
THE OIL AND GAS LAW REVIEW

EDITOR
CHRISTOPHER B STRONG

LAW BUSINESS RESEARCH

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THE OIL AND GAS LAW REVIEW

Editor
CHRISTOPHER B STRONG

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EDITOR'S PREFACE

I am very pleased to have been able to take part in this first edition of *The Oil and Gas Law Review*. This publication is intended to be a practical analysis of recent developments around the globe in this exciting industry. My hope is that it will serve as a valuable resource to attorneys in private practice, in in-house positions, in government service and in academia who are seeking to keep abreast of legal developments on the oil and gas front.

Input from leading oil and gas practitioners around the world has been gathered for *The Oil and Gas Law Review*. The publication is divided into 22 chapters, each addressing legal issues in a particular jurisdiction. Our goal in selecting these jurisdictions was to ensure that most of the major oil and gas producing regions were represented. Although the oil and gas business is a global one, laws and regulations vary significantly from jurisdiction to jurisdiction, and sometimes even between states or regions of a particular jurisdiction. For practitioners within the oil and gas industry, keeping up with global legal developments is a constant effort. By gathering recent and insightful information from the world's major oil and gas jurisdictions this book will be a major step in addressing this need.

Over the past several years, a number of major trends have emerged in the global oil and gas industry. The first and undoubtedly most important of these is the growing importance of unconventional resources to the global oil and gas industry. The 'shale boom' that started in North America and is slowly starting to spread to other parts of the world has upended the industry. The United States looks set to shortly becoming a net exporter of petroleum for the first time in decades, and other jurisdictions are seeking to emulate its success. At the same time, lawmakers and regulators, particularly those in jurisdictions that are unused to large-scale onshore exploration and production activities, are struggling with how best to address the inherent environmental issues. The struggle with how to effectively balance the benefits of increased domestic production of petroleum with the perceived environmental risks of 'fracking' will no doubt occupy the attention of lawmakers, regulators and lawyers for many years.

A second emerging trend is the opening (or reopening) of new jurisdictions to oil and gas exploration and production activities. Jurisdictions such as Tanzania and Mozambique, which just a few years ago received scant attention from international oil and gas companies, are now receiving significant attention, with major gas finds seemingly announced on a monthly basis. A similar situation is playing out in the Eastern Mediterranean, where discoveries in offshore Israel, Lebanon and Cyprus have the potential to transform both economies and regional politics. Iraq, closed to foreign investment during its years of economic sanctions, has re-emerged as one of the world's major oil provinces with both majors and independents investing billions of dollars in petroleum sector. Finally, decades after nationalising its oil industry, Mexico's new president has announced plans to allow private investment in its upstream sector. Each of these jurisdictions will have to craft a legal regime that strikes an appropriate balance between attracting foreign investment while at the same time ensuring that economic rents are retained by the state for the benefit of the people.

Finally, in a period of sustained high oil prices, resource nationalism is an issue in many parts of the world. Whether taking the form of windfall taxes, forced renegotiation of contractual terms agreed during a period of lower prices, or stronger measures, oil and gas investment remains an area fraught with political and legal risk as some producing jurisdictions seek to change the rules of the game mid-course in light of increased oil prices and other changed circumstances from the time an investment was originally made. Although impossible to avoid entirely, lawyers advising clients in the oil and gas business are constantly seeking to get a handle on political and legal risk so that they can advise their clients accordingly.

Each of the trends mentioned above, as well as a number of others that space has not permitted me to discuss, will no doubt attract considerable attention from lawmakers, regulators and attorneys in the coming year, and I hope that the readers of *The Oil and Gas Law Review* will find it to be a helpful resource in that regard. I am grateful to all of the contributing authors for their efforts and insights.

Christopher B Strong

Vinson & Elkins LLP

London

November 2013

Chapter 16

RUSSIA

Natalya Morozova and Rob Patterson¹

I INTRODUCTION

Russia is a major global producer, exporter and consumer of oil and gas. According to the BP Statistical Review of World Energy 2013, in 2012 Russia had 5.2 per cent of the world's proven oil reserves, the eighth largest globally and sufficient to last for 22.4 years at the same rate of production. Russia was the second-largest producer of oil following Saudi Arabia, and the fifth-largest consumer of oil following the US, China, India and Japan. In 2012, more than three-quarters of Russia's oil exports were destined for Europe. At the end of 2012, Russia had the second-largest proven natural gas reserves in the world following Iran, and was the second-largest producer and consumer of natural gas following the US. Russia was the largest exporter of pipeline natural gas in the world, with the exports limited to just two markets: Europe and the Former Soviet Union. Russia's LNG exports amounted to just 4.5 per cent of the global exports in 2012.

Russia's natural resources industry, and in particular the oil and gas sector, has been its principal economic driver over the past 15 years. Russia's current economy is heavily reliant on its oil and natural gas exports. According to the World Bank in Russia's Economic Report No. 29, in 2012 oil and gas revenues provided half of the revenues of the federal government's budget and two-thirds of Russia's exports. As a result, the country's economic health is exposed to commodity price volatility and changes in external demand. According to Report No. 30, Russia's prospects in 2014 will largely depend on the recovery of Russia's oil and gas primary consumer, namely Europe.

1 Natalya Morozova and Rob Patterson are partners at Vinson & Elkins LLP.

II LEGAL AND REGULATORY FRAMEWORK

Much of the current legislation governing the use of natural resources in Russia emerged around 1995 and has been evolving over the years since then. All of the key laws in this area have undergone continuous revisions and changes and remain in a state of development.

i Domestic oil and gas legislation

The legal framework of the oil and gas legislation in the Russian Federation revolves around the following laws:

- a* Constitution of the Russian Federation. It sets forth the principal rules on ownership rights to natural resources.
- b* Federal Law on Subsoil (the Subsoil Law). This is the core law governing a vast range of rules covering the allocation and development of natural resources.
- c* Federal Law on Gas Supply in the Russian Federation (the Gas Supply Law). This law governs primarily natural gas development, transportation and sales.
- d* Federal Law on Natural Monopolies. This law in part governs transportation of oil and gas via trunk pipelines.
- e* Federal Law on the Continental Shelf of the Russian Federation. This law contains specific rules on the development of natural resources on the continental shelf.
- f* Federal Law on Production Sharing Agreements. This sets forth the regime for the development of natural resources via production sharing agreements.
- g* Federal Law on Energy Saving and Energy Efficiency.

The following federal laws are also relevant to the legal framework of the natural resources industry of the Russian Federation:

- a* The Codes of the Russian Federation, including the Civil Code, Land Code, Water Code, Forest Code, Tax Code, Code on Administrative Violations and Criminal Code.
- b* Federal Law on Environmental Protection.
- c* Federal Law on Ecological Expertise.
- d* Supreme Council Regulations on the Procedure of Enactment of the Provisions on the Procedure of Licensing of the Subsoil Use of 1992 (the Subsoil Use Licensing Regulations).

The federal government has also adopted a policy on oil and gas, the main document setting forth that policy being the 2030 Energy Strategy. The main objectives determined are:

- a* a transition to an innovative economy and better energy efficiency;
- b* the formation of a competitive environment in the energy sector; and
- c* further integration into the global energy system.

In December 2012, the government approved the State Programme of Protection of Environment for 2012–2020. The main objective of the programme is to improve ecological safety and preserve natural ecosystems in Russia.

In February 2013, the President signed into law the ambitious Strategic Programme of Development of the Arctic up to 2020. The main objective of the programme is to explore the Arctic shelf, prepare its oil and gas resources for exploration, and form an Arctic reserve fund of deposits.

ii Regulation

The Ministry of Natural Resources and Environment is the government body that prepares and subsequently implements government programmes according to its powers and responsibilities in the oil and gas sector.

The Ministry of Natural Resources and Environment's main objective is the replacement of reserves, since new discoveries are falling while the large producing deposits are being depleted. The Ministry has prepared a programme of natural reserves replacement to stimulate geological exploration up until 2020. From 2014, the Ministry will determine the procedure of setting regular payments for the use of subsoil.

The Federal Agency for Subsoil Use, an agency subordinate to the Ministry of Natural Resources and Environment, is the key regulator of oil and gas extraction. Its responsibilities include:

- a* issuing subsoil licences and supervising the holders' compliance with the terms of such licences;
- b* making decisions on the termination or suspension of subsoil licences;
- c* organising geological exploration of the subsoil by the state;
- d* maintaining federal and territorial geological data on the subsoil;
- e* organising the conduct of tenders and auctions for the right to use subsoil;
- f* maintaining the state cadastre of deposits; and
- g* making decisions on discovery of deposits by holders of geological research licences.

The Agency's power to participate in the consideration and approval of the deposits' development plans prepared by holders of subsoil licences was abolished by the government in March 2013.

The Federal Service for Environmental, Technological and Nuclear Surveillance is the key regulator of technical issues in the development of natural resources. It issues:

- a* mining allotments determining the boundaries of deposits; and
- b* industrial safety certificates and operating licences, including for hazardous industrial activities relating to oil and gas operations.

The Federal Service for Supervision of Use of Natural Resources (Rosprirodnadzor) is a federal government body whose main responsibilities are to ensure rational, uninterrupted and environmentally safe use of subsoil. It monitors and takes enforcement action in connection with violations in the use of subsoil and illegal actions causing a negative effect on the environment.

iii Treaties

Foreign arbitral awards are in principle recognised and enforceable in Russia under the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral

Awards, to which Russia is a party. In general, foreign arbitral awards are more enforceable internationally than court judgments rendered outside Russia as foreign judgements, as a rule, are enforceable under bilateral treaties only.

Russia has implemented the Law on International Commercial Arbitration, which is based on the UNCITRAL Model Law and under which any disputes of a commercial nature that involve a foreign party or commercial disputes where at least one party is a Russian company with foreign investments may be referred to international commercial arbitration. An arbitration agreement is mandatory for referral of disputes to international commercial arbitration and it must be in writing. There are certain exceptions, including for example, insolvency proceedings, disputes about registration, reorganisation or liquidation of companies, disputes between companies and their shareholders, and competition issues. It is important to remember that an arbitral award rendered by a tribunal in Russia may be set aside by the state arbitration court. Enforcement of foreign arbitral awards is conducted through state arbitration courts.

To promote foreign investment, Russia has signed and ratified a number of bilateral investment treaties (BITs). Diligent investors structure their holdings in Russia so that they might gain protection from such a BIT. Many such BITs give investors a direct right of action against the state and the right to bring claims in international arbitration outside Russia, which is likely to be less susceptible to manipulation by the Russian government. Although tax planning objectives typically prevail, some investors will structure their deals so that they obtain access to the investment protection remedies available through a BIT. Such structuring should occur at the time the deal is discussed and should be coordinated with tax planning.

Russia has entered into more than 80 bilateral treaties for the avoidance of double taxation.

III LICENSING

Russian law provides for both a licensing and a production sharing regime for the use of natural resources.

The licensing regime is the main regime in Russia. It is governed primarily by the Subsoil Law and the subsoil regulations adopted under it. In general, the licensing regime is based on the administrative relationships between the state (the owner of subsoil) and private legal entities and individual entrepreneurs (users of subsoil). A subsoil licence is a special government consent, which certifies the right of its holder to use a deposit within the stated boundaries, according to the stated purpose, during the stated period and in compliance with determined terms. Many such terms are determined in a licensing agreement, which is a constituent part of a subsoil licence. Breach of the licensing agreement by the subsoil user may result in termination of the licence.

The production-sharing regime is characterised as a civil law relationship between the state and a private investor. However, it has very limited application. The use of subsoil under a production sharing agreement is governed primarily by the production sharing agreement itself, which is entered into under the Law on Production Sharing Agreements, but is also certified by a licence issued under the Subsoil Law. Under this regime, the grant of rights to exploit deposits under a production sharing agreement

can only be approved by the passing of a special federal law. No production-sharing agreements have been signed since the Law was adopted. There are only a few operational PSAs now in Russia, all of which were signed before end of 1995 when the Law on Production Sharing Agreements was adopted.

Under the Subsoil Law, a subsoil licence grants the licence holder an exclusive right to use a particular subsoil plot on the terms and conditions specified in the licence. These include terms specifying:

- a* the purpose of the subsoil use;
- b* borders of the land plot granted for subsoil use;
- c* deadlines (such as the start and end of the production);
- d* production volume; and
- e* payments for subsoil use.

These may be specified in more detail in a licence agreement entered into by a competent state authority and the licence holder.

There are several types of subsoil licences granted in relation to geological research and exploration, and the production of natural resources, including:

- a* a licence for the geological exploration and assessment of a subsoil plot;
- b* a licence for the production of natural resources;
- c* a combined geological research, exploration and production licence allowing for geological exploration and assessment and subsequent production of natural resources; and
- d* the rights granted by a subsoil licence cannot be leased to other persons.

Under the Constitution, natural resources in subsoil are state property and are subject to the joint jurisdiction of the Russian Federation and the region where the relevant natural resources are located. They are not owned by a holder of a subsoil licence until they are extracted. Russian law does not provide for any rights of an owner of the land surface to the subsoil under the land surface. Disposal of subsoil deposits is prohibited. Deposits cannot be the subject of any purchase, sale, gift, succession, contribution or pledge, or be disposed of in any other way.

Holders of subsoil licences have the right to perform geological research and/or extract natural resources. Such rights (certified by the applicable subsoil licence) can be transferred from one person to another if their transfer is permitted by federal laws. The Subsoil Law imposes very harsh limitations on any transfers of the rights to use subsoil.

When extracted, natural resources become the property of the holder of the right to use subsoil and extract the relevant natural resources.

IV PRODUCTION RESTRICTIONS

A subsoil licence, a licence agreement and/or other documents enclosed with a subsoil licence usually impose certain obligations on a licence holder, such as to reach and maintain certain agreed volumes of production. Production of resources above such volumes is prohibited.

The right to use subsoil can be restricted, suspended or terminated in a number of cases and, in particular, if:

- a* there is a direct threat to life and health of people working or living in the area affected by the subsoil use;
- b* the licence holder has breached material terms of the licence;
- c* the licence holder systematically violates the subsoil use procedures;
- d* the occurrence of an emergency situation (disaster, military action and so on);
- e* the licence holder's production does not reach the volumes required by the terms of the licence;
- f* the licence holder has been liquidated;
- g* the licence holder requests suspension or termination; and
- h* the licence holder has failed to file reporting data in accordance with the subsoil laws.

The export of oil from Russia is restricted only by the capacity of the transportation system owned and operated by Transneft. Capacity in its trunk pipeline network and sea terminals is allocated to oil producers for export deliveries in accordance with the principle of equal access, based on information gathered by the Central Dispatching Department of the Fuel and Energy Complex.

As far as natural gas is concerned, Gazprom has a monopoly to export natural gas in all its forms, including liquefied natural gas (LNG). While President Putin has supported the liberalisation of LNG exports, this has not yet been implemented. Inside Russia, Gazprom, as the owner of the United Gas Supply System (UGSS), must provide independent gas producers access to its natural gas transportation system, subject only to: (1) availability of capacity on the UGSS; (2) compliance of the gas being transported with established quality and technical parameters; and (3) availability of connecting and branch pipelines to consumers. Reportedly, in some cases Gazprom abuses its rights.

Oil prices are not regulated. Natural gas prices and oil and natural gas transportation tariffs in Russia are regulated under the Law on Natural Monopolies and the Gas Supply Law. Wholesale price regulation applies to gas produced by Gazprom and its subsidiaries, but does not apply to gas produced by entities not affiliated with Gazprom.

The wholesale price of natural gas produced by independent gas producers is not regulated. However, certain consumers, such as residential consumers, are entitled to fixed retail gas prices.

V ASSIGNMENTS OF INTERESTS

In general, under Russian law, rights to use natural resources cannot be transferred by a holder to third parties through a transactional arrangement. As a result, the acquisition of shares (participation interests) in Russian companies that hold subsoil licences remains the primary mechanism of acquiring any existing interest in natural resources in Russia. Rights to use natural resources cannot be pledged or leased.

The Subsoil Law provides for a limited number of cases where subsoil use rights are, or can be, transferred from a subsoil user to another person or entity and the subsoil use licence is reissued in the name of the transferee without the need to undergo the

procedure of applying for a new licence through a tender or auction. Such cases generally include corporate reorganisations, acquisitions of businesses in the course of bankruptcy proceedings, and transfers of subsoil use rights to related companies.

VI TAX

The specific tax payable by extractors of natural resources in Russia is the mineral extraction tax. It is generally calculated based on the value of natural resources extracted from the subsoil with reference to the price (excluding VAT and excise taxes) at which the extracted resources were sold, and is paid on a monthly basis. However, for oil and gas mineral extraction tax is calculated based on the physical volumes of extracted resources.

In addition, producers of oil and gas are subject to the corporate profits tax at a 20 per cent rate. It applies to all taxpayers in the Russian Federation. Of the 20 per cent rate, 2 per cent is payable to the federal treasury and 18 per cent is payable to the treasury of the relevant member region. Member regions can grant a tax privilege of up to 2.5 per cent.

Producers of oil and gas are also subject to value added tax (VAT), which applies to the sales of goods, works and services in Russia or imported into Russia and is payable to the federal treasury. The main VAT rate is 18 per cent. Exports enjoy the zero rate VAT and the right of recovery of the input VAT.

In addition, Russian oil and oil products are subject to export customs duties. The Russian government establishes the rates of export customs duties for oil, oil products and liquefied petroleum gas (LPG) monthly. The rates are determined generally based on the methodology approved by the federal government, which generally accounts for the average world price of the Urals blend, Mediterranean and Rotterdam (for oil and its products), and the average prices for LPG at the border with Poland.

VII ENVIRONMENTAL IMPACT AND DECOMMISSIONING

Russian environmental legislation applies in full to oil and gas development. It establishes a pay-to-pollute regime administered generally by the Federal Service for Environmental, Technological and Nuclear Surveillance, which issues pollution discharge (harmful emissions) permits. Oil and gas production projects require both an environmental impact assessment by an independent environmental expert and a prior favourable environmental opinion issued by the competent public authorities. The purpose of this evaluation is to: (1) verify that the project ensures protection of the environment and the rational use and restoration of natural resources; and (2) assess the short-term and long-term environmental, economic and demographic impact of the subsoil use.

Further, subsoil licences are granted on the condition that the licence holder undertakes to comply with Russian environmental standards and norms (these include air, water and soil pollution limits, waste management requirements, animal protection, human health, and so on). Once a subsoil licence is issued, the licence holder's compliance with licensing requirements is supervised by the Federal Agency for Subsoil Use (Rosnedra).

On expiration (or termination) of a licence, a licence holder must, at its own expense:

- a* ensure mining allotments and drilling wells are brought to a safe condition that is not hazardous to the life and health of the population and environment;
- b* re-cultivate the land and return it to a condition adequate for future use; and
- c* submit geological and other documentation.

Conservation must be conducted in a manner securing preservation of a deposit, mining allotment and drilling wells for the period of conservation.

VIII FOREIGN INVESTMENT CONSIDERATIONS

i Establishment

According to the Law on Foreign Investment in the Russian Federation (the Investment Law), foreign investors, including investors in the oil and gas sector, are allowed to make investments in Russia in any form that is not prohibited by law. Generally, foreign direct investment in Russia can be conducted either by forming (or purchasing an interest in) a Russian legal entity or by establishing a branch of a non-Russian company in Russia (without forming a separate legal entity). There is a variety of business structures that may be used by investors to form a wholly-owned subsidiary or create a joint venture with Russian partners.

According to the Civil Code of the Russian Federation (the Civil Code), commercial legal entities may be created in the form of, *inter alia*, business partnerships and companies. The business forms that are typically used by foreign investors are joint-stock companies (public or private) and limited liability companies.

Formation of a joint-stock company or a limited liability company requires the adoption of a charter and the capitalisation of the company. The minimum charter capital of a limited liability company is 10,000 roubles and of a joint-stock company 100,000 roubles.

A company must be registered with the state registration authority, which is the local tax inspectorate at the place of location of the company's executive body. The registration of a company usually takes between 15 and 30 days. The newly created company is granted a main state registration number (OGRN) and a taxpayer's identification number (INN). The state registration is confirmed by a certificate of state registration issued by the tax inspectorate.

Simultaneously with the state registration, tax registration and registration with various funds (such as the Pension Fund) is conducted by the same authority. Following the state registration, shares in a joint-stock company must be registered with the Federal Financial Markets Service or its department. The charter capital of a limited liability company is divided into participation interests, rather than stock.

Information on the state registration of a legal entity is incorporated in the Unified State Register of Legal Entities and Entrepreneurs and is partially publicly available on the web page of the Federal Tax Service on the internet.

According to the Civil Code, commercial companies can engage in any types of activities that are not prohibited by law. Some activities require obtaining of an operational licence (as discussed below) or participation in a self-regulatory organisation.

The predominant approach to structuring a business by foreign investors in Russia is to use a non-Russian company formed in an offshore jurisdiction as a holding vehicle for the entire corporate structure. There are two primary reasons for this: (1) greater tax advantages; and (2) use of developed and predictable corporate governance rules to govern the relationship between the foreign investor and its Russian partners.

ii Capital, labour and content restrictions

At present, the hard currency control regime is somewhat liberal. There are no hard currency control requirements, such as government consents to loans or opening bank accounts outside Russia, or mandatory sales of hard currency proceeds. However, there are still a few requirements that are obligatory for Russian residents, including (1) a general prohibition on payments in a foreign currency between Russian residents; (2) repatriation of hard currency export proceeds by Russian residents; and (3) opening of 'transaction passports' with servicing banks in relation to transactions exceeding US\$50,000 or equivalent, and certain others.

Subject to a few exceptions set forth in international treaties, to work in Russia, a foreign employee must have an individual work permit, and to employ foreign employees, a Russian employer generally must have the relevant permit. Such permits are often subject to quotas and must be applied for well in advance without any guarantee that they will be obtained. The term of the above permits are typically one year only and they are linked to a specific region. A significantly less burdensome and expedited regime of employment of foreign citizens, a so-called 'highly qualified specialists regime' is available in all industries, including oil and gas. At present, the only criteria that must be complied with in order to use such regime is to pay foreign employees not less than 2 million roubles per year in Russia and to provide evidence of such payment to the Russian Federal Migration Service.

Some natural resources deposits (so-called 'fields of federal significance') are subject to special national security restrictions. In terms of oil and gas, these are deposits with reserves of 70 million tons of oil or more or reserves of 50 billion cubic metres or more of gas. Acquisitions of shares or indirect control over companies that hold subsoil licences to the fields of federal significance are subject to significant restrictions pursuant to the Law on the Procedure of Foreign Investment in Business Entities Having Strategic Importance for the Defence of the Country and the Security of the State (the Law on Foreign Investments in Strategic Companies).

Foreign investment proposals are reviewed by the strategic investment government commission headed by the Prime Minister. The Commission's prior approval is required for the acquisition of control over a target company involved in geological study and/or exploration and development of a field of federal significance. For these purposes, control is defined as the acquisition (directly or indirectly) of 25 per cent or more of the shares in such target company. If the acquirer is a foreign state or an international organisation (with certain exceptions) or a legal entity controlled by a foreign state or an

international organisation, the threshold at which the prior approval of the Commission is required is reduced to 5 per cent.

Other restrictions on the rights of foreign investors or Russian companies with foreign investment of any size to deposits of natural resources that are of federal significance are provided for in the Subsoil Law and the Law on the Continental Shelf and certain other laws.

The new law imposes the following restrictions that affect the ability of foreign companies and Russian companies with foreign investment of any size to acquire or keep control of significant natural resources deposits in Russia:

- a* the Russian government has the right to refuse to grant a production licence to, or to terminate a combined geological research, exploration and production licence held by, a foreign or Russian company with foreign investment, if it discovers a deposit that falls under criteria of a deposit of federal significance; and
- b* Russian national defence and security executive bodies are allowed to prohibit participation of Russian companies with foreign investment in auctions or tenders for the rights to use deposits of federal significance.

Any transfers of existing licences for such deposits to companies with foreign investment that exceed the thresholds or do not otherwise comply with the criteria outlined in the Law on Foreign Investments in Strategic Companies with regard to natural resources in deposits of federal significance are prohibited. The only exemption to this prohibition is a transfer pursuant to a resolution of the government of the Russian Federation. The production of natural resources from a deposit of federal significance under a combined licence can commence only after the geological study stage is completed and a resolution of the government of the Russian Federation granting the right to production is taken.

Further, licence holders for deposits located or partially located on the Russian continental shelf must be Russian companies having no less than five years' experience of working on the continental shelf and having more than 50 per cent of its voting shares directly or indirectly owned or otherwise controlled by the Russian Federation. This restriction effectively prohibits any foreign investment in the Russian continental shelf other than via the Russian state-controlled majors Gazprom and Rosneft.

A transferee of a licence relating to a subsoil deposit of federal significance that is a Russian entity with foreign participation must submit evidence supporting that the transfer of the licence to such transferee is not prohibited under the Subsoil Law or, alternatively, the resolution of the government granting consent to such transfer. If such government resolution is not provided by the transferee, then the Federal Agency for Subsoil Use must forward the supporting evidence to the Federal Antimonopoly Service and it is entitled to reject the requested transfer of the licence.

If, in the course of a geological study, a subsoil user who is a foreign investor or a Russian legal entity with foreign equity investment makes a discovery of a deposit of federal significance, the government of the Russian Federation may refuse to grant the right to use the deposit for exploration and production or, if the licence is a combined licence, may terminate the right to use the deposit for exploration and production, on the grounds of a threat to national defence and security. In such circumstances, the licence holder's expenses incurred in carrying out the survey and evaluation, as well as the

lump sum payment made by a licence holder in accordance with the combined licence terms, must be compensated.

iii Anti-corruption

The state of corruption in Russia is often characterised as endemic. It is an overall perception that corruption within government and, in particular, law enforcement bodies and the lack of an accountable, competent and reliable court system are the main problems that Russia faces in attempting to secure increased levels of foreign direct investment. Some businesses and individuals do not trust the government and law enforcers, and generally view them not as protective, but as dangerous factors. The oil and gas industry is probably less affected by government corruption because of the dominance of state-controlled major companies.

IX CURRENT DEVELOPMENTS

The Russian government has recently introduced a number of tax incentives in the oil and gas industry.

The Ministry of Natural Resources and Environment has recognised that the existence of the risk of a subsoil licence revocation following the discovery of a field of federal significance has a negative impact and is an economic barrier for investment by private companies in geological exploration. The Ministry has prepared a bill which provides that foreign companies will be granted guarantees on the preservation of their rights if a qualifying deposit is discovered.

The need for amendments liberalising the rules governing foreign investors in the Russian natural resources sector results from the need to attract direct foreign investment in the development of the sector.

President Putin has supported gradual liberalisation of LNG exports. At present, Gazprom has a monopoly to export natural gas in all its forms, including LNG. However, there is a perception that if Russia does not adopt an active policy, it risks completely losing the global LNG market to competitors. This perception has been magnified by the huge increase in natural gas production in the United States over the past few years, and the growing prospect of the LNG exports from there. This development is likely to apply only to LNG produced from gas deposits located partially or fully in territorial waters, on the continental shelf, or on the peninsulas of Yamal and Gydan. It is also anticipated that such liberalisation will be restricted to the markets where Gazprom does not supply natural gas through pipelines in order to avoid any competition with such gas in the existing markets (such as Europe).

In October 2013, the government's commission approved the bill that allows to export LNG, in addition to Gazprom and its subsidiary, those subsoil users whose subsoil licence provides for a construction of an LNG plant as of 1 January 2013, as well as the state-owned companies whose deposits are located within territorial waters, internal sea, or on the continental shelf, including the Black and Azov Seas. Such liberalisation may positively affect only NOVATEK and Rosneft.

Appendix 1

ABOUT THE AUTHORS

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Natalya Morozova has been with Vinson & Elkins since 1991. She has extensive experience in, and has worked on, a significant number of complex international mergers and acquisitions, private equity investments, project development transactions, regulation of foreign investment, and general corporate practice with the principal focus on the energy/natural resources sector. Her practice has involved many high-profile issues shaping Russia's corporate environment, creating international joint ventures and structuring corporate relationships between shareholders.

In 2013, Natalya was recognised in *Chambers Global*, energy and natural resources for Russia; *Europe and EMEA Legal Experts* in commercial law, project finance/energy, corporate and M&A for Russia; and *The Legal 500* for Europe, energy and natural resources sector. She has been co-administrative and managing partner of the Vinson & Elkins' Moscow office since 2004.

ROB PATTERSON

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Rob Patterson is an energy transactional lawyer, with a broad practice that includes cross-border mergers and acquisitions and the development and financing of energy and infrastructure projects. He has advised on a wide range of international transactions in the oil and gas, power, petrochemicals and LNG sectors.

In addition to his extensive knowledge about the energy sector, Rob also has substantial experience advising on broader corporate and commercial matters, including M&A transactions, joint ventures, financings, corporate reorganisations, and a wide range of commercial contracts. Rob is an English-qualified solicitor and was co-administrative partner of the firm's Moscow office from 2006 to 2010 and managing partner of the Beijing office from 2012 to 2013. He has recently returned to Vinson & Elkins' Moscow office.

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