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## COMMENTS AND ANALYSIS

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### A.A. KONOPLIANIK'S COMMENTS ON THE DRAFT LAW "ON OIL AND GAS"

(see Volume 27 of the Bulletin)

The draft law "On Oil and Gas" of the Russian Federation was submitted to the State Duma Council on April 18, 1994 by the Committee on Industry, Construction, Transport and Energy. On May 19, 1994 the Head of the RF Mintopenergo, Yu. Shafranik, presented the Draft at a session of the Presidium of the RF Government.

Below A.A. Konoplianiuk's comments on some of the Articles and provisions of this draft law.

#### Article 3. FEDERAL FUND OF RESERVED OIL AND GAS FIELDS

*The concept of a Federal Fund of Reserved Fields (FFRF), which this article is based on, seems to be questionable. The authors of this article propose to create a strategic reserve of oil and gas fields of "not licensed yet known oil and gas fields and prospective blocks" to form the FFRF. The FFRF will be managed by the RF Government and development, assessment and production of the fields from this Fund will be financed from the Federal budget. What results can be expected if this approach to the creation of the FFRF is used?*

*First, to commence the production of the fields which would be included in the FFRF would take 5-7 years from the time that the need arises. Moreover, it will also take some time to grant a license to the contractor for effecting respective operations.*

*Second, such a creation of the FFRF will require amendment of at least two of Federal laws, which is not within the Governments jurisdiction (it is the jurisdiction of the Federal Assembly) as follows:*

*- the law "On the Subsurface", particularly the provision on the compulsory use of competitive procedures for granting of licenses (for the subsurface usage);*

*- the law "On Foreign Investments", particularly the provision on the exceptions from the established procedure for investments in Russia.*

*I believe the suggested mechanism for creation of strategic reserves of oil and gas in Russia do not comply with the purpose of the creation of the Fund, if the purpose is to have fields in reserve for cases of emergency in which national security is involved. This requires that the Fund be formed of fields ready to produce oil and gas, but kept idle (conserved), that is fields that may be put into production in a very brief time.*

#### Article 4. PARTICULAR FEATURES OF LICENSES

*This article suggests to exclude the time period during which a FFRF field (or its part) stays conserved from the term of the respective license and exempt the licensee from payments for the right to use the field for the entire period of the field conservation.*



*I believe the period of conservation should be excluded from the license term if the suggestion to keep the field idle comes from the Government. In this case the State may propose either to conserve the field with a respective extension of the license term (that is, to preserve the licensee's exclusive rights to develop and produce the field after the period of conservation is over) or to transfer the field to the FFRF. In other words, exemption from the payment for the right to use the subsurface should be granted only in cases in which the conservation is initiated by the State. If the initiative to conserve a field comes from the licensee, but the Government is not interested in it, the period of conservation should be included in the license validity term and payments for subsurface usage should be charged.*

#### Article 5. PROCEDURE OF GRANTING LICENSES FOR GEOLOGICAL STUDIES OF THE SUBSURFACE WITH SUBSEQUENT OIL AND GAS PRODUCTION

*This article proposes to use the "amount of capital investments in development of infrastructure needed for oil and gas production" as one of the basic criteria when choosing the investor to grant a license. I think this may stimulate the licensee to unnecessarily increase the expenses, knowing that the preference will be given to the applicant who (other terms being equal) proposes to spend more capital for the project (or for infrastructure, if not for the whole project). Such an approach will not stimulate the investor to minimize expenses but, on the contrary, to apply the most costly technologies which might be not rational from a financial standpoint.*

*Another (and most questionable) issue in this article is the protectionist provision for holding closed bidding rounds (with participation exclusively of Russian oil companies and organizations). Both the need for this provision and the arguments in its favor are doubtful. It is worthwhile to note that the authors of this provision do not suggest it be applied when holding auctions (maybe because the fiscal revenues are expected to be higher from foreign investors than from domestic competitors?), but only when holding bidding rounds, that is when leasing much better explored and assessed fields (blocks). The most important criteria proposed for determination of the winner of a closed bidding for development of hydrocarbon (non-replaceable!) resources is the maximum possible use of domestic companies, not the maximum efficiency of the development.*

*Licensing via a closed (purely national) bidding round and the procedure for holding such bidding rounds (by authorized state power organs) suggested in Article 5 of the Draft could well be applicable when forming the FFRF as proposed in Article 3. In all other cases however, the goal of achieving the most efficient development of fields must be given a priority over the need for maximum employment of Russian enterprises. Minding my disagreement with the FFRF plan as formulated in Article 3, I should add that I believe the most efficient development of fields should be given the priority in all cases, without exception.*

#### Article 9. OWNERSHIP OF PROPERTY

*I can not agree with the following provision in this Article: "the licensee owns only the property (both the assets and real estate) which was created or purchased by the licensee from his own finances". This definition one more time points out the persistent misunderstanding in my country of the fact that there does not exist any investor that would finance a more or less large risky project with exclusively his own money. The major part of such projects is usually financed from loans. An investor traditionally finances only the first, most risky stages of a project (e.g. the exploration and assessment), from his own funds.*

*Also, in the second paragraph of this article there is a provision for an "automatic" transfer of the ownership of the property (from the licensee to the State) as soon as the term of its amortization (offsetting) expires, which is not in the interest of the State. First of all, the very concept of the transfer of a newly created private*

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*property to the State after its amortization is questionable. This is actually a masked form of "peaceful" nationalization. If this logic is followed almost all the property in this country will belong to the State (especially at the present rates of amortization) and private property will be limited to a narrow ("venture") domain where its owner may take a risk at the start of a project. Secondly, the investors will naturally try to transfer the (amortized) property to the State as early as possible, thus transferring to the State the load of responsibilities for its management and the related expenses.*

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### **MISCELLANEOUS**

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#### **ERRONEOUS NEWS**

The Interfax "Mining & Metals Report" No. 19 (117) of May 13, 1994 reported that the Roscomnedra had already sent the Directors of local Geolcoms "... instructions on the procedure for transferring licenses for the right to use underground resources" and many of our readers have asked questions concerning this document.

The Bulletin editors would like, first of all, to stress, that no such document has been sent by the Roscomnedra to any of its regional offices thus far. In reality these instructions are only now being drafted in the Roscomnedra. This draft can not be adopted and released as an official document because the appropriate legal basis does not yet exist. A respective provision was included into the Draft Amendments to the RF Law "On the Subsurface" (Article 14-1 "On Reassignment of the Rights"), submitted to the State Duma on May 14, 1994 for consideration and adoption. Only after (and if) these Draft Amendments are approved (adopted as a Law) can the Instructions in question be revised.

As soon as this document is adopted it will be published in this Bulletin, which is the official Publication of the Roscomnedra.