminary agreement with the Committee on the terms and conditions of exploration before the auction begins. The bidder offering the highest price for the license wins the auction. The winner is then required to sign a final agreement on exploration terms and conditions and a sale-purchase agreement. The license fee must be paid in full within 10 banking days of signing the sale-purchase agreement. Ukrainian residents must pay for the license in Ukrainian currency, and non-residents may pay in foreign currency at the rate of the National Bank of Ukraine effective on the date of payment. The winner of the auction is prohibited from granting, selling or otherwise alienating its rights to explore the mineral resources parcel to another individual or legal entity.

Potential buyers must pay a fee for technical and geological information on the mineral resources parcel, as well as to cover any expenses related to participation in the auction. Such fees are not refundable.

An auction is considered valid if at least two bidders participate. The initial asking price for a license which has been offered for sale and not sold may be reduced by up to 50% and offered again at a subsequent auction.

Conclusion

The Resolution provides much-needed clarification on the procedure for conducting auctions to grant mineral resources exploration licenses. The increased transparency provided by the new procedure may help reduce favoritism in the allocation of mineral exploration licenses. In addition, truly competitive auctions will allow for licenses to be sold at market prices, potentially benefiting Ukraine's state budget.

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Development of the Ukrainian Legislation on Production Sharing Agreements[1]

Creation of Ukraine's PSA legislation

Before 1999, Ukraine lacked legislation on production sharing agreements. This situation changed on 14 September 1999, when Ukraine's Parliament (i.e., the Verkhovna Rada) adopted the Law of Ukraine "On Production Sharing Agreements" (the "PSA Law").

The PSA Law incorporated the same PSA principles and rules recognized throughout the world and provided both Ukrainian and foreign investors with the possibility to begin working under a PSA regime in Ukraine[2].

[1] Reproduced from the website of Russian-Ukrainian Legal Group, P.A. 2004, at http://www.rulg.com/

[2] An English translation of the PSA Law can be found at the Russian-Ukrainian Legal Group's website at the following address: http://www.rulg.com/documents/PSA_Law_as_adopted_English.doc.

Subsequently, Ukraine's Cabinet of Ministers, along with Parliament and other state agencies, approved a number of implementing regulations that expanded on and further developed Ukrainian PSA legislation.

In particular, in 2000, Parliament adopted the Law "On Amendments to Certain Legislative Acts of Ukraine", which harmonized Ukraine's most important legislative acts in the sphere of oil and gas with the PSA law.

That same year, the Cabinet approved the Regulations on the Interdepartmental Committee on Organization of Execution and Fulfillment of Production Sharing Agreements and appointed the initial members of the Interdepartmental Committee. This Committee is one of the most important state agencies involved in all PSA projects. The Cabinet then approved the Resolutions "On Utilizing Part of the Production Transferred to the Ownership of the State in Compliance with Production Sharing Agreements" and "On Approval of the Procedure for Registration of Draft Production Sharing Agreements and the State Registration of a Production Sharing Agreement". The Cabinet also promulgated several less important PSA-related ordinances.

In 2001, the Ministry for the Economy and European Integration of Ukraine issued an Order "On Approving the Instructions on the Organization of Holding a Tender for the Conclusion of Production Sharing Agreements and the Instructions for Drafting, Improving and Signing Production Sharing Agreements"[3].

Problems with Practical Implementation of the PSA Legislation

The PSA Law and other relevant regulations established frameworks for implementing PSA projects in Ukraine. Nevertheless, no such projects were undertaken for more than two years after the regulations have been enacted. The main reasons for this were (i) Ukraine's unattractive investment climate and (ii) a lack of understanding of how PSAs work, by both state agencies and businesses.

Ukraine's political and business environment posed numerous risks at the time, which appears to have dissuaded the world's major oil and gas players from undertaking any large-scale PSA projects in Ukraine. Meanwhile, local companies, which might have been willing to undertake PSAs, lacked the funds to finance such ventures. They especially did not want to be the first to undertake the financial risk of investing under an untried legal regime.

Additionally, Ukraine's state agencies themselves often failed to comprehend even the most basic principals of PSA law. This was particularly true of Ukraine's tax agencies.

Recent Developments

The situation described above changed in 2003. An improving business climate, the improve financial state of some local companies and a better understanding of the PSA regime's advantages have combined to encourage at least a few large Ukrainian companies to begin exploring the possibility of starting PSA projects. Simultaneously, some large international corporations have recently been visiting Ukraine and appear to be interested in implementing their own PSA projects.

These developments have resurrected Ukraine's PSA legislation. Interested parties are now analyzing PSA legislation from the perspective of its practical implementation – an exercise that had been purely theoretical in the past. Already, numerous practical suggestions for improving Ukraine's PSA legislation have been raised, and businesses are beginning to seek the active cooperation of Parliament and other state agencies in further improving the laws.

The most significant step in this regard was the filing with Parliament of the Bill "On Amending the PSA Law". This Bill has already passed its first reading and is being prepared for second reading before Parliament. The Bill proposes to introduce many progressive changes, for example: better regulation of tender procedures. The issue of how to transfer title to produced production is to be better regulated as well. The Bill also clarifies and simplifies the procedure for conducting PSA operations on the continental shelf, better defines the mutual rights and obligations of parties to PSA in cases when several investors are parties to the PSA, provides additional benefits for companies working under a licensing regime, permits the use of internationally-recognized customs in the PSA sphere, clarifies certain issues concerning taxation, grants the parties the right to resolve disputes with international arbitration and improves various other details concerning operations under production sharing agreements.

We should also note that the Cabinet has recently approved two resolutions defining the areas, which can be used under the PSA regime. These resolutions have significantly advanced several major projects towards practical implementation.

All of the above-mentioned developments support the view that production sharing agreements will have a promising future in Ukraine. They have become matters of interest for both foreign and domestic investors and it is very likely that more than one production sharing agreement will be signed soon.

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[3] A list of the normative acts adopted in relation to the PSA Law can be found at the Russian-Ukrainian Legal Group's website at the following address: http://www.rulg.com/documents/PSAlist_21.07.03.doc.