

Multiple investment regimes in the Russian subsoil use: a postponed reality or just a pie in the sky ?

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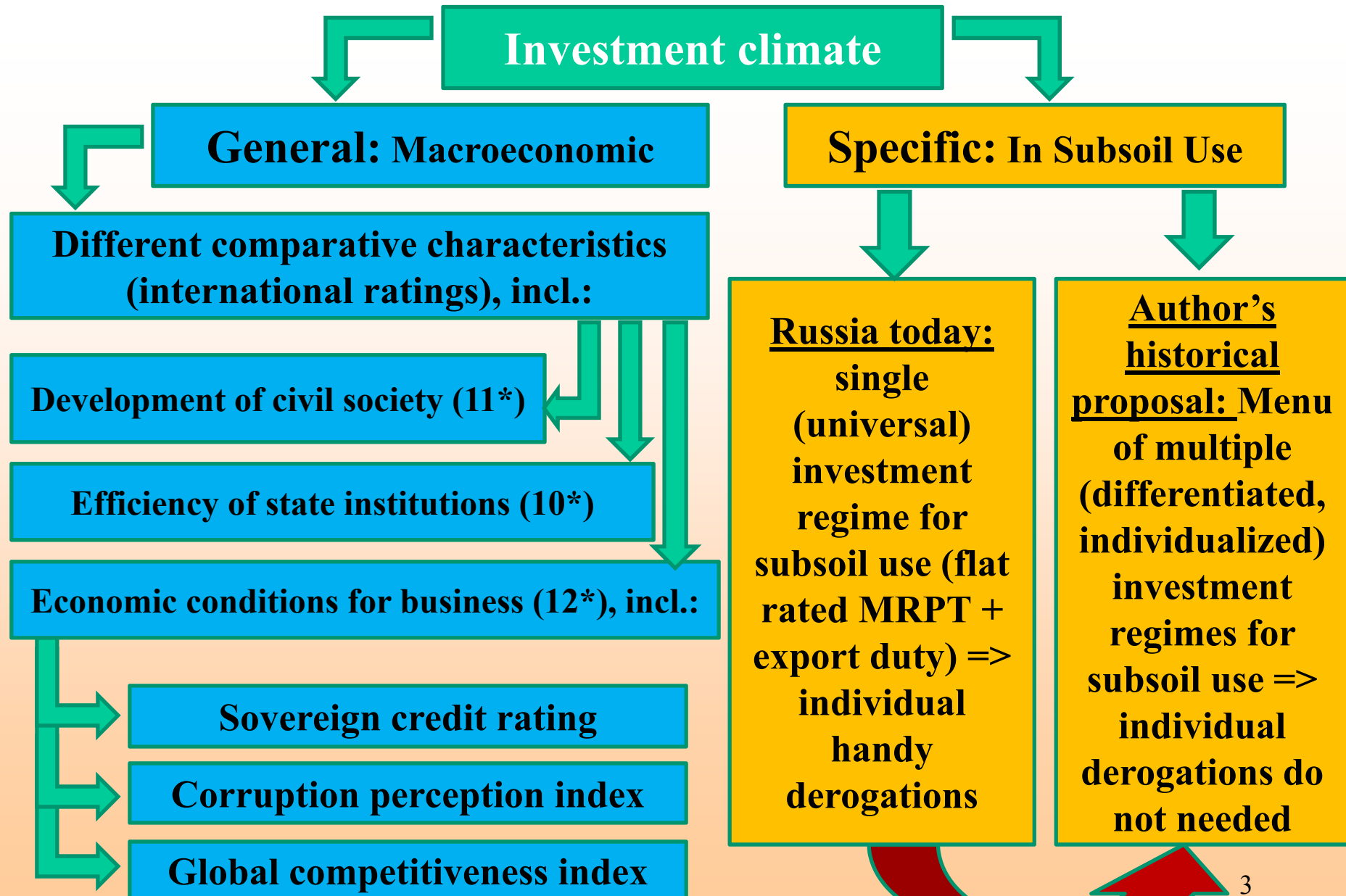
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Annual CEPMLP Honorary Fellow’s lecture,
Center for Energy, Petroleum and Mineral Law & Policy, Dundee University,
Dundee, Scotland, UK, 29 November 2012

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- 4) Which way to go & how it may work

Investment climate in subsoil use: two dimensions

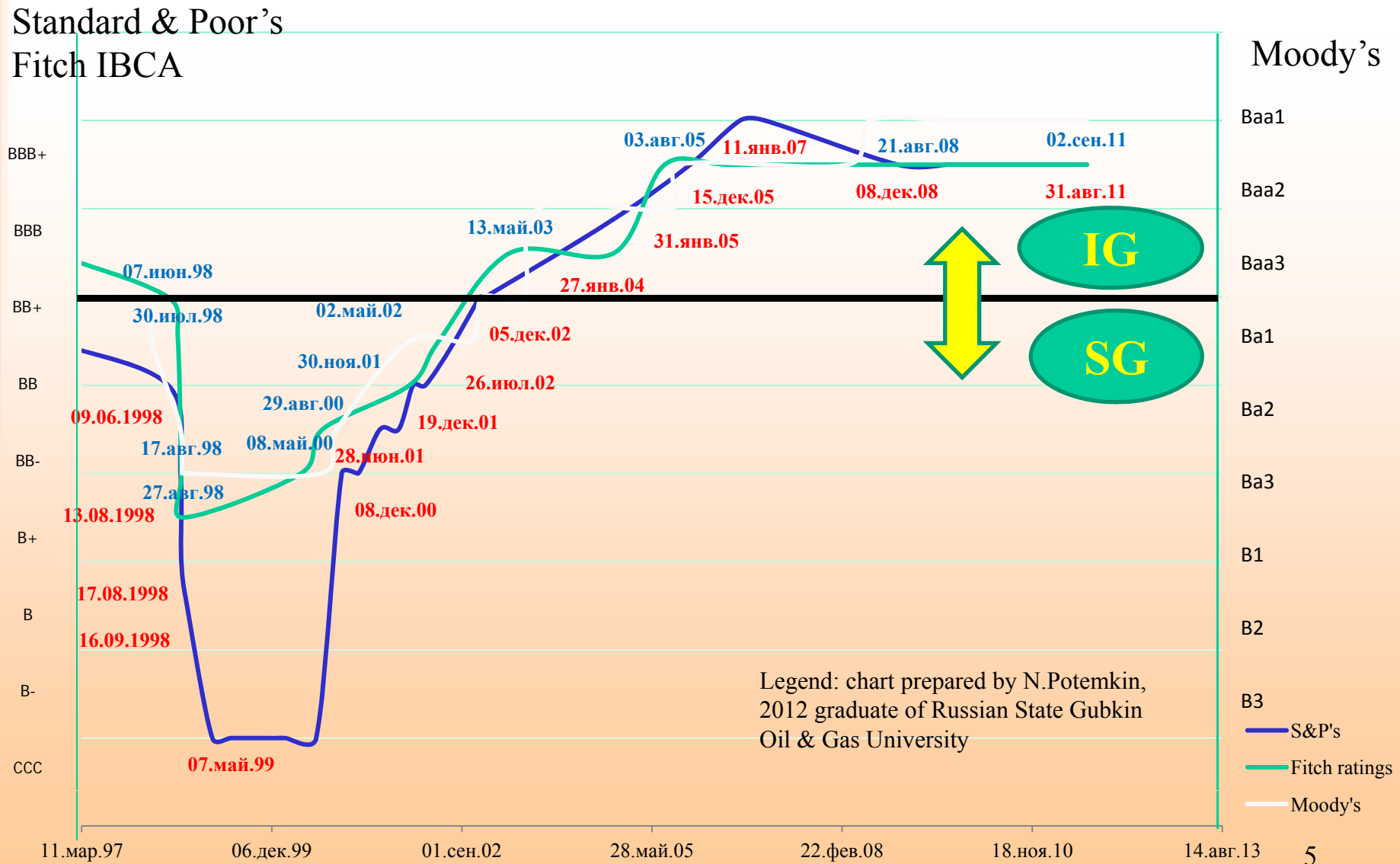


Russia at the scale of major international rating agencies (long-term investment credit ratings in foreign currency)

	Moody's	Standard & Poor's	Fitch IBCA	Short description	LIBOR+
Investment grades	Aaa	AAA	AAA	Maximum safety level	Up to 4,25%
	Aa1	AA+	AA+	High level of reliability	
	Aa2	AA	AA		
	Aa3	AA-	AA-		
	A1	A+	A+	Reliability above medium	
	A2	A	A		
	A3	A-	A-		
	Baa1 (RUSSIA: rating awarded 08.10.2008)	BBB+	BBB+	Reliability BELOW MEDIUM	Up to 6%
	Baa2	BBB (RUSSIA: rating confirmed 31.08.2011)	BBB (RUSSIA: rating confirmed 02.09.2011)		
	Baa3	BBB-	BBB-		
Speculative grades	Ba1	BB+	BB+	Non-investment, speculative grade	Up to 14%
	Ba2	BB	BB		
	Ba3	BB-	BB-		
	B1	B+	B+	Highly speculative grade	Up to 19%
	B2	B	B		
	B3	B-	B-		
	Caa	CCC+	CCC	High risk, emitter is in difficult situation	
	--	CCC	--		
	--	CCC-	--		
	Ca	CC	--	Highest speculative rating, default possible	
	C	C	--		
	--	--	DDD	Default	Up to 204% 4
	--	SD	DD		
--	D	D			
--	--	--			

09.11.2012,
LIBOR 1Y:
USD=0.86,
EUR=0.52,
GBP=1.07

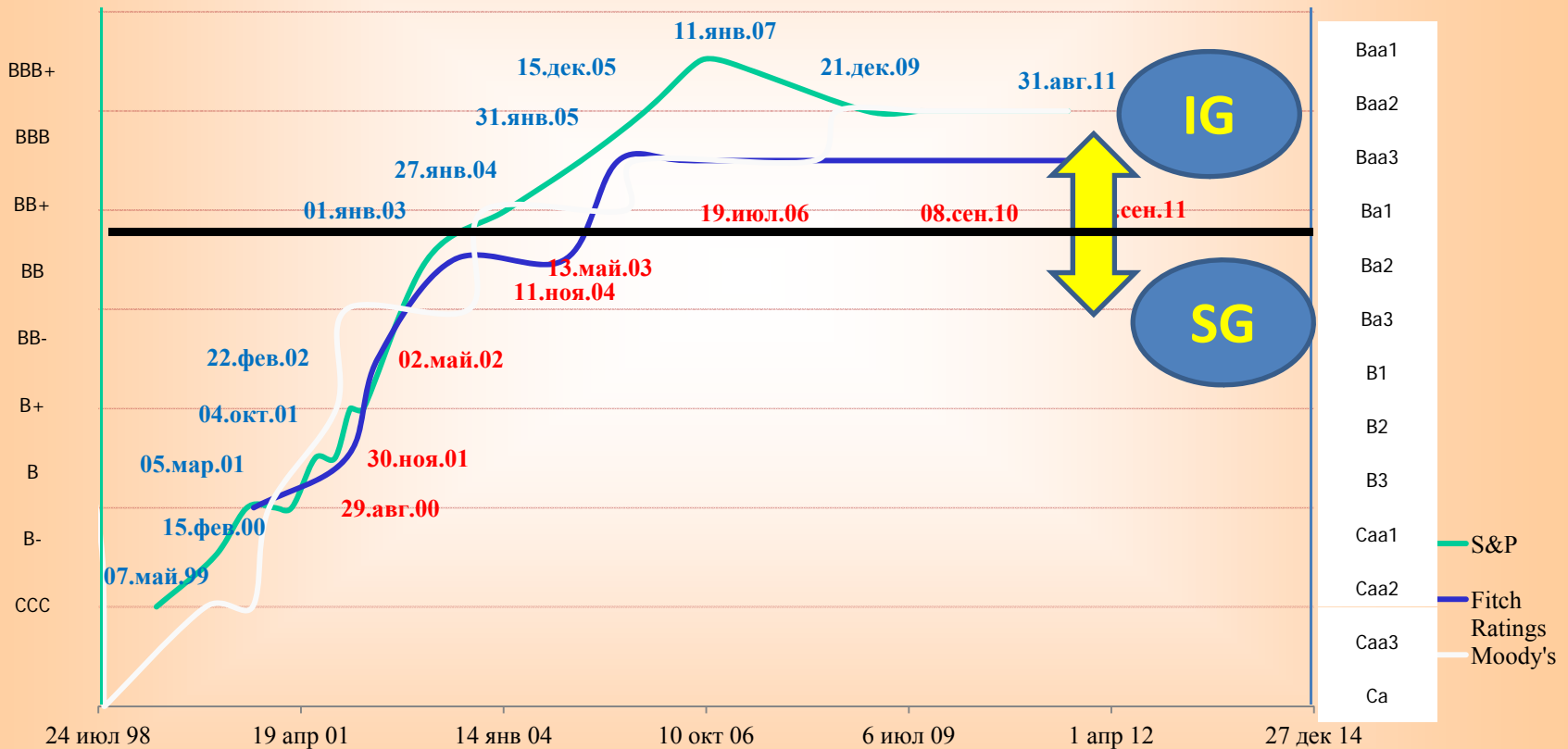
Russia: long-term sovereign credit rating in foreign currency



Russia: long-term sovereign credit rating in national currency

Standard & Poor's
Fitch IBCA

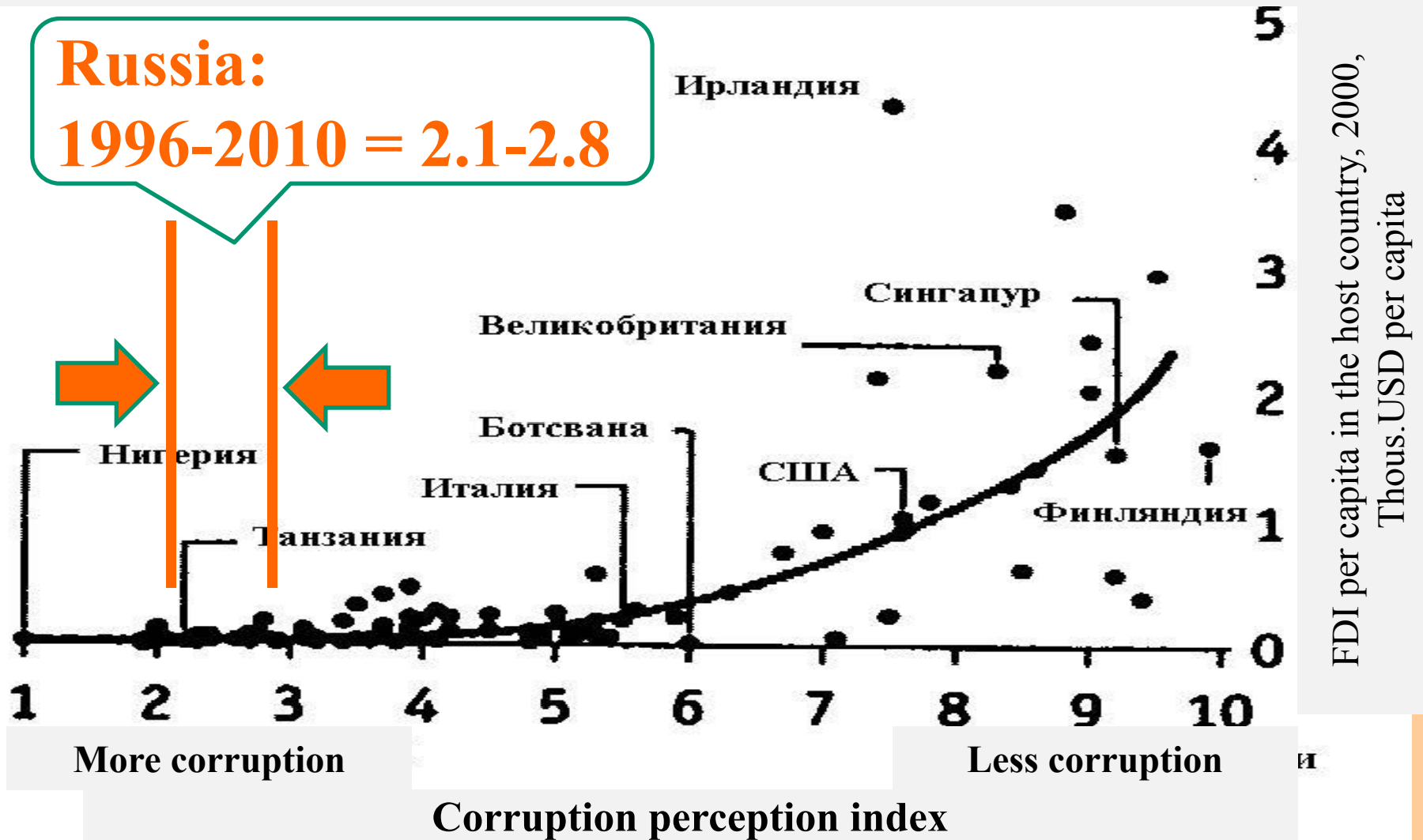
Moody's



Legend: chart prepared by N.Potemkin, 2012 graduate of Russian State Gubkin Oil & Gas University

FDI inflow vs. "corruption perception index" correlation

Russia:
1996-2010 = 2.1-2.8



Source: Special report "Bribery and business". - The Economist", March 2, 2002, p.68
«Нефтегазовая Вертикаль», 2011, № 15-16, с.45

Energy projects financing

- Equity (corporate) vs debt (project) financing: 30/70-40/60
- The rule: Project rating < company rating < host state rating (=> for current Russia project ratings - in speculative grades zone)
- Debt financing in Russia mostly via externally-raised syndicated loans, even if underwriter is Russian bank; in case of Russian state banks = de facto state sovereign guaranty => but Russia rating reliability below medium
- Global financial crisis + Eurozone crisis + low Russia rating => shrinking of available zone of potential project financing
- In crisis role of project financing decrease, and of corporate financing, on contrary, increase, but current financial in-crisis problems of the companies (more difficult servicing of debt & on-going needs) => shrinking of available zone of potential corporate financing
- => Russia: still high risks of financing energy (subsoil) investment projects... => how to diminish them in the given circumstances?

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Comparative data on implementation of subsoil use tax/investment regimes worldwide, 2003 & 2009

-	2003		2009	
Number of states in analysis (data available from G.Barrows), incl.:	180		177	
Oil producing states, using:		91		104
- Tax + Royalty	113	45	111	55
- PSA	54	34	55	38
- Both T+R & PSA	13	12	11	11

Based on data, kindly provided to author by Gordon Barrows (Barrows Inc./AIPN)

Author's historical proposal: possible composition of investment regimes (investment matrix/menu) for Russian subsoil use (within legal vs. taxation axes)

Key idea: to create competition between investment regimes for investor

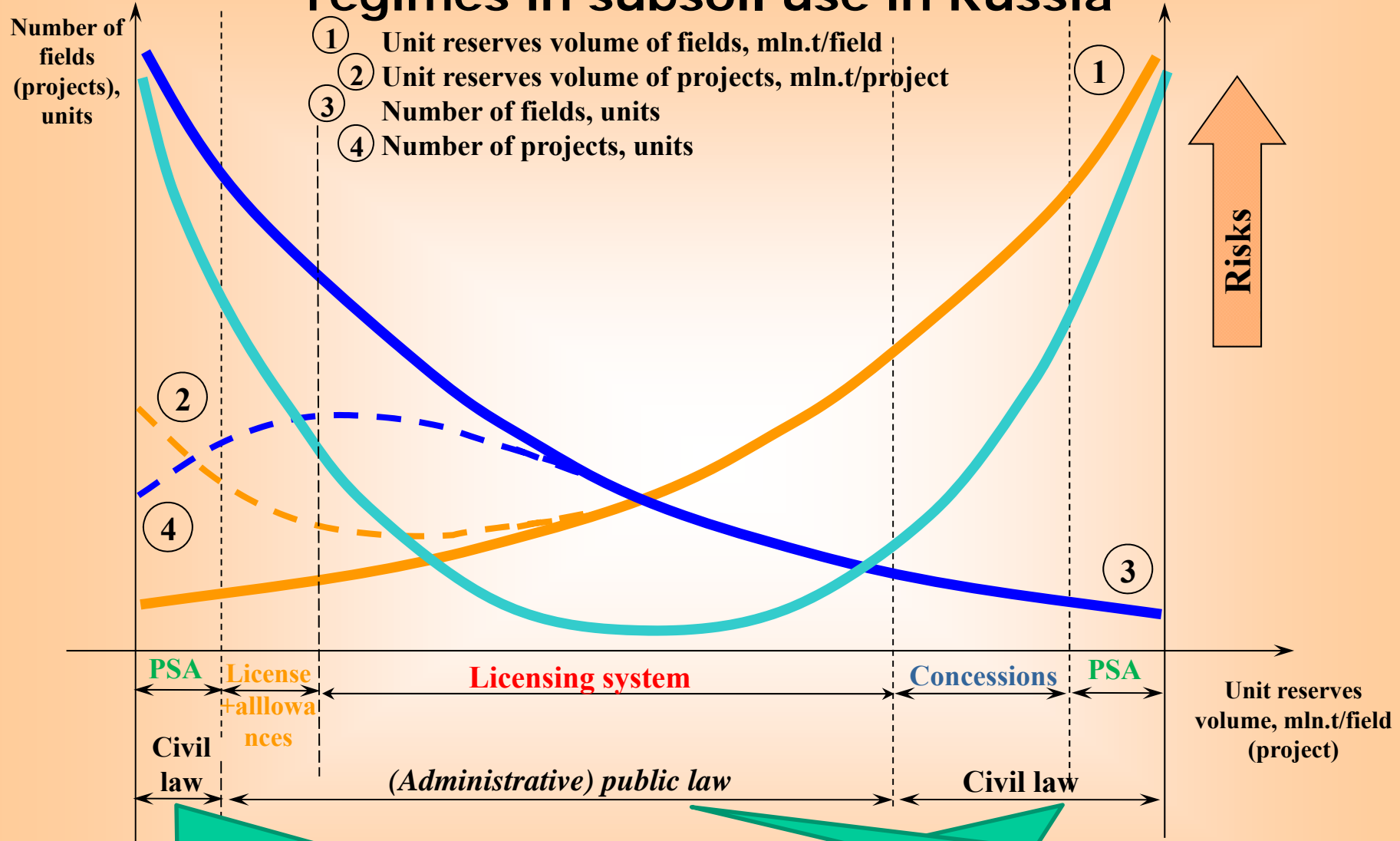
A way to increase investment attractiveness of Russian subsoil use

		Legal system	
		Administrative (public)	Civil
Tax treatment	General (common)	Licenses ①	Concessions ③
	Special (incl. individualized)	Licenses with allowances (differentiated licensing regime) ②	PSAs ④

Different investment regimes in subsoil use: comparative legal & tax advantages/disadvantages

Investment regime	Investment regime's characteristics during project life-time	
	Tax pressure	Legal stability
Licensing (1)	Non-optimal (high), established unilaterally	No
Licensing with allowances (special / differentiated tax regimes) (2)	Non-optimal (high / diminished), established unilaterally	No
Concessions (3)	Non-optimal (high), established unilaterally	Yes
PSA (4)	Optimal, negotiated	Yes

Proposed application zones for different investment regimes in subsoil use in Russia

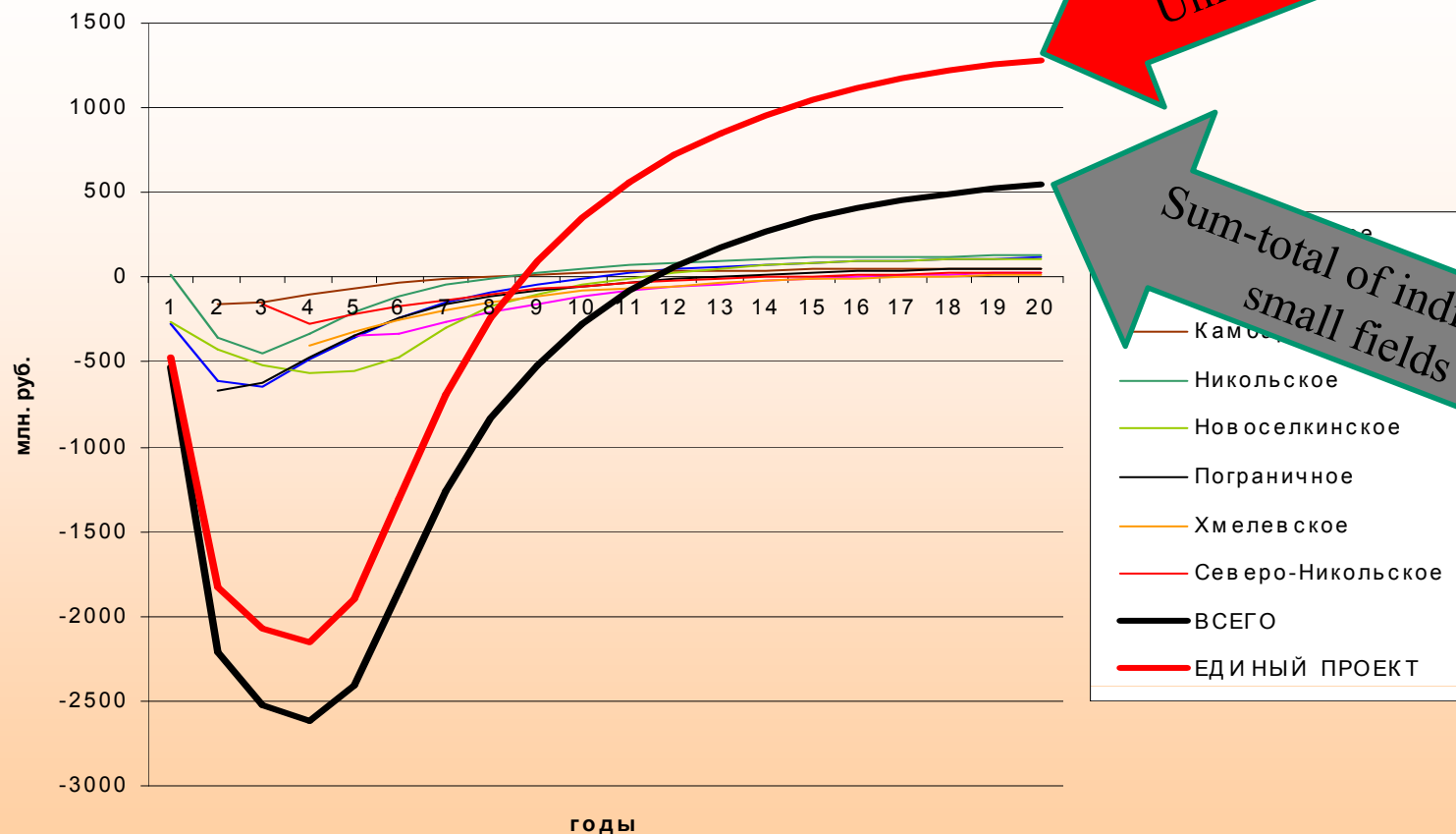


Zone of responsibility of **regional** authorities
 => “one key” of the two (the “second key”)

Zone of responsibility of **federal** authorities =>
 “one key” (the “first” one) *or* both “two keys”

Cumulated DCF/NPV of individual fields and of united project combined of these fields (Udmurtia project case)

Чистый дисконтированный доход по каждому месторождению и в сумме



Source: В.Грушин, А.Конопляник, Н.Оксенгорн. О порядке перевода мелких месторождений углеводородов на режим СРП (в порядке обсуждения). – «Нефтяное хозяйство», июнь 2002, № 6, с.83-89.

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Six Major periods of oil taxation development in Russia (1)

- 1) 1991-1996:** Development of tax system within market-oriented economy started (RFSS=>WB/HU). Licensing system of subsoil use (Law “On Subsoil”, 1992) allows multiple investment regimes with different taxation models (Art.12). Payments for subsoil use (royalty) introduced with differentiated levels. Law on concessions and other petroleum agreements (1st version, for foreign investors only, 1993) approved by Supreme Soviet but vetoed by President. PSA regime established (Decree/Law “On PSAs”, 1993/1995). Law on concessions (2nd version – for foreign & domestic investors, 1995) has not passed State Duma. Tax legislation is not codified.
- 2) 1997-2000:** Tax Code introduced. Tax Code chapter on “tax on incremental earnings” (windfall profit tax) adopted in first reading. Differentiated tax regime de facto in place under licensing with differentiated royalty. PSA regime further developed.

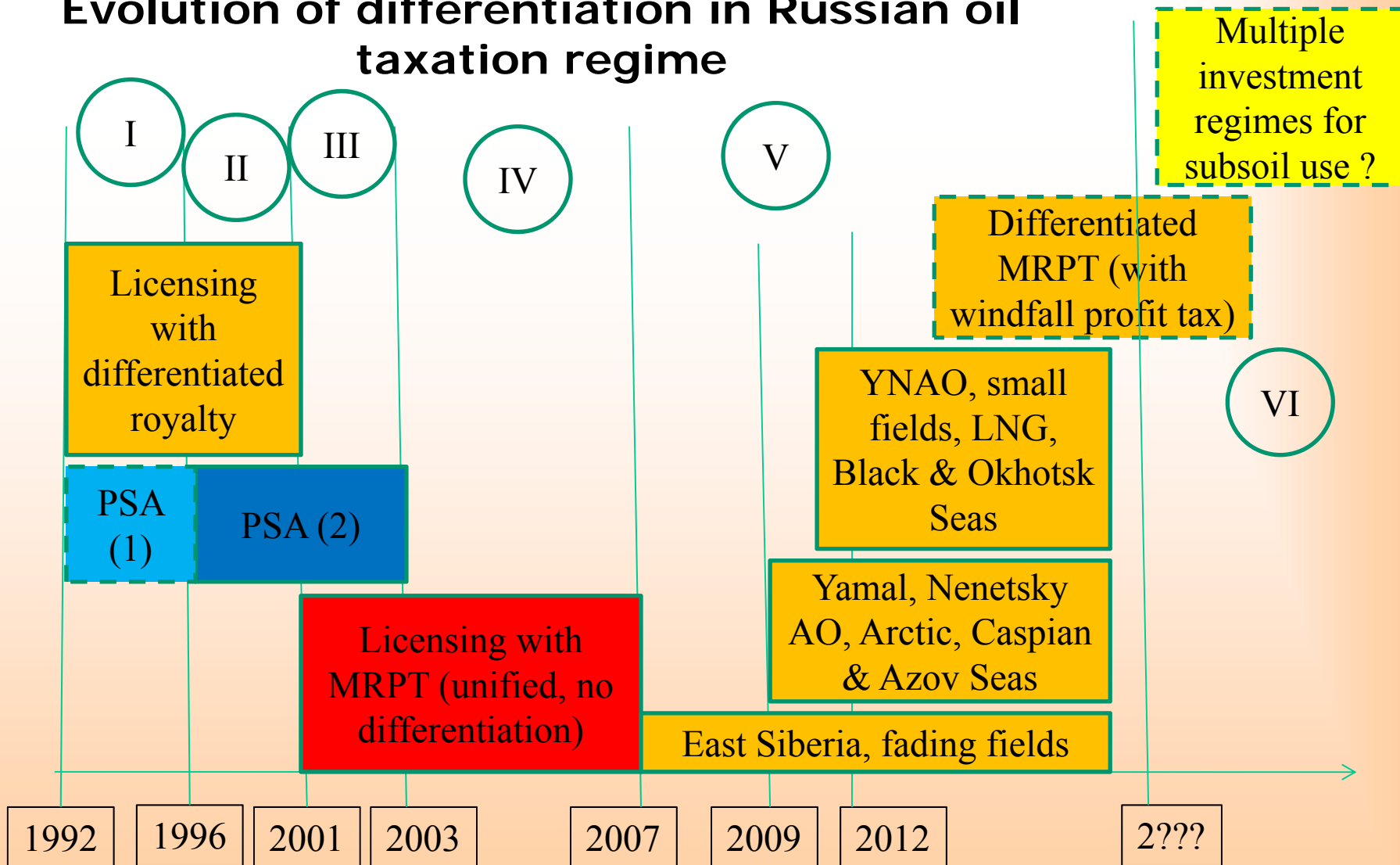
Six major periods of oil taxation development in Russia (2)

- 3) **2001-June 2003:** Transition from differentiated to unified tax regime. Substitution of royalty, VMSB, excise tax by flat-rated MRPT. Introduction of systemic oil customs export duty. PSA still acting.
- 4) **June-2003-2006:** Factual cancellation of PSA regime (“Putin-Khodorkovsky” FL-65/06.06.2003). Establishment of single & unified tax regime. Law on infrastructure concessions adopted, but it excludes subsoil use.
- 5) **2007-nowadays:** Differentiation of MRPT-based tax regime started. Introduction of regional & for individual projects tax allowances (slow start of deviation from unified tax regime).
- 6) **2??? & onwards:** Continuation of further differentiation of tax regime (based on economically justified logic), incl. multiple investment regimes, or ...?

Based on: А.Конопляник. Реформы в нефтяной отрасли России (налоги, СПП, концессии) и их последствия для инвесторов. – М.: «Олита», 2002; Е.Дьячкова. Экономическое регулирование нефтегазовой отрасли в постсоветской России. – М.: ООО «Геоинформмарк», 2011

А.Konoplyanik, CEPMLP, Dundee University, 29.11.2012

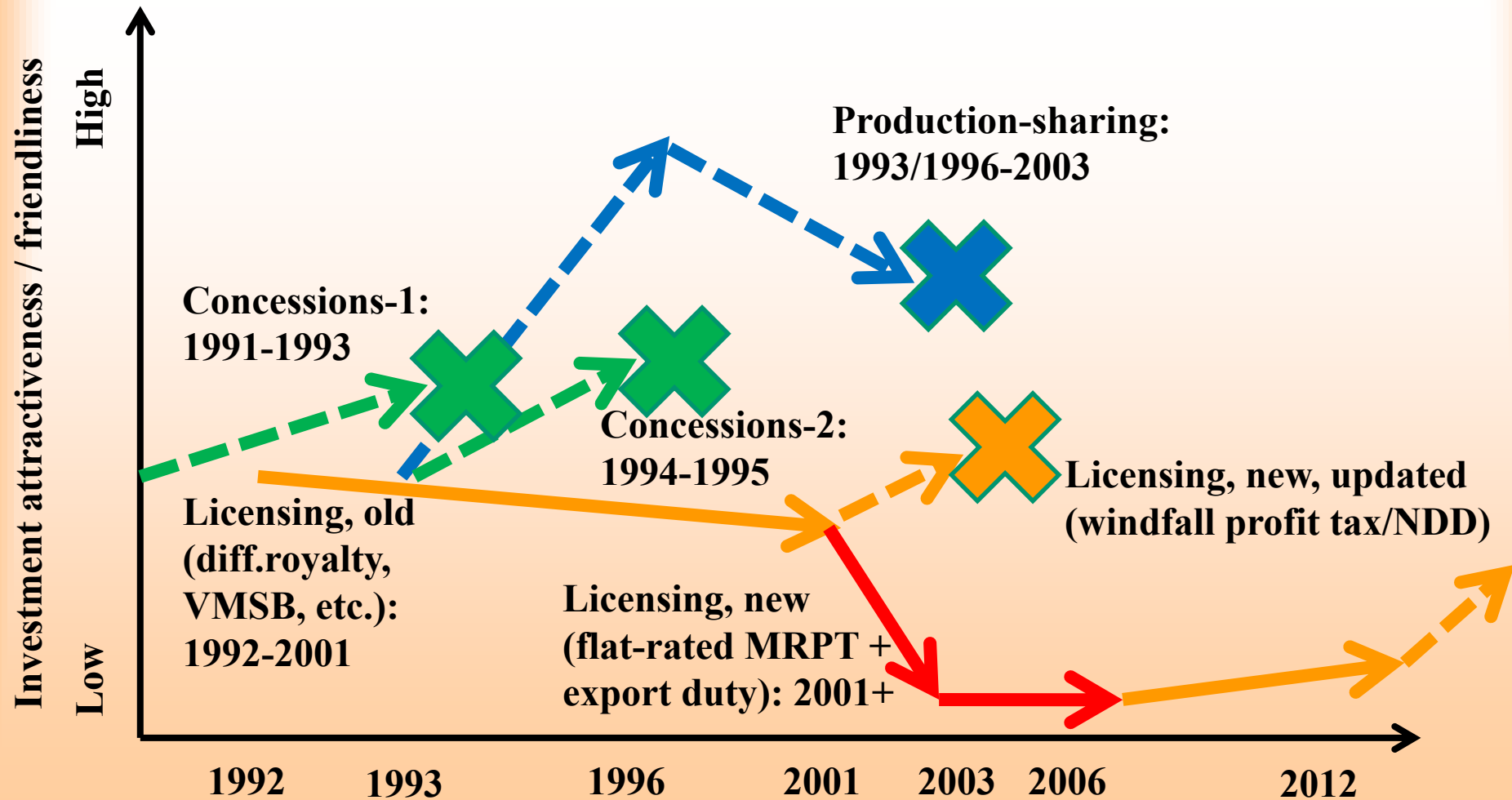
Evolution of differentiation in Russian oil taxation regime



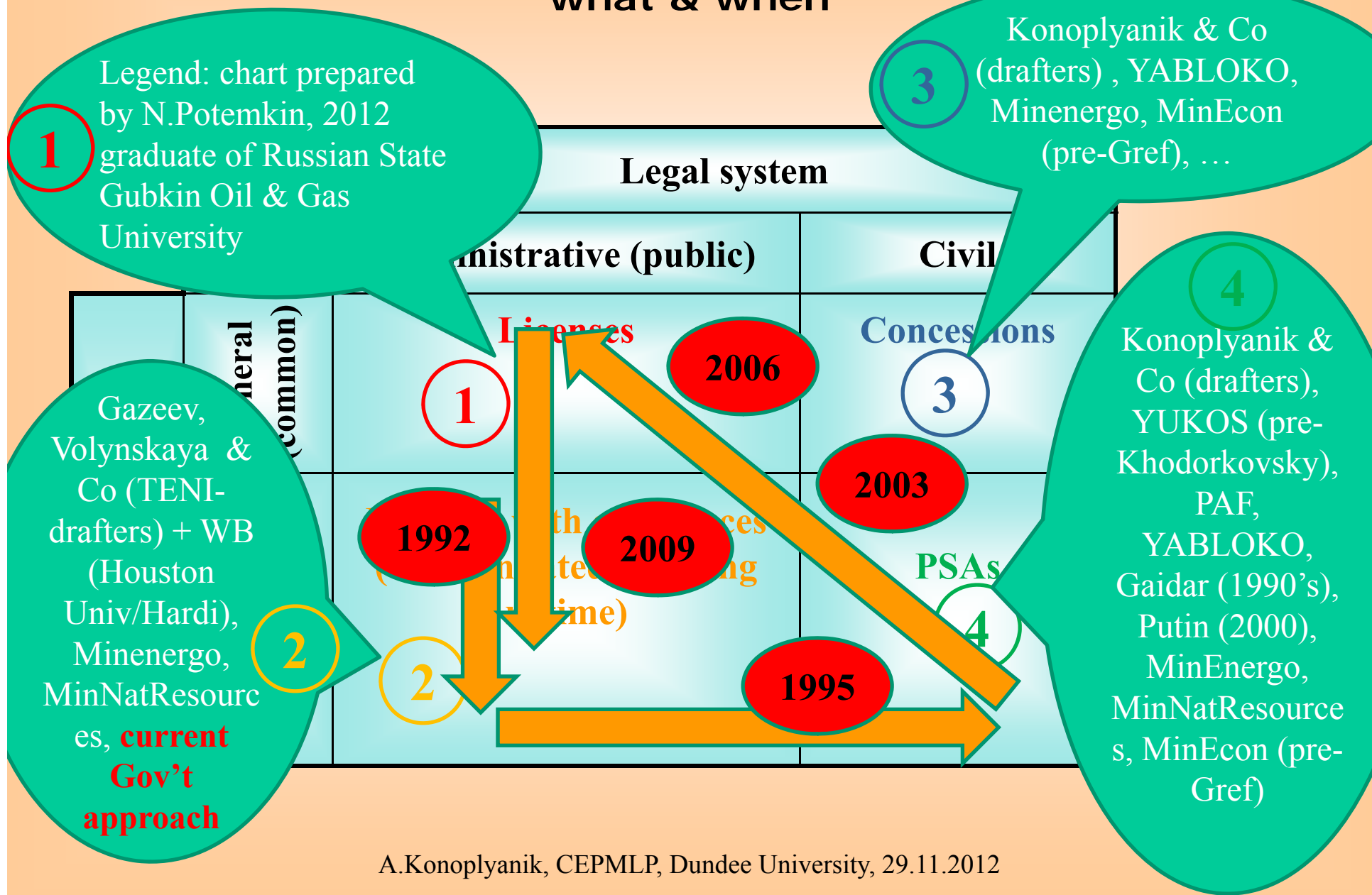
Legend: (i) colours correspond to that of investment regimes as in slides 3-4; (ii) PSA(1) = 3 acting PSA projects in Russia signed; PSA(2) = period of factual action of PSA Law; (iv) Roman figures in circles – periods as in previous slide

Based on: Е.Дьячкова. Экономическое регулирование нефтегазовой отрасли в постсоветской России. – М.: ООО «Геоинформмарк», 2011

Russian subsoil legislation development: preferential state's alternatives always worsened oil & gas investment climate



Evolution of tax regimes in Russian subsoil: who supports what & when



Comparison of flat-rate MRPT and PSA systems

Figure 1: Flat-rate tax system

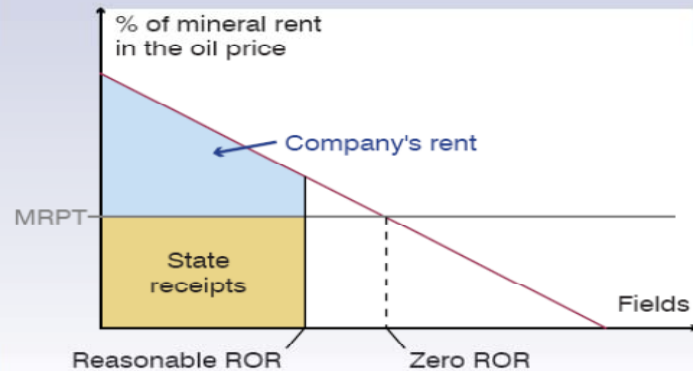


Figure 2: PSA

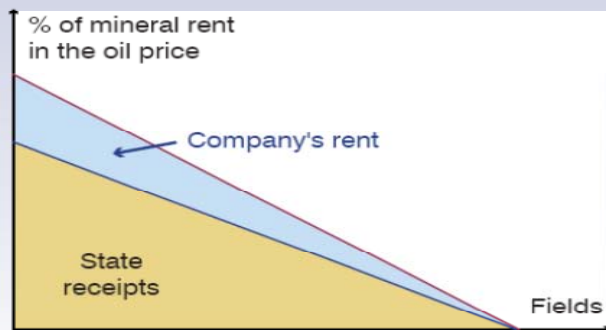
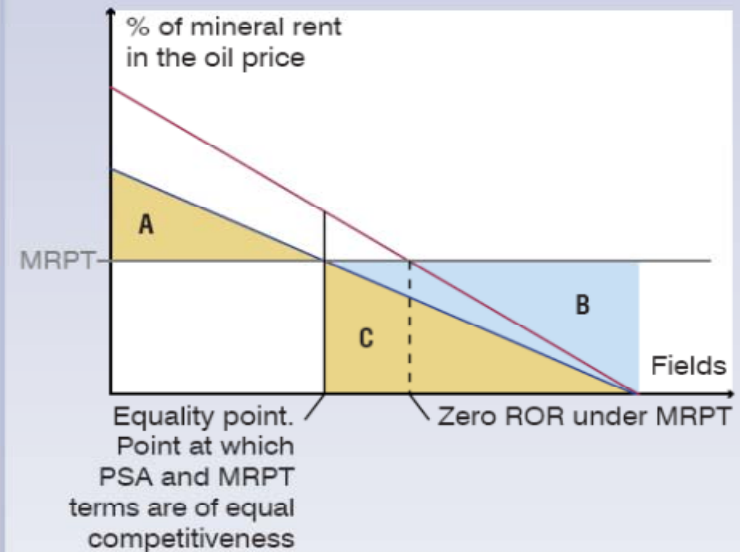


Figure 3: Transfer from MRPT to PSA



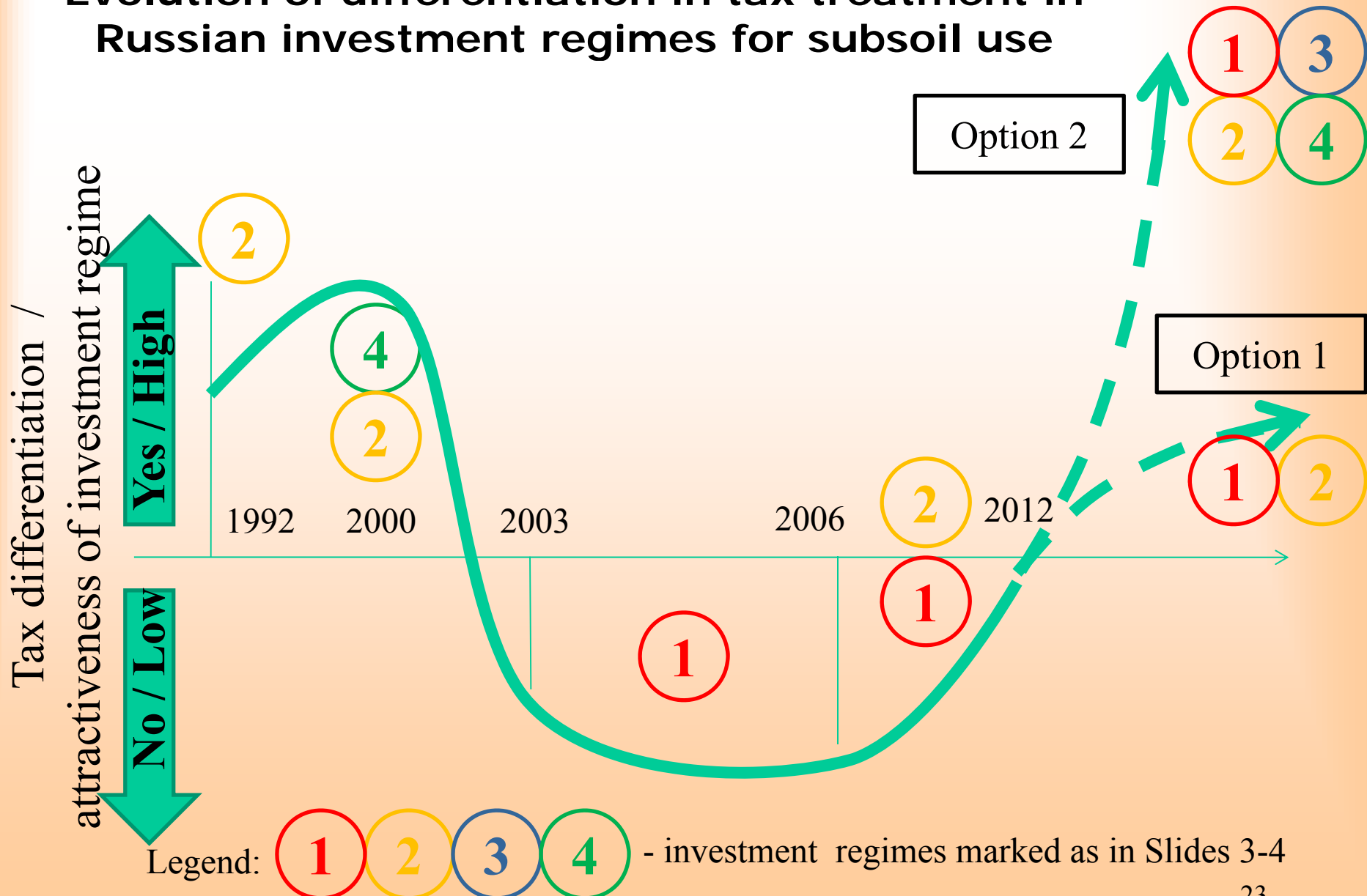
- A: Companies' incremental rent-type earnings under MRPT, which transferred into state take under PSAs
- B: Revenues that the opponents of PSAs wrongly claim are lost to the state under transition to PSAs
- C: Incremental state earnings under PSAs through development of non-profitable fields under MRPT with flat rate

Source: A.Konoplyanik. A struggle for mineral rent. - *"Petroleum Economist"*, August 2003, p. 23 – 24; Андрей Конопляник: «Ухудшение экономических условий возвращает на повестку дня законодателей вопрос целесообразности реабилитации СРП». - *«Нефть и капитал»*, 2009, № 3, с.18-23.

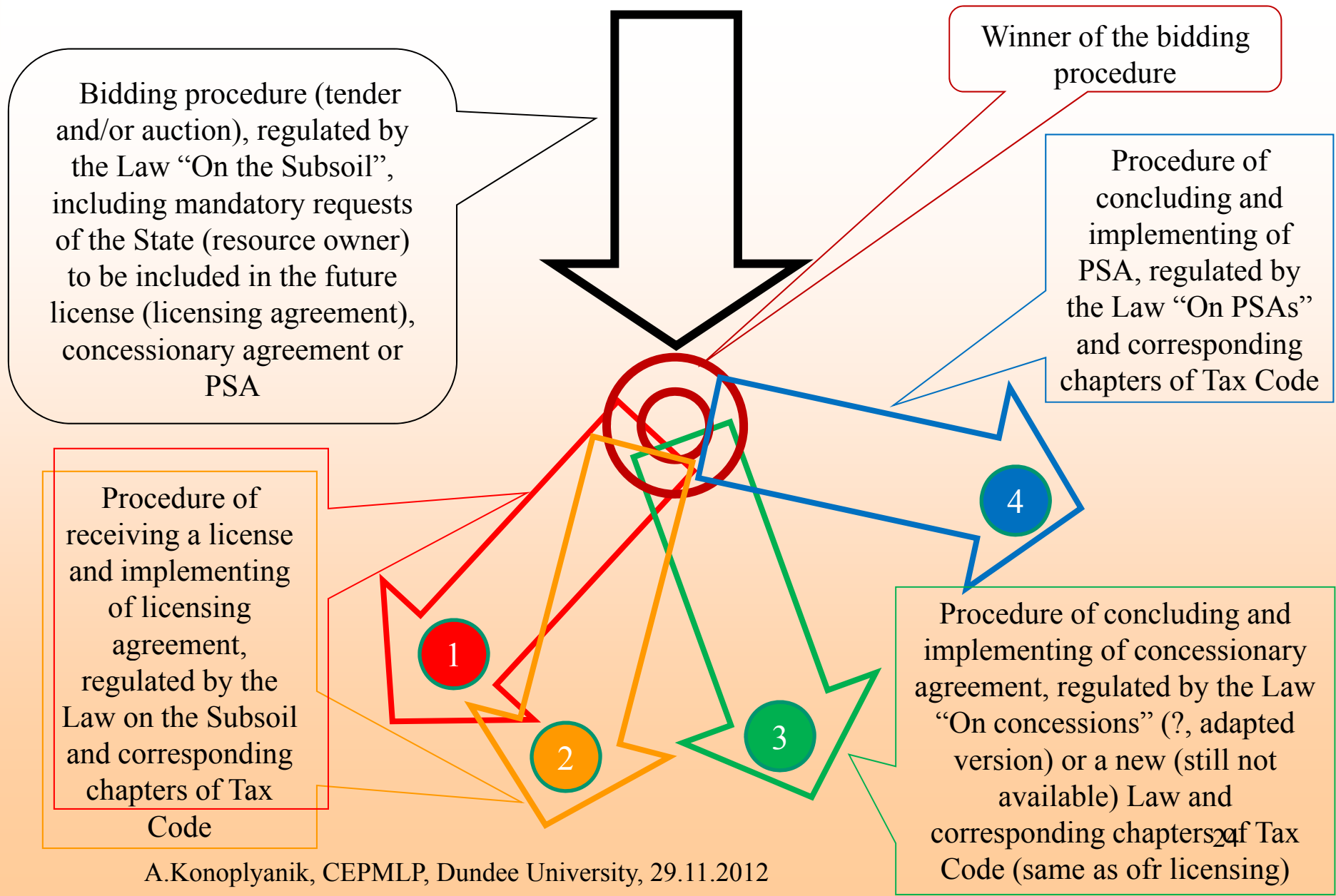
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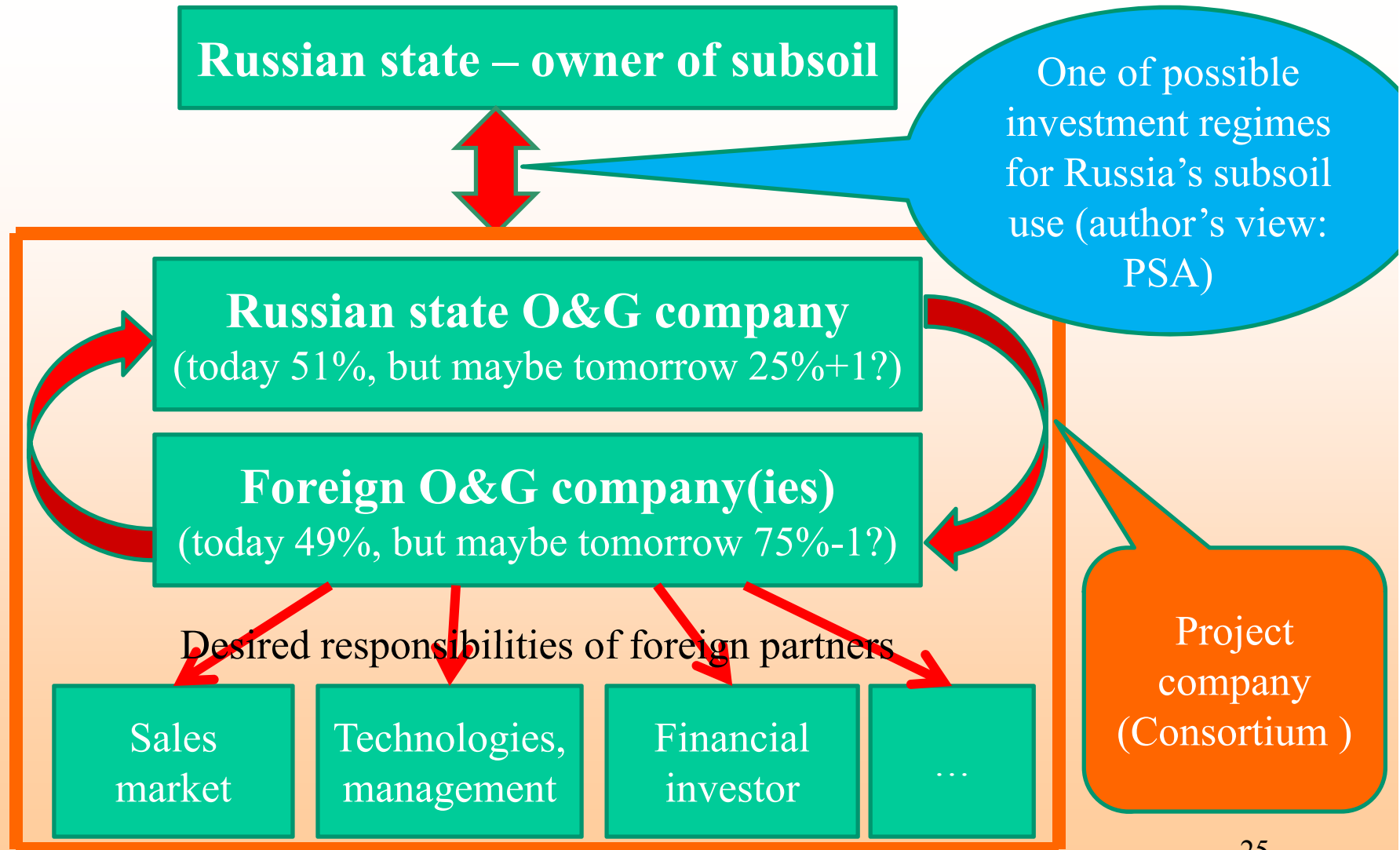
Evolution of differentiation in tax treatment in Russian investment regimes for subsoil use



Equal & competitive investment regimes in Russian subsoil use (historical proposal of the author)



Possible organizational structure of consortia for Russian Arctic offshore O&G development (within author's concept of multiple investment regimes for subsoil use)



**Thank you for your
attention**

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