

Legislation on Russian Subsoil Use: Current Status and Trends

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This overview briefly describes the current status of subsoil and oil & gas legislation in Russia in light of the latest energy law developments, which were addressed at a conference "Energy Week – 2006" on energy law and practice at the Golden Ring Hotel on 23-24 November 2006.

1. Current Aspects of Subsoil Use Legislation

1.1. Rule-making activity of the Ministry of Natural Resources of the Russian Federation (MNR) and legislation improvement plan

Speaker: *D. Vasilevskaya*, PhD, Deputy Head of the Department of State Policy in Subsoil Use, MNR

In light of the recent developments of subsoil legislation, a number of amendments have been introduced to Federal Law No. 2395 "On Subsoil" dated 21 February 1992 (Subsoil Law).¹ In particular, the speaker focused attention on the provisions amending Article 17.1 of the Subsoil Law, which, among other things, simplify the transfer of subsoil use rights from a parent company to a subsidiary and transfers between subsidiary companies. The regulations for implementing the amendments on the procedure of re-issuance of licences are expected to be in place by the first quarter of 2007.

Work on the Draft Administrative Reglament of the Federal Subsoil Use Agency (FSUA) is getting closer to completion. It is expected to be finalized by the end of December of 2006. The Draft Reglament will provide a detailed procedure for the authorized state bodies to prepare and conduct tenders or auctions for obtaining the subsoil use rights.

The amendments were proposed in respect of subsoil users' right to conduct a geological study of underlying beds since in practice this may constitute a problem.² In this regard, the respective amendments will allow subsoil users already holding exploration and production licences to obtain

the necessary licences for a geological study of the subsoil.

The MNR also simplified the procedure for granting subsoil use rights for mineral exploration and production purposes upon discovery of a mineral deposit. The respective amendments will substantially reduce the number of administrative burdens.

The MNR plans to introduce amendments to the current Subsoil Law enlarging the provision which will set the requirements for the content of technical projects linked with subsoil use. The type of subsoil use and natural resource type will serve as the criteria for the differentiation of the relevant requirements.³

The provisions of the current Subsoil Law very broadly govern the procedure for termination of subsoil use rights. The MNR is initiating the adoption of amendments that would provide: (i) a detailed procedure for termination of subsoil use rights; (ii) a definition of the "material" terms of subsoil use; and (iii) possibly the procedure for the termination of the subsoil use rights by the commission.

1.2. Current status and development of the regulatory regime for granting subsoil plots for use

Speaker: *E. Mazkov*, Deputy Director, Legal department, Center for Production Sharing Agreements (PSA), Implementation and Subsoil Use Legal Support (SPR-Nedra), MNR.

The order of MNR No. 61 establishes the procedure for the review of applications for obtaining subsoil use rights for geological study of the subsoil plots. The speaker addressed the following issues that remain uncertain:

¹ E.g. amendments introduced for the purpose of concretization of the requirements with respect to the content of a subsoil use license or amendments which lay out the possibility for issuing of a combined license of subsoil use on continental shelf.

² The current subsoil legislation envisages that a mining allotment has to be limited in depth. In this regard, a subsoil user, holding an exploration and production license, does not have the right to conduct a geological study of a subsoil plot on the underlying beds.

³ The current Subsoil Law contains a provision which broadly identifies the necessity for technical projects for subsoil use activities without concretization of the requirements to the content of the technical projects.

- (i) the difficulties in creating lists of subsoil plots available for a geological study. Russian legislation does not have a regulatory document in place which would apply to this issue but only guidelines developed by MNR.⁴
- (ii) review of an application for obtaining the subsoil use right.
- (iii) review of an application consists of five blocks.

The first three blocks are subject to analyses and consideration. The current legislation does not adequately lay out the key procedure which would address issues with granting a subsoil plot under tender procedure. A solution was found in developing the administrative procedure envisaged by the aforementioned Administrative Reglament.

2. Subsoil Use Practice Experience on the Continental Shelf

2.1. Analysis of conclusion of PSA for certain subsoil plots without tender procedure

Speaker: V. Sokolov, Legal Consultant, Price-waterhouseCoopers

Since the adoption of the PSA Law in 1995,⁵ the procedure for conclusion of PSAs was subject to changes. The current PSA Law envisages a provision requiring a tender procedure along with the "special provision"⁶ which allows concluding a PSA for certain subsoil plots without following the tender procedure.

The special provision shall not apply if the following criteria are met: **(i)** a subsoil plot is not on the list of objects of subsoil plots subject for granting under an PSA; **(ii)** the land plot was granted to a subsoil user under a general procedure (a licence was issued) before 2003; **(iii)** a subsoil plot is located on the continental shelf of the RF, the exclusive economic zone of the RF or in the Caspian seabed which is under the jurisdiction of the RF and **(iv)** exploration

of a subsoil plot under international agreements of the RF.

Thus, while the legislation envisages the special provision, it does not provide a mechanism for its implementation. The lack of such mechanism therefore leads to the requirement for setting up a commission for a second tender application.⁷ In this regard, the introduced special provision shall not be considered a part of the PSA Law since it does not directly amend the current PSA Law but contradicts it.

2.2. Problems of oilfield development in Kazakhstan region

Speaker: N. Osadchaya, Legal Consultant, Price-waterhouseCoopers.

The Caspian Sea region contains significant reserves of oil and natural gas. Due to its dynamic economic development, the Caspian region has become a central focus of both Russian and foreign leading investors in the oil and gas sector. However, the implementation of these goals will be difficult in light of the region's situation which the speaker defined as follows:

- (i) the status of the Caspian Sea is unclear. Thus, the applicability of the 1982 UN Convention of the Law of the Sea could be questioned.
- (ii) the establishment of an overarching agreement among five Caspian littoral States is necessary;
- (iii) all five Caspian littoral states have different approaches to delimitation of borders of the Caspian region.
- (iv) there has been no unified and coordinated approach developed by the Russian state authorities to define the status of the Caspian Sea;

Considering the uncertainties regarding the status of the Caspian Sea, the speaker described what questions may be raised as a result of this uncertain status:

- (i) what taxes should be paid by oil and gas companies, their suppliers and contractors?
- (ii) should a subsoil use license contain additional terms and requirements applicable to subsoil plots located on the continental shelf?

⁴ Order of MNR No. 238 "On Approval of Guidelines on the Procedure for the Creation of the Lists of Objects Available for Use for a Geological Study".

⁵ Federal Law No. 225-FZ "On Production Sharing Agreements", dated 30 December 1995.

⁶ It is provided by Article 7 (4) of Federal Law No. 65 FZ "On introducing amendments into part two of the tax code of the Russian Federation, on introducing amendments and additions into some other legislative acts of the Russian Federation and on declaring invalid some legislative acts of the Russian Federation" dated 6 June 2003.

⁷ The PSA law requires two tender procedures. The first tender procedure defines the impossibility for granting a subsoil use rights under conditions other than PSA and the second tender procedure defines a potential investor.

- (iii) should PSAs for subsoil plots, located on the Russian part of the Caspian Sea, be envisaged by special federal laws (as it is required for subsoil plots located on the shelf)?
- (iv) should foreign shipping be allowed on the waters of the Caspian Sea?

3. Oil & Gas Legislation in Russia: Current Status and Development

3.1. Commentaries on Federal Law No. 117-FZ “On the Export of Gas”, dated 18 July 2006

Speaker: *I. Makarov*, Associate, Jones Day Law Firm

The speaker discussed the purposes and objectives of the adoption of the Law along with its implementation problems.

The Law has been adopted to protect the economic interests of Russia, fulfill international obligations for gas export, guarantee revenues to the federal budget and maintain the energy balance in Russia. First, while discussing the Law’s purpose to protect the economic interests of Russia, the speaker mentioned that many factors related to the world gas market would most likely significantly influence the gas price set by a supplier (e.g., competition with gas produced by PSA projects, with LNG and other energy sources). Second, the speaker doubted the legal framework for fulfilling international obligations on gas export. The Law provides that an “exclusive export right” based on a licence is granted to the organization that owns the unified gas supply system, i.e. Gazprom, or its 100% subsidiary. However, Gazprom’s gas supply obligations are of a private nature; they are not part of Russia’s international obligations. Speaking on the legal aim to guarantee revenues to the federal budget, Mr. Makarov emphasized that profit maximization is important to both Gazprom and independent gas producers. As to the aim of maintaining the energy balance in Russia, the speaker said a balance could be achieved using administrative means; while Gazprom’s obligations and those of independent gas producers are the same. The issue of abnormal profits possibly resulting from the implementation of the Law has not been resolved. Overall, the Law lacks an implementation mechanism.

3.2. Implementation Problems of Federal Law No. 117-FZ “On Export of Gas”

Speaker: *A. Gladkov*, Deputy General Director, ERTA Consulting.

The speaker pointed out that there is a lack of a clear definition to which types of gas the Law is intended to apply. Pursuant to Article 2, which mentions that gas is extracted from all types of hydrocarbon deposits and transported in a gaseous or liquefied state, the Ministry of Economic Development issued exclusive gas export licenses to virtually all of the legal entities which had foreign-economic activity customs code No. 2711. Later the Federal Customs Service re-called those licenses. Therefore, the definition of export gas needs to be clarified.

Furthermore, the Law does not specify the exact number of potential holders of the exclusive gas export license. As a result, these licenses have been granted to three organizations: open JCS “Gazprom”, LLC “Gazexport” and LLC “Severgazprom”. However, neither the business activities of these organizations nor the cooperation procedures have been established. Therefore, the Law must specify the quantity of exclusive gas export license holders and their cooperation procedures.

Finally, the Law has failed to clearly identify the procedures for the export of gas. The cooperation procedures between an exclusive gas export license holder and a company that is willing to export its gas have to be set. The mechanism by the Russian government surrounding the formation of an export policy is not clear. The Law must further elaborate on the definition of gas export sources, commission remuneration and internal market prices.

4. Legal aspects of hydrocarbon production and trading

4.1. Regulatory framework for independent gas producers: current status, problems and trends

Speaker: *S. Eryomin*, Senior Adviser for regulatory issues of TNK-BP Management

The speaker identified the main regulations surrounding the activities of independent gas producers:

1) **Extraction** – Subsoil law, Resolution of Supreme Council No. 3314-1 on subsoil use licensing;

2) **Transportation** – Federal law No. 147-FZ “On natural monopolies”, dated 17 August 1995; Government Decree No. 858 on access to Gazprom’s gas transportation system, dated 14 July 1997; Government Decree No. 1021 on price and tariff regulation, dated 29 December 2000; Federal Tariff Service Order No. 151-ý/1 on gas transportation tariffs, dated 28 July 2006;

3) **Distribution** – Government Decree No. 1370 on access to local gas distribution infrastructure; Federal Tariff Service Order No. 186-ý/3 on tariffs for gas transportation through gas distribution infrastructure, dated 15 August 2006;

4) **Sales** – Federal law “On Competition”; Federal law “On Export of gas”; Government decrees No. 162 on supply rules, dated 5 February 1998; No. 1021 on price and tariff regulation, dated 29 December 2000; No. 534 on gas electronic sales experiment, dated 2 February 2006; Federal Tariff Service Order No. 194-ý/12 on the retail price for gas sold to the population, dated 23 November 2004;

5) **Storage** – Mr. Eryomin pointed out, however, that there are no respective regulations on the **storage** of gas.

4.2. Associated petroleum gas: legal issues

Speaker: *N. Tolstikh*, General Director of State Unitary Enterprise “Center for legal problems of Northern territories”

In Russia there is no specific law regarding associated gas from petroleum extraction. Certain rules with regard to associated petroleum gas are outlined in the Federal Law No. 7-FZ “On protection of the Environment”, dated 10 January 2002 (paragraph 2 of Article 46); the Russian Federation Law “On Subsoil” No. 2395-1, dated 21 February 1992 (paragraph 1, 5, 6 of Article 23); and Regulations on Development of oil and gas/oil fields, approved by Minnefteprom in 1984 (section 2.1.2(g)). However, these rules cannot be implemented properly for the following reasons: **(1)** the term for utilization, or permitted use, of associated petroleum gas is not legally defined; **(2)** associated petroleum gas is not one of the legally established types of mineral deposits; **(3)** price control by the state at the current level makes utilization of associated gas not economically feasible; **(4)** lack of transportation infrastructure to deliver associated gas to a processing plant; **(5)** lack of a customer base for the processed gas. □