

Insight

February 2014

Russia Energy & Natural Resources

This 2013 Legal Year-in-Review has been prepared by the White & Case Moscow Energy Team for our clients to give you an overview of 2013's principal legislative developments affecting the Russian energy & natural resources sectors.

In this Review you will find spotlight updates related to:

- Development of Russia's Offshore Oil and Gas Projects: Foreign Operators
- Liberalization of LNG export from Russia

We have also included short updates on other relevant legislative changes that occurred in the specified sectors throughout 2013.

Foreign Operators for the Development of Russia's Offshore Oil and Gas Projects

Under Russian law, only state-controlled companies with at least five years of Russian continental shelf development experience (i.e. Gazprom, Rosneft and their affiliates) may hold subsoil licences to develop offshore fields. However, in order to attract and channel foreign investments and know-how into offshore oil and gas production, there has recently been an important development in Russian legislation, to allow companies other than Rosneft and Gazprom to participate in offshore projects as operators.

On 30 September 2013 the President signed Federal Law No. 268-FZ amending the Russian Tax Code and the Federal Laws "On Customs Tariffs" and "On the Continental Shelf" (taking effect as of 1 January 2014, save for certain provisions). While focusing on enhancing tax incentives to be available to companies engaged in offshore hydrocarbon production activities (including works related to the construction, operation and use of artificial islands, installations and facilities), the Law also recognizes the role of an operator of a new offshore hydrocarbon field and provides a legal basis for cooperation between Russian subsoil license holders for the development of these fields and such operators for the performance of works related to the production of the respective field on a contractual basis.



For more information, please contact:

Igor Ostapets

Partner

+ 7 495 787 3019

iostapets@whitecase.com

Adam Smith

Counsel

+ 7 495 787 3002

adam.smith@whitecase.com

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White & Case LLC
Tel + 7 495 787 3000
Fax + 7 495 787 3001
whitecase.com

Under the Law, in order to qualify as an operator, a company (including a foreign company) is to meet all of the following criteria:

- (i) a subsoil license holder of an offshore deposit (or one of its affiliates) is to have a direct or indirect equity participation in such company. The Law does not specify any percentage of equity participation by such license holder. Based on practical examples, foreign partners usually obtain a one-third stake in JVs with Rosneft or Gazprom with respect to the development of Russia's certain offshore fields.
- (ii) a company conducts operations (either itself or by engaging contractors) at a **new** offshore hydrocarbon field (i.e., those with commercial operations beginning from 1 January 2016);
- (iii) a company performs works at a new offshore hydrocarbon field on the basis of an agreement with the relevant license holder (i.e., operations agreement), and such agreement provides for a fee to be paid to the operator in an amount depending on, among other things, volumes of extracted hydrocarbons and (or) income earned from the sale of such hydrocarbons (i.e., these agreements are "risk service agreements").

Pursuant to the Law, a company is qualified as an operator from the date of entering into an operations agreement provided that a tax authority is duly notified. For the purposes of applying a special tax regime, only one company may hold the status of an operator with respect to a given new offshore hydrocarbon field.

The introduction of provisions related to the operators and operations agreements are of significant nature as they fill gaps in Russian legislation and, therefore, provide more comfort to potential investors with respect to the application of these types of arrangements in Russia.

Liberalization of LNG export from Russia

On 30 November 2013 the President signed Federal Law No. 318-FZ amending the Federal Laws "On the Fundamentals of State Regulation of Foreign Trade Activities" and "On Gas Export" with respect to the liberalization of export of liquefied natural gas ("LNG"). Before the enactment of the Law, the owner of the Unified Gas Supply System (Gazprom) or its fully owned subsidiary (Gazexport) had exclusive rights to export gas (including LNG) outside Russia. In accordance with the new Law, which is in effect from 1 December 2013, Gazprom (Gazexport) retain the monopoly over export of gas in gaseous form via the pipeline system while the exclusive right to export LNG extends to:

- (i) (i) companies holding licenses for the development of subsoil blocks of federal significance (e.g., those containing gas reserves of no less than 50 billion cubic meters) where such licenses, as of 1 January 2013, provide either for (i) the construction of facilities to produce LNG or (ii) dispatch of natural gas to an LNG facility for liquefaction;
- (ii) state-owned companies (e.g., those in which the Russian Federation holds more than 50% of the total votes represented by the share capital of such company) and their controlled subsidiaries, which produce LNG based on gaseous gas they extract from offshore fields in relation to which they are the subsoil users, or gas produced under production sharing agreements.

The amended Federal Law "On the Fundamentals of State Regulation of Foreign Trade Activities" authorizes the Ministry of Energy to issue licenses for export of LNG. LNG license holders are to submit information related to export of gas (e.g., destination, counterparty, etc.) to the Ministry of Energy. Such system of reporting/coordination is aimed at avoiding competition among gas exporters/producers on the global market. The list of such information and the procedure for its submission are yet to be approved by the Government.

Considering that these changes have been actively lobbied by the Russian independent gas producer Novatek and the state-owned oil producer Rosneft, they may turn out to be beneficial for the state as this will help to increase Russia's share on the global LNG market and attract foreign investments into existing and future gas production projects in Russia.

Legislative Update Briefs

Subsoil

Addressing liability for oil spills

On 30 December 2012 the President signed Federal law No. 287-FZ "On the Prevention and Clean-Up of Oil Spills in Internal Sea Waters, Territorial Sea and the Continental Shelf of the Russian Federation".

Pursuant to the Law, companies (in particular those using underwater pipelines, drilling for the purpose of subsoil use and transporting and storing oil and oil products within the internal sea waters, territorial sea and continental shelf of the Russian Federation) are obliged to develop and submit for approval a plan for the prevention and clean-up of oil spills. Such companies are also to secure the performance of their financial obligations to implement measures envisaged under the plan (e.g., by means of a bank guarantee, an insurance contract or a corporate reserve fund). A methodology for determining the amount of security is yet to be established. The Law also specifies that where a subcontractor (operator) is engaged by a subsoil license holder for conducting such works, the subcontractor (operator) and the relevant subsoil license holder shall be jointly liable for the damage caused to the environment and (or) third parties by its subcontractor (operator).

The Law entered into force on 1 July 2013.

Auctions for the right to use "strategic" deposits

On 30 December 2012 the President signed Federal Law No. 323-FZ amending the Law "On Subsoil" ("Subsoil Law"). Following the amendments, tenders for the right to use subsoil deposits of federal significance may only be held in the form of auctions.

The Law entered into force on 11 January 2013.

Term for geological study works extended

As a general rule, subsoil areas may be leased for the purpose of conducting geological study works for a term of five years (or ten years for subsoil areas located within the internal sea waters, territorial sea and continental shelf). On 23 July 2013 the President signed Federal Law No. 227-FZ amending the Subsoil Law to extend the lease period from five to seven years with respect to subsoil areas located in regions with complicated weather conditions (e.g., Yamalo-Nenets Autonomous District, Sakhalin and Kamchatka Regions).

The Law entered into force on 1 January 2014.

Oil reserves no longer a state secret

The Federal Law "On State Secrecy" provides that information on the amounts of reserves in the subsoil, extraction, production and consumption of strategic types of natural resources of the Russian Federation constitutes a state secret. Pursuant to the Law, oil and gas dissolved in oil were included in the list of strategic natural resources, and relevant information was regarded as a state secret (Government Resolution No. 210 dated 2 April 2002). In order to give a powerful boost to the investments in hydrocarbon production, on 5 July 2013 the Government issued Resolution No. 569 removing the information on the amount of reserves of oil and gas dissolved in oil contained in the subsoil from the respective list, meaning that such information is no longer treated as a state secret.

The Resolution entered into force on 17 July 2013.

New classification of oil and gas reserves

On 1 November 2013 the Ministry of Natural Resources issued Order No. 477 approving a new Classification of reserves and resources of oil and combustible gases.

The Classification establishes unified principles for the estimation and state accounting of reserves and resources of oil, inflammable gas and gas condensate in Russia. It provides for a clearer gradation between reserves of categories A, B and C and resources of category D, with a slight revision of the indexation of the categories. The principal difference is that the new Classification, as compared to the existing one, takes into account the economic viability for a subsoil user to extract reserves based on the effective project decisions with respect to field development.

The Order will enter into force on 1 January 2016.

Power

New measures to support renewable generation investment projects in Russia

On 28 May 2013 the Government issued Resolution No. 449 "On a Mechanism for the Support of Renewable Energy Sources on the Wholesale Electric Power and Capacity Market."

The Resolution establishes a mechanism to support the use of renewable sources of energy for power generation in Russia via the wholesale market for generation capacity. (The capacity market provides means for power generators to receive certain capacity payments in return for keeping their facilities ready to generate.)

The Resolution provides for an annual competitive selection of investment projects for the construction of renewable generating facilities to be organized by the commercial operator, OJSC "Administrator of the Trading System of the Wholesale Electricity Market." Renewable generation projects selected through this process qualify for long-term agreements on the delivery of renewable capacity under which the project sponsor is entitled to capacity payments over a 15-year supply period. The payments are calculated on a basis set out in the Resolution that is intended to allow for recovery of capital invested and a certain level of return.

The Resolution also promotes localization of renewable projects (i.e., domestic production within Russia of the equipment used) by requiring that projects meet minimum projected levels of localization in order to qualify for the selection process, and applying a significant discount to the capacity payments received by projects that do not in fact meet the target level. The target levels for the degree of localization are set out in the Program (discussed below).

The Resolution entered into force on 11 June 2013.

On 28 May 2013 the Government issued Decree No. 861-r "On Amendments to the Guidelines for State Policy of Increasing the Effectiveness of the Use of Renewable Energy Sources for the Period until 2020" (the "Program").

The Program, approved under Government Decree No. 1-r dated 8 January 2009, outlines steps to be taken by government authorities in order to promote greater use of renewable energy sources, and establishes targets for electricity generation using renewable energy sources. Pursuant to the amendments, the Program establishes targets for new capacity to be installed to use renewable generating facilities of each type (i.e., wind, solar and hydro power). In particular, the target is to install almost 6,000 MW of new capacity by 2020 (now the total installed capacity does not exceed 2,200 MW). The Program also establishes target levels for the degree of localization of renewable generating facilities, including: (i) wind projects, 35% for 2014, rising to 65% from 2016; (ii) solar projects, 50% for 2014, rising to 70% from 2016; (iii) and hydroelectric projects, 20% for 2014 (with capacity less than 25 MW), rising to 65% from 2018.

The Decree entered into force on 28 May 2013.

[For more information on these new measures, please see our Client insight as of June 2013]

Environmental/Industrial Safety

National target for limiting GHG emission

On 30 September 2013 the President issued Decree No. 752 "On Reduction of Greenhouse Gases Emission."

Russia decided not to undertake new quantitative commitments on reduction of greenhouse gases ("GHG") emission under the Kyoto Protocol but instead chose to set a national target for limiting the level of GHG emissions. Accordingly, for the purposes of implementing its national Climate Doctrine (approved under Presidential Decree No. 861-rp on 17 December 2009), the President issued the Decree establishing a national goal to keep the level of GHG emissions to 75 percent at most of the level of such emissions in 1990 (the base year for the Kyoto Protocol) by 2020. The specific national action plan and targets for emission reduction by industry is to be adopted by the Government within the next six months.

The Decree entered into force on 1 October 2013.

Classification of hazardous production facilities

On 4 March 2013 the President signed Federal Law No. 22-FZ amending the Federal Law "On Industrial Safety of Hazardous Production Facilities" and certain other legislative acts.

The new Law, in particular, sub-divides hazardous production facilities into four classes of hazard depending on the level of potential danger (e.g., Class I hazard facilities have the highest level of danger). The appropriate class of hazard is to be assigned to facilities upon their state registration. Facilities which were registered before 15 March 2013 (the date the Law entered into force) should have been re-registered prior to 1 January 2014.

Following the enactment of the Law, requirements applicable to hazardous production facilities now vary depending on the class of hazard. In particular,

- Explosive, inflammable and chemically hazardous facilities rated as Class IV hazard may be operated without a license (1 July 2013);
- Action plans for post-accident clean-up in relation to certain types of facilities rated as Class I, II or III hazard must be approved (1 January 2014);
- An industrial safety management system (1 January 2014) and industrial safety declarations in relation to facilities rated as Class I or II hazard must be approved; and
- Continuous state supervision of facilities rated as Class I hazard is to be established (1 January 2014).

The Law also abolishes the requirement to obtain permits from the Federal Service for Ecological, Technological and Nuclear Supervision to use technical devices at hazardous production facilities. Until necessary technical regulations establishing other forms of compliance for certain types of technical devices are adopted, such technical devices are subject to industrial safety expert review. In addition, the Law, in certain cases, gives organizations an opportunity to establish individual standards of industrial safety for a hazardous production facility in preparation for design documentation (e.g., if relevant industrial safety rules are not sufficient or not established under Russian law).

The Law entered into force on 15 March 2013, save for certain provisions.

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