The Regulation of Subsoil Resource Usage and its Inclusion into the Framework of Civil Law

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Introduction

There are two main changes in the regulation of natural resource use and management apparent from the policy of the Russian government over the past 12 months. The first is the changed relationship between federal and regional government in matters pertaining to resource use and management, formally enacted on August 22nd 2004 by way of article 13 of the law amending the federal law On the Basic Principles of Organisation of the Legislative and Executive Authorities of the Russian Federation Subjects (hereinafter the Amending Law).[1] The current law On Subsoil[2] contains provisions of both a 'policy-oriented'[3] and 'technical' nature.[4] The amendments introduced by the Amending Law aim to secure the more effective implementation of state policy with regards to resource management by way of introducing changes in both areas.

The second major change to be introduced in the regulation of natural resource use and management is contained within chapter 5 of the new draft law On Subsoil (hereinafter the Draft Law), a bill that was submitted to the State Duma by the government in June 2005.[5] The purported aim of these new provisions is to increase the 'security of contract' of the subsoil user by way of moving away from a system of licensing for subsoil use to a legal regime based on civil law agreements.[6] Indeed, securing that the rights of a subsoil user are not vulnerable to unjustified termination by the state is of crucial importance. Past experience has demonstrated how a failure to comply with the terms of a license can lead to the suspension of production, and, in the event of a breach of one of the essential terms, to the revocation of the license.[7] The vulnerability of the subsoil user to such action is acute as in accordance with article 17.1 he is liable for the non-fulfilment of obligations under the license by previous users. Not only do the more onerous obligations require the license holder to strictly adhere to development plan provisions and to prevent environmental damage, but article 20, as amended by the Amending Law, expressly stipulates that any transfer of a subsoil use right in violation of article 17.1 constitutes grounds for early termination.

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[1] Federal Law No. 122-fz of 22 August 2004 *O vnesenii izmenenii v zakonodatel'nye akty rossiiskoi federatsii I priznanii utrarivshimi silu nekotorykh zakonodatel'nykh aktov rossiiskoi federatsii v sviazi s priniatiem federal'nykh zakonov 'O vnesenii izmenenii i dopolnenii v federal'nyi zakon ob obshchikh printsipakh organizatsii zakonodatel'nykh i ispolnitel'nykh organov gosudarstvennoi vlasti sub"ektov rossiiskoi federatsii I ob obshchikh printsipakh organizatsii mestnogo samoupravleniia v rossiiskoi federatsii* (hereinafter the Amending Law.) Sobranie zakonodatel'stva RF (hereinafter SZRF) 30 August 2004 No. 35 p. 3607. These provisions of the Amending Law introduced a considerable number of changes into the law On Subsoil, some effective as from 31 August 2004, and others from 1 January 2005.

[2] Federal Law No. 2395-1 of 21 February 1992 *O nedrakh* with subsequent amendments (herein after the current law On Subsoil). SZRF 6 March 1995 No. 10 p. 823.

[3] i.e. those establishing grounds for subsoil use rights arising in article 10.1 of the current Law On Subsoil op.cit. note 2.

[4] i.e. those providing guidelines for the convention of auctions allocating the right to use subsoil in article 13.1 of the current law On Subsoil op.cit. note 2.

[5] All references in this article are to the version of the Draft Law published on 25 March 2005.

[6] Although this article will focus on the provisions of chapter 5 of the Draft Law op.cit. note 7 it is important to note that in recognition of the fact that rights to explore and produce more than 90 % of oil reserves and more than 80 % of gas reserves are already distributed the Draft Law permits existing subsoil users to continue to operate in accordance with the terms contained in their licenses. Such licenses will, however, become subject to the provisions of chapter 6 of the Draft Law when it enters force, provisions that do not fully correspond with those of the current law On Subsoil. As an alternative, article 124.1 provides the possibility for a subsoil user under an existing license to demand the conclusion of a subsoil use contract with the state without the convention of an auction. Furthermore, paragraph 8 of article 124 provides that in the event of a disagreement over the terms to be incorporated into this contract, the dispute shall be considered by a court in accordance with the procedures established by civil legislation.

[7] In accordance with article 22 of the current law On Subsoil, op.cit. note 2, in the event of a breach of the essential terms of the licence, the list of which is established in article 12 and whose nature is defined in article 432.1 of Federal law No. 52-fz of 30 November 1994 *O vvedenii v deistvie chasti pervoi grazhdanskogo kodeksa rossiiskoi federatsii* (herein after the Civil Code Part 1) the licence may be revoked. SZRF 5 December 1994 No. 32 p. 3302

The proposed contract-based system aims to provide greater security of contract for the investor by making the subsoil use right a property right that is regulated by civil law. The subsoil use agreement concluded between the investor and the state is to contain obligations and rights to be agreed between the two parties, and any dispute arising as a result of an attempt to amend or terminate the contract will be subject to a court hearing. Furthermore, as a subject of a civil law agreement the subsoil use right may be transferred, unless otherwise stipulated.

It is the ability of the Draft Law to provide such security that is the main focus of this article.

The analysis encompasses; the scope provided by the law for the conclusion of a balanced subsoil use agreement; the contract's vulnerability to unilateral amendment or termination; the presence of provisions that a subsoil user may utilize to mitigate risk; and, the identification of a transferable right that can act as collateral for project financing. This first point will be addressed in the context of the difficulties experienced within projects regulated by product sharing agreements (hereinafter PSAs) where the state is a party to a contract while remaining the regulatory authority. This analysis will also consider the applicability of the provisions of the Draft Law, the combination of which are essentially administrative and civil law arrangements creating a potential for parallel and inconsistent regulation.

The Subsoil Use Right

The Issuing of a Use Right

Article 60.1 of the Draft Law, reiterating the amendments made by the Amending Law to article 13.1 of the current law On Subsoil, allocates the authority to decide upon the tender or auction commission's composition, and the procedure adopted for such auctions for the allocation of subsoil use rights for onshore subsoil parcels to the Ministry of Natural Resources (MNR) or its regional department. A further change introduced to article 13.1 by the Amending Law, providing for a maximum 45 day period between the publication of the announcement and the holding of an auction, is also restated in the Draft Law at article 62.1.

Furthermore, the Draft Law makes it clear that exclusive criteria may be employed for selecting the type of auction to be convened.[8] Under current legislation auctions may be closed with only specific categories of companies, or indeed specific companies, being invited to participate. Of greater concern is the fact that article 61.5 of the Draft Law provides that such restrictions may be imposed by the auction organisers. The article fails, however, to provide rules and procedures for the auction organizer to make such a decision. Not only is there a failure to clearly identify the circumstances in which 'foreign' participation in an auction may be restricted or prohibited, article 61 also fails to supply any criteria to determine the precise nature of 'a group of entities associated with a foreign entity.'

The Nature of a Use Right

Article 47 of the Draft Law provides that in a subsoil use contract one party, the Russian Federation (together with the subject of the Russian Federation when the agreement involves a subsoil area of local significance) shall undertake to grant the use of a subsoil area to the other party, the subsoil user, by way of creating a right of temporary possession and use. What should be noted from the outset is the fact that what is being created is a use right to the subsoil plot. Article 16.5 of the Draft Law states that the subsoil plot itself cannot be the object of a civil law transaction, which repeats the current situation that in accordance with article 1.2 of the current law On Subsoil, underground resources are stated to be in the ownership of the state and are therefore not capable of private ownership.[9]

It should also be noted that article 10 of the Draft Law op.cit. note 7 removes from this definition of 'state' the idea of the joint ownership of the regional government.

In this respect the state regulation of an underground natural resource is no different to that found in other petroleum producing countries. It is also common practice in other petroleum producing countries that the state retains the right provided in article 19.2 of the Draft Law which provides for the possibility of the government to decide at a later date, without defining the criteria upon which a decision would be made, which resources are to be considered 'strategic resources.'[10]

In a similar vein to other legal systems, the Draft Law provides that, whereas subsoil is to remain

[8] Article 70 of the Draft Law op.cit note 7 provides for the awarding of subsoil use rights without auctions.

[9] Article 1.2 of the current law On Subsoil op.cit. note 2. It should be noted that article 9.2 of the Constitution, op.cit. note 18 provides for the possibility of underground resources to be in private ownership.

[10] This mirrors the provisions of article 8 of the current law on Subsoil: 'The use of individual areas of subsoil may be restricted or prohibited for reasons of national security and environmental protection.'

inalienable state property, the ownership of minerals extracted as a result of the use of a subsoil plot shall belong to the subsoil user.[11] The civil law nature of this relationship between the subsoil user and the minerals produced in Russia is, however, threatened by the contents of article 23 of the Draft Law which provides that government may exercise its preferential right to acquire strategic minerals as property on a contractual basis. The potential for arbitrary action on behalf of state bodies is increased by the failure of the article to indicate the criteria upon which the government may list strategic minerals. The threat to property rights as subjects of civil law is therefore exacerbated by the failure to specify the conditions upon which such a compulsory purchase would take place.

The State as a Party to a Subsoil Use Contract

The PSA as a precursor

In theory, the fundamental difference in the regulatory scheme envisioned by the current law On Subsoil and the PSA law has hinged on the distinction between an administrative grant of rights, versus rights arising out of a PSA itself. A license is a state permission and is not recognized as creating a property right.[12] Although a license is issued to the investor under a PSA, it is intended to serve simply as a confirmation of the contract rights and not as an independent source of rights and obligations. Crucially, the PSA law gives the parties considerable flexibility in terms of negotiating and structuring the agreement. As an example, the investor's share of this production may be exported from Russia under the terms and procedures specified in the PSA without quantitative restrictions on export in accordance with article 9.2. Furthermore, article 17.2 of the PSA law allows the state and the company to re-negotiate the terms of the contract if the commercial returns from the investment get worse as a result of changes in legislation.

It is debatable, however, that in terms of the practical running of a PSA project the impact of administrative law has been significantly reduced. As a general principle, in accordance with article 1.1, a PSA is subject to the PSA Law, and in accordance with article 1.3 subject to civil law. Various other provisions however, make explicit reference to Russian administrative law as being applicable in many areas of a PSA's operation.[13] This problem of the state appearing as a party to what is essentially a private law agreement, while simultaneously continuing to fulfil regulatory functions, are likely to plague the development of the new system of subsoil use contracts as envisaged by chapter 5 of the Draft Law. The provisions of chapter 5 of the Draft Law fail to clearly define the legal nature of a subsoil use contract, and as a consequence it is impossible to identify the extent to which the provisions of civil legislation shall be applicable to the use of subsoil. Indeed, the combination of what are essentially administrative and civil law arrangements generate the potential for parallel and inconsistent regulation. Not only is the regulation of natural resource use at the very intersection of administrative and civil law, perhaps more importantly, the Civil Code does not possess provisions that can effectively balance the interests of a private party and the state in any form of subsoil use agreement.

The Basic Provisions of the New Contractual Model

Article 50.1 of the Draft Law states that the parties to a subsoil contract are free to negotiate the terms of a contract, unless the content of a respective term or condition is stipulated by federal legislation or by other legal acts adopted in accordance with federal law, including the decision of the state body that convened the auction. This is in contrast with the current approach which expressly states in article 12 of the law On Subsoil that the terms must be included in a license agreement.[14]

Replicating the general civil law regulation of agreements, article 79.1 states that: 'A subsoil use contract may be amended upon agreement of its parties, or upon a demand of its parties upon a court ruling in cases envisaged by this federal law.' The security of a contract is seemingly strengthened by the provisions of article 79.4, which states that if an agreement cannot be reached then the contract is to be amended by a court, and that the consequences of an amendment of a subsoil use contract shall be defined by civil legislation. In theory this undoubtedly represents an improvement of the position under the current law On Subsoil.[15]

Similarly, article 80.1 of the Draft Law seemingly increases security for the subsoil user by way of reducing the likelihood of the unilateral termination

[11] Op. cit. note 2.Article 1.2 of the current law On Subsoil op.cit. note 2

[12] Article 11 of the current law On Subsoil op.cit note 2.

[13] See articles 1,2, 6.1, 8.1, 9.2, 12, and 13.2 of PSA law op.cit. note 11.

[14] Article 12 of current law On Subsoil op.cit. note 2.

[15] Article 12 of current law On Subsoil op.cit. note 2.

of the contract.[16] Not only is the reference of any dispute between the parties to a court mandatory, but article 80.3 expressly restricts the grounds upon which a contract may be terminated as the result of the initiative of the state upon a court ruling.[17] Furthermore, article 58.1 of the Draft Law identifies those conditions for which a breach does not provide the state with the right of termination.[18] With regards to the identification of circumstances in which one of the parties may terminate their obligations under a subsoil use license, article 98.1 seemingly provides an exhaustive list of the grounds upon which the executive body involved in the formalization of the license may make the decision to terminate the user's rights prematurely.[19] It is arguable whether the security of a user under a contract would be enhanced by having such a list expressly stated as being exhaustive, in a similar vein to article 20 of the current law On Subsoil.[20]

It remains to be seen whether or not the reference in article 79.1 and 80.1 of the Draft Law, allowing future amendments to the law to alter the circumstances in which an amendment or termination to the subsoil use contract may arise, will pose a serious threat to the apparent security provided by a subsoil use contract. Indeed, the general movement towards the civil law regulation of subsoil use does include specific provisions that can only be characterized as a regression in terms of guarantees offered to an investor. Article 10 of the current law On Subsoil was amended by the Amending Law to state that the period of exploration or production 'shall be extended' upon the application of the user in order to complete exploration / extraction 'on condition of the absence of violation of license terms.' This embodied an improvement on the previous version which stated that the period 'may be extended… on the condition of compliance with the agreed licence use terms.'[21] This assurance is not repeated in article 40 of the Draft Law.

The Draft Law does contain a number of provisions, however, which undoubtedly embody an improvement to the security available to subsoil users. Article 81.1 stipulates that the courts will decide, at the request of the subsoil user if a 'fundamental change in circumstances' has occurred that would necessitate the revision or annulment of the contract.[22] Such changes, allowing for contractual disputes arising out of subsoil use contracts to be referred to court, are considerable given the fact that article 50 of the current law On Subsoil restricts this right to refer to a court to appeals against the decisions of government bodies that are contrary to the provisions of the law On Subsoil.

It is questionable, however, whether the framework provided by civil legislation is able to provide the scope of provisions that can allow for the conclusion of a balance of obligations and rights between a holder of property rights and the state. Crucially, the integrated set of legal mechanisms that mitigate risk, the right to refer disputes to third party arbitration,[23] the provision of exhaustive lists of grounds upon which the state may declare a contract invalid or terminated, and the limitation of liability *vis a vis* damage caused by the previous user are conspicuously absent. The latter point is of special relevance in light of the continued failure to identify a methodology for quantifying liability for environmental damage (article 122.3 of the Draft Law fails to define precisely what can be the subject of such damage.)

The general movement towards the civil law regulation of subsoil use may be characterised as a radical yet 'ill-prepared' departure from the current system of licensing. Within the current law On Subsoil, article 22 explicitly identifies the obligations and rights of the subsoil user.[24] In contrast, the Draft Law provides the 'parties' with no guidelines as to the terms that should be included in a contract with the state. It has been decided not to provide any scope for the development of a 'model contract' that could be utilised to secure a balance of interest between the parties at different stages of a project. Given the lack of any precedent for such an agreement, and the different legal approaches of the typical lawyers representing a subsoil user and the state, it is unlikely that a Civil Code that possesses no specific provisions aimed at this form of property use can provide an effective framework for the development of subsoil use contracts. The somewhat lopsided nature of this future relationship between a private user and the state is suggested by the government's retention of the right to restrict use rights in circumstances and with terms that are not identified.

[16] Article 80.1 of the Draft Law op.cit. note 7 stipulates that: 'A subsoil area use contract may be cancelled upon the agreement of its parties or upon a demand of one of its parties upon a court ruling in cases envisaged by this Federal Law.'

[17] Article 80.3 of the Draft Law op.cit. note 7.

[18] Article 58.1 of the Draft Law op.cit. note 7.

[19] Article 98.1 of the Draft Law op.cit. note 7.

[20] Article 20 of the current law On Subsoil op.cit. note 2.

[21] Article 10 of the current law On Subsoil op.cit. note.

[22] Similarly, article 95 (5) of the Draft Law op.cit. note 7 provides a possibility for a reconsideration of the terms of a license on which development has been agreed in the event that there is a significant change in the volume of production as a result of circumstances that are beyond the subsoil user's control.

[23] In terms of the resolution of contractual disputes that may arise, the amended article 248 of Federal Law No. 96-fz of 24 July 2002 *O vvedenii v deistvie arbitrazhnogo protsessual'nogo kodeksa rossiiskoi federatsii* stipulates that state commercial courts have exclusive jurisdiction over any disputes between a foreign party and the state if the subject of the dispute is over the right to use subsoil. SZRF 29 July 2002 No. 30 p. 3013.

[24] Article 22 of the current law On Subsoil op.cit note 2.

Limitations on Transfer: the Applicability of Civil Law to Subsoil Use Contracts

Under the current licensing system subsoil use rights are not transferable, including by way of security. There are, however, exceptions to this rule. The fact that these exceptions have changed over time inducing contradictory interpretations as to whether the rights under a licence may be assigned to third parties. The 1992 law On Subsoil did not permit the re-issuance of licenses. The 1995 law On Subsoil permitted the re-issuance of licenses only when the license holder underwent a corporate reorganisation, merged with another company, or if the license holder went bankrupt. Transfers to a third party were not permitted. In 1995, however, the Committee on Geology and Sub Soil Use issued Order No. 65 of 18 May 1995 whose instructions purported to create an exception to this rule.[25] Section 17 of Order No. 65 stipulated that in case a company user of subsoil founded a new company, including a joint venture with foreign investments, with the special purpose to continue subsoil use in compliance with the terms of the license at a land plot belonging to the company's founder, and the company founder held at least a 50% interest of the new company, the license could be assigned to the new company.

It became common practice for Russian oil companies to assign subsoil use rights as a capital contribution to joint ventures, although the validity of such assignments was questionable based on the underlying subsoil use licences, i.e. administrative instruments. Clause 17 of Instruction No. 65 was finally abrogated on 22 April 1999 by Order No. 89 of the Ministry of Natural Resources.[26] The amendments to article 17.1 of the law on SubSoil that went into force on 14 May 2001, resolved much of the confusion surrounding this issue. The amendments legitimized the transfer of subsoil use rights from the holder of a subsoil use license to another new entity, to the extent that the old license holder has acted as the founder of such an entity, and holds at least 50% interest in such an entity at the time of the transfer of rights.[27]

The novelty provided by the Draft Law with regards to the transfer of use rights to a third party is embodied in the general statement contained within article 20.1, which provides that a subsoil use right may be transferred 'by means of legal succession and be an object of a civil law transaction as far as the circulation of this right is permitted by this federal law and federal legislation in general.' The impact of this inclusion of a subsoil use right within the jurisdiction of civil law is, however, negated by the provisions of article 20.2 which states that 'it may be stipulated, in accordance with procedures established by federal law, that the subsoil area use right for certain types of use may be transferred only to certain types of subsoil users.' In a similar vein to the provisions of article 61.5, bestowing on the auction organizers the right to impose restrictions on the participants of an auction, article 20.2 fails to identify the criteria upon which a potential transferee may be excluded from being party to a transfer of use rights.

In addition to allowing the state to restrict the range of entities allowed to participate in the transfer of subsoil use rights, the Draft Law does not clearly identify whether and to what extent the state will have the right to regulate or refuse consent for different forms of the transfer of use rights. The provisions contained within article 55 and 94 of the Draft Law appear to confuse the role of the state with regards to the authorisation of a transfer of use rights under both subsoil use contracts and licences.

There are two ways to transfer subsoil use rights, by way of assignment and by way of the reorganization of the holder of the use right. Article 55.1 of the Draft Law allows for the transfer of use rights under a subsoil use contract unless federal law stipulates otherwise. The right is to be transferred, however, are contingent upon procedures set by civil legislation of the Russian Federation, and upon consent of the executive body that made the subsoil use contract.[28] Crucially, article 55.3 does not contain an exhaustive list of the grounds upon which the state may refuse consent mentioning *inter alia*: a non- compliance of the transferee with requirements made to subsoil users by federal laws and by the decisions of the auction organizer regulating this specific subsoil area, and that transfer of the subsoil use right is not permitted by a federal law. In contrast the article dealing with the transfer of a use right under a licence, article 94.1, expressly permits a reorganisation as a type of transfer.[29] The provisions of the Draft Law should clarify in what circumstances the state is re-

[25] *Prikaz komiteta RF po geologii i ispol'zovaniiu nedr of 18 May 1995 no. 65 Ob ytverzhdenii instruktsii o poriadke pereoformleniia litsenzii na pol'zovanie nedrami.* Registered by Ministry of Justice 25 May 1995 No. 860.

[26] *Prikaz ministerstva prirodnykh resursov RF* of 22 April 1999 No. 89 *Ob otmene punkta 17 instruktsii.* Registered by Ministry of Justice 12 May 1999 No. 1783.

[27] Amendment to article 17.1 by law No. 52-fz of 14 May 2001 *O vnesenii dopolneniia v stat'iu 17.1 zakona rossiiskoi federatsii o nedrakh.* SZRF 21 May 2001 No. 221 p. 2061.

[28] Article 55.3 of the Draft Law op.cit. note 7 provides that within 30 days after the subsoil user's application has been received, the executive body has to review it and send to the subsoil user a written consent on transfer or, a motivated refusal. The subsoil user in the court may appeal inaction of the executive body or its refusal to agree on the transfer of the subsoil area use right.

[29] Article 94.1 of the Draft Law op.cit. note 7.

quired to give authorisation for a transfer. With regards to reorganisation, the respective article should stipulate that the state may prohibit such a type of transfer only on the grounds expressly stated in this provision of the law.

A lack of clarity also exists with regards to the proposed transfer of a use right by way of enforcing a security taken over the use right. In contrast to article 17.1 of the current law On Subsoil which expressly prohibits the pledge of a subsoil use right,[30] article 56.1 of the Draft Law expressly provides that a subsoil use right may be pledged. This right is rendered unenforceable, as in practice the lender is denied the realization of the value of the security. Article 56.2 provides that regardless of the mortgagees compliance with the requirements imposed on subsoil users by federal laws and by the decisions of the auction organizer regulating a specific subsoil area, the mortgage agreement is prohibited from providing for the transfer of the subsoil use right secured by the mortgage to the mortgagee. Therefore, although project financing is in theory made possible by the general provisions of the Draft Law, the law fails to provide an enforceable security.

The Applicability of the Law On Subsoil

An integral part of the subsoil licensing procedure has been the license holder's right to the relevant surface land plot as well as access to water. As an example, in accordance with the provisions of the current law On Subsoil, the preliminary boundaries of the subsoil mining allotment are defined upon the issuance of the licence and are specified in it. The final allotment of land to the license holder is made after the programme of work on the licensed field is approved, and must be obtained prior to commencing subsoil use.[31] Problems have been caused for license holders due to the fact that the formulation of this land lease agreement is subject to the provisions of the Land Code, and are not automatically conferrable. In practice the local authorities have in the past deliberately postponed the conclusion of the land lease agreement due to the absence of an integrated approach in legislation to the issuing of both subsoil and other necessary use rights.

The provisions of the Draft Law suggest that the current difficulty of identifying a hierarchy between different applicable legislative acts may be exacerbated. The provisions repeatedly fail even to identify which law is applicable and in what circumstances. In article 44.1 of the Draft Law it is stated that: 'Land areas shall be granted to subsoil users in accordance with the land legislation of the Russian Federation and *with account taken* (с учетом) of provisions of this Federal Law.' This in contrast to article 11 of the current law On Subsoil, which expressly states the applicable law and the procedure for its application.

To further illustrate this point, at present the law On Subsoil and the PSA law regulate exclusively projects under the ordinary licensing regime and PSA regime respectively. Article 2.7 of the Draft Law removes this separation, making the provisions of the Draft Law applicable to projects operated under PSAs. The text of article 2.7 states that projects under the PSA regime shall 'be regulated by the Federal Law On Production Sharing Agreements *with account taken* (с учетом) of the provisions of this Federal Law.' The wording used, *with account taken* (с учетом), has no precise legal meaning, thus rendering a PSA project vulnerable to parallel and inconsistent regulation.[32] As a consequence, any future amendment to the law On Subsoil would therefore have an impact upon a PSA project where the subsoil licence had initially been offered at auction under the ordinary tax and licensing regime. The uncertainty this creates is exacerbated by the fact that the Draft Law does not contain any mechanism to mitigate against such a risk, i.e. a grandfather clause similar to article 17.2 of the PSA law.

The difficulty of defining the applicability of the provisions of the Draft Law, and as a consequence of subsequent amendments, is also of relevance to existing license agreements. Article 123.4 makes the provisions of chapter 6 of the Draft Law retrospectively applicable for current license agreements. More extremely, article 124 permits the state to refuse to enter into a subsoil use license or contract if a company that has already obtained a use right has not yet entered into a license agreement.

The Failure to Define the Function and Competence of State Bodies

In a similar vein to the PSA law, the Draft Law has failed to adequately separate the role of the state as a party to the subsoil use contract and as a regulatory authority. Articles 6 and 8 of the Draft Law, with regards to the federal executive and regional

[30] The final paragraph of article 17.1 of the current law On Subsoil op.cit. note 2.

[31] Articles 11 of the current law On Subsoil. Op.cit. note 2.

[32] It should be noted that with regards to the fields that are already included in the List Law for PSA development, in accordance with article 2.3 of Federal Law No. 65-fz of 6 June 2003 op.cit. note 12, key provisions of the law On Subsoil shall not be applicable.

executive respectively, identify the scope of the executive authority of state bodies.[33] With regards to the actual implementation of programmes of granting areas for subsoil use however, the provisions of article 114 are declarative in their nature about the aims of the state management of the use of natural resources.[34] The competence and function of different state bodies is not delimited, and the limits of the prerogative power used to achieve broadly stated aims are not clearly identified. This situation does not differ from that found under article 35 of the current law On Subsoil.[35]

The retention of prerogative for state executive bodies is a common feature of the legislation of different countries regulating the use of natural resources. In other countries, however, such as Norway, this prerogative power may only be exercised in accordance with requirements effectively imposed by Constitutional and EC legislation promoting fair administrative practice.[36] As has already been emphasised in this article the Draft Law fails to clearly identify the grounds upon which state executive bodies may develop specific criteria for restricting a right otherwise afforded by the provisions of the law. In the absence not only of any legislation or practice identifying a hierarchy between legislative acts, but of any consistent practice asserting the primacy of the provisions of legislation over the provisions of sub-legislation, the very failure of the Draft Law to clearly identify limits for the exercise and scope of prerogative is of concern.

Indeed, the wording of some of the provisions of the Draft Law is so wide that the exact scope of the criteria to be subsequently developed by the government cannot be discerned from the text. Rather than simply providing a mechanism for executing the provisions contained with the law itself the sub-legislative acts that are introduced by the government will themselves identify the extent of a state agency's prerogative to regulate a particular issue, i.e. in article 23 with regards to the identification of strategic resources that are to be the subject of a compulsory purchase made by the state.

Conclusion

Both in the current law On Subsoil and the Draft Law there is a possibility that a license or contract may be prematurely terminated by the bodies which have granted the use right.[37] The termination of a use right in the future will with the promulgation of the Draft Law, however, be determined by a court when the parties are not in agreement. Yet the apparent protection afforded by this provision of the Draft Law should be qualified by the recognition that the court may rule in favour of the state when its unilateral demand for termination is 'envisaged by this Federal Law.' Although the move away from a licensing system towards a contractual system provides a subsoil user with a greater access to a remedy in the event of a breach of contract by the state, the level of protection the subsoil use contract provides will primarily depend upon the practical limitations of its enforceability.

This dependency must be viewed in light of the scope identified in this article for the partial and arbitrary behavior of state bodies, from the determination of auction criteria to the susceptibility of the conditions of use to amendment, and the contract itself to unilateral termination. The opportunity to identify when such a risk will arise may well be reduced by the introduction of the Draft Law. Provisions that clearly identified the instances of a user's vulnerability, such as the exhaustive nature of the circumstances in article 20 of the current law On Subsoil when a use right could be unilaterally terminated, will be replaced by what is in effect an open-ended list of grounds where termination may be ruled by a court on the application of the state after an amendment to the law itself.

The experience of petroleum producers over the past decade has revealed that it is more the continued lack of clearly defined regulatory authority than the imperfections of legislative acts that is the impediment to the establishment of a transparent and predictable framework for the state management of natural resource use. The successful development in practice of the proposed contract-based system for subsoil use is in reality dependent upon the implementation of a system for the regulation of resource use where the jurisdiction and function of state bodies are clearly defined. □

[33] Article 6 of the Draft Law op.cit. note 7.

[34] Article 114 of the Draft Law op.cit. note 7.

[35] Article 35 of the current law On Subsoil op.cit. note 2.

[36] As an example, the Norwegian Ministry of Petroleum may only propose the opening up of an area for exploration as stipulated by section 3.1.4 of the Petroleum Act 1996, if it acts in accordance with article 110b of the Constitution and article 20 of the Environmental Information Act of 2004 with regards to informing the public.

[37] Article 20 of the current law On Subsoil op.cit. note 2 and article 80.1 of the Draft Law op.cit. note 7 respectively.