

THE OIL AND GAS
LAW REVIEW

NINTH EDITION

Editor
Christopher B Strong

THE LAWREVIEWS

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This article was first published in October 2021
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Published in the United Kingdom

by Law Business Research Ltd, London

Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK

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Enquiries concerning editorial content should be directed
to the Publisher – clare.bolton@lbresearch.com

ISBN 978-1-83862-807-9

Printed in Great Britain by

Encompass Print Solutions, Derbyshire

Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

AB & DAVID AFRICA

ACCORD CHAMBERS

AMERELLER LEGAL CONSULTANTS

ASHURST

BOMCHIL

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DLA PIPER WEISS-TESSBACH GMBH

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PREFACE

International oil and gas law is a fascinating field, sitting at an intersection of law, politics and business. Practitioners in this field must be familiar not only with international norms and practices but also with local legal and regulatory requirements, which can vary substantially from jurisdiction to jurisdiction. The task can be daunting, especially in the context of fast-paced transactions or urgent legal or operational issues.

The Oil and Gas Law Review is intended to serve as a starting point for practitioners in gaining an understanding of the key legal requirements in the jurisdictions in which they may be advising clients on transactional and operational matters. The thinking behind the subtopics it covers has been to try to answer those questions that come up most frequently when dealing with a new or unfamiliar jurisdiction. Although not a substitute for detailed local law advice, the hope is that it will nevertheless serve as a reference guide and point users in the right direction when considering local legal issues.

I would like to thank the many experts who contributed to this volume. Without their substantial efforts, a work such as this would not be possible. Thanks also to the editors and publishers of *The Oil and Gas Law Review* for having the vision to publish a volume such as this and for their efforts in making it such a success.

Christopher B Strong

Vinson & Elkins LLP

London

October 2021

RUSSIA

*Natalya Morozova*¹

I INTRODUCTION

Russia is a major global producer, supplier and consumer of oil and gas. Its oil and gas industry is well established and efficient, given the severe climate and vast territories and distances. In 2020, Russia was the third-largest producer of crude oil and remained the second-largest producer of natural gas, accounting for 17 per cent and 12 per cent, respectively, of global output.² However, in 2020, Russia's gas and oil production and exports featured a large decrease: production of oil decreased by 8.7 per cent and oil exports decreased by 11 per cent, production of natural gas decreased by 6.2 per cent and gas exports decreased by 8.7 per cent.³

At the end of 2020, Russia once again had the largest share in the world of total proven reserves of natural gas.⁴ Because it is necessary to explore for and discover significant additional resources to maintain and grow current production levels, this has resulted in an increased focus on exploration in the Arctic, in East Siberia and in the Far East. Development of the Russian Far East is a national priority for the twenty-first century. In July 2020, a set of new laws on the government support of commercial activity in the Arctic was adopted. The Russian Arctic has become the world's largest special economic zone with an almost five million km² territory.

Russia's economy continues to be reliant on revenues derived from its oil and natural gas exports and taxes paid by major hydrocarbon companies. Significant attention is paid to the development of the oil and gas (and, generally, energy) industry. However, the share of oil and gas revenues in all revenues of the Russian federal treasury decreased from 39.3 per cent in 2019 to 28 per cent in 2020, according to the Report of the Accounting Chamber of the Russian Federation of February 2021.⁵ This dynamic is associated with a decrease in energy prices and volumes of energy exports in 2020.

Generally, in the face of the covid-19 pandemic, which has hit global demand and caused oil and gas prices to fall substantially, the oil and gas industry in Russia remains robust. Russia continues to be active in the efforts to bring oil production and consumption into balance via the OPEC+ agreement from the Organization of the Petroleum Exporting Countries concerning cuts in oil production following the drastic pandemic-linked slowdown.

1 Natalya Morozova is a Vinson & Elkins retired partner, now counsel at Nadmitov, Ivanov & Partners.

2 According to BP's Statistical Review of World Energy 2021.

3 *ibid.*

4 *ibid.*

5 Report of the Accounting Chamber of the Russian Federation published on its site on 24 February 2021.

Significant attention was given to energy safety in the new Doctrine of the Energy Safety of the Russian Federation adopted in May 2019 by Presidential Order. The Doctrine updates challenges, dangers and risks and determines the trends, objects and aims of the government activities in guaranteeing energy safety.

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 amendments and remain in a state of development.

i Domestic oil and gas legislation

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

- a* The Constitution of the Russian Federation: it sets forth the principal rules on ownership rights to natural resources;
- b* The Federal Law on Subsoil (the Subsoil Law): this is the core law governing a vast range of rules covering the geological study, allocation, development and protection of natural resources;
- c* The Federal Law on Gas Supply in the Russian Federation (the Gas Supply Law): this law primarily governs natural gas development, transportation and sales;
- d* The Federal Law on Natural Monopolies: this law in part governs transportation of oil and gas via trunk pipelines;
- e* The 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* The Federal Law on Production Sharing Agreements: this sets forth the regime for the development of natural resources via production sharing agreements; and
- g* The Federal Law on Export of Gas.

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

- 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* The Federal Law on Environmental Protection;
- c* The Federal Law on Ecological Expertise;
- d* The 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);
- e* The Federal Law on Exclusive Economic Zone of the Russian Federation;
- f* The Federal Law on Sanitary and Epidemiological Welfare of Population;
- g* The Federal Law on Protection of Atmospheric Air;
- h* The Federal Law on Internal Waters, Territorial Sea and Contiguous Zone;
- i* The Federal Law on the Zones of Territorial Development in the Russian Federation;
- j* The Federal Law on Foreign Investments in Strategic Companies;
- k* The Federal Law on Limiting Greenhouse Gas Emissions;
- l* Order of the President on the Doctrine of the Energy Safety of the Russian Federation; and
- m* Order of the Federal Government of the Russian Federation on the 2035 Energy Strategy.

The federal government has adopted a policy on the oil and gas sector, the main document setting forth that policy being the 2030 Energy Strategy. The main objectives determined are: (1) creation of an innovative and efficient energy sector; (2) adequate development of the energy sector to comply with the needs of the growing economy and Russia's economic interests in international markets; and (3) the energy sector as a driving force of the socially orientated innovative development.

In June 2020, the 2030 Energy Strategy was replaced by the governmental order with the 2035 Energy Strategy.

Regions (i.e., the constituent subjects of Russia) may adopt their own laws and other legal acts governing the use of natural resources. These legal acts, however, cannot be in conflict with federal legal acts.

ii Regulation

The Ministry of Natural Resources and Environment is the government body that is responsible for the preparation and subsequent implementation of government policies in the oil and gas sector, as well as the development and regulation of research, use, replacement and protection of natural resources, including subsoil.

The Ministry of Natural Resources and Environment's (Minprirody) main objective is the replacement of reserves, because new discoveries are falling as the large producing deposits are being depleted. The ministry has prepared a programme for the replacement of natural reserves to stimulate geological exploration up until 2020.

The Federal Agency of 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 these 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 the discovery of deposits by holders of geological research licences.

The Federal Service for Environmental, Technological and Nuclear Surveillance is the key regulator of technical issues in the development of natural resources. It issues: (1) mining allotments determining the boundaries of deposits; and (2) industrial safety certificates and operating licences, including for hazardous industrial activities relating to oil and gas operations.

The Federal Service for the Supervision of the Use of Natural Resources is a federal government body subordinate to the Ministry of Natural Resources and Environment whose main responsibility is 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.

The Ministry of Energy is the government body that prepares and subsequently implements government policies and develops regulation in the fuel and energy industry, including oil and gas development, refining sectors, trunk oil, oil products and gas pipelines, the development of hydrocarbons on the basis of production sharing agreements and the

petrochemical industry. Although the Minister of Energy is often in the world news in relation to the efforts of Russia to stabilise the global oil market and balance oil prices, the powers of the ministry in relation to the oil and gas sector are limited mainly to controlling the fuel and energy balance of Russia and its regions, development of gas supply programmes and gasification plans.

The Ministry for the Development of Far East and Arctic was formed recently and is responsible for the government programmes of development in the relevant regions.

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 judgments, 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. Recognition and enforcement of foreign commercial arbitral awards is conducted through state (federal) arbitration courts.

To promote foreign investment, Russia has signed and ratified a number of bilateral investment treaties (BITs). Although Russia has signed the Energy Charter Treaty (ECT), which is aimed, in part, at protection of foreign investments and protection against key non-commercial risks, it has never ratified the ECT. Under Russian law, the ECT is subject to ratification and as a result has never become effective for Russia. 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. Although tax planning objectives typically prevail, some investors will structure their deals to 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. In 2020–2021, Russia has renegotiated BITs with Cyprus, Malta and Luxemburg and terminated the treaty with the Netherlands. The changes in the treaties generally provide for taxation of dividends and interest at source at the rate of 15 per cent.

In 2018, following more than 20 years of discussion, five Caspian coastal states, including Russia, signed the Convention on the Legal Status of the Caspian Sea. The event was described as epoch-making. The Convention will serve as a basis for the delimitation of the seabed, which will still require further separate treaties between the littoral nations. The way to divide the huge oil and gas resources of the Caspian Sea is opening frozen and allowing new energy projects in the area.

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 (the 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 licence agreement, which is an auxiliary and constituent part of a subsoil licence. Breach of the terms of a licence or a licence agreement by the subsoil user may result in termination or suspension of the licence, and, consequently, of the right to use the subsoil deposit. Such termination or suspension may be challenged in court.

Previously, the rights to use subsoil deposits were generally granted based on the results of a competitive tender or an auction. From 1 January 2022, tenders for the rights to use subsoil deposits will be held only in the form of an auction. In addition, a register of unscrupulous participants in such auctions will be introduced.

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 now only a few operational production sharing agreements in Russia, all of which were signed before the 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* the borders of the land plot granted for subsoil use;
- c* the deadlines (such as the start and end of the production);
- d* the production volume; and
- e* the 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; and
- c* a combined geological research, exploration and production licence allowing for geological exploration and assessment and subsequent production of natural resources.

Under the Constitution, natural resources in subsoil are state property and are subject to the joint jurisdiction of Russia and the region, namely the constituent subject of Russia, 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 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 strict 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 or other documents enclosed with a subsoil licence usually impose certain obligations on a licence holder, including the obligation to reach and maintain certain agreed volumes of production. Production of resources above such volumes is prohibited. Production below such volumes or delay in reaching production levels are also considered breaches of the licence.

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 the life or 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* an emergency occurs (natural disaster, military action, etc.);
- 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; or
- 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 by pipeline. Historically, this monopoly also extended to the export of liquefied natural gas (LNG), but recent developments, discussed further below, have resulted in a modest liberalisation of the regime as far as LNG is concerned. 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: availability of capacity on the UGSS;

compliance of the gas being transported with established quality and technical parameters; and 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. Historically, Gazprom has enjoyed the deficit of natural gas in the domestic market; however, at present, there is an overproduction of natural gas. The flexibility in terms of pricing available to independent gas producers who can offer discounts to customers has gradually helped them to gain, at Gazprom's expense, a sizable share of the internal market.

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 direct 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 (from a parent to a subsidiary, from a subsidiary to a parent or between subsidiaries).

The acquisition of subsoil rights by foreign investors may be subject to certain restrictions and is discussed further below.

VI TAX

Generally, value from hydrocarbon resources is derived via taxation and export duties. The principal tax payable by extractors of natural resources in Russia is mineral extraction tax (MET). 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, gas condensate and gas, MET is calculated based on the physical volumes of extracted resources.

In addition, producers of oil and gas are subject to corporate profits tax at the rate of 20 per cent. It applies to all taxpayers in Russia. Of the 20 per cent rate, 2 per cent is payable to the federal treasury and 18 per cent to the treasury of the relevant member region. Member regions (i.e., the constituent subjects of Russia) 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 zero rate VAT and the right of recovery of 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.

On 1 January 2015, Russia launched a reform in the taxation of the oil and gas upstream and downstream sectors. In general, the tax reform involves increasing the mineral extraction tax and decreasing the export customs duties and excises from oil products. In July 2018, the State Duma passed the laws governing completion of the tax reform (known as tax manoeuvre). According to the laws, export duties will be reduced from 30 per cent to zero per cent during six years beginning from 2019 with a simultaneous increase of mineral extraction tax on oil for three consecutive years up to 2021. In addition, the tax reform includes reverse excises and dampening excises, as well as the right of the government to introduce export duties on exports of oil products. The foregoing measures were introduced to deal with the shortage of oil products on internal markets. However, the reform has been frustrated by the coronavirus pandemic.

An increase in spending to provide pandemic-associated support to the businesses and population, along with decreased oil and gas revenues, required the government to amend Russian tax legislation. On 1 January 2021, certain legal acts were introduced abolishing the reduced rate of MET for oil fields with a depletion of more than 80 per cent. The MET exemption for extra-viscous oil was excluded. Another important change was the cancellation of several oil export privileges. Export duty exemptions for oil with special characteristics have been cancelled at 15 oil fields. The reduced rate of the export duty on extra-viscous oil was also cancelled.

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.

From July 2021, all projects related to production, processing, transportation, storage and (or) sale of oil and oil products must incorporate a plan for the prevention and elimination of oil and oil products spills and any other negative impact on the environment, which plan must be approved by the Federal Service for the Supervision of the Use of Natural Resources. In addition, a company must provide sufficient financial security for full compensation of the harm to the environment, life, health and (or) property of individuals and companies.

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.

On expiry (or termination) of a licence, a licence holder must, at its own expense: (1) ensure that 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; (2) recultivate the land and return it to a condition adequate for future use; and (3) 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.

On 2 July 2021, the Law on Limiting Greenhouse Gas Emissions was adopted. It creates a legal mechanism to monitor and incentivise the reduction of greenhouse gas (GHG) emissions. The largest emitters of GHG, among which are oil and gas producers, fell under the new regulation.

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 are a variety of business structures that may be used by investors to form a subsidiary or create a joint venture with Russian partners.

According to the Civil Code of Russia (the Civil Code), commercial legal entities may be created in the form of, inter alia, business partnerships and corporations. The business forms that are typically used by foreign investors are joint-stock companies (public or non-public) 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 and of a non-public joint-stock company is 10,000 roubles and of a public 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 five and 15 days. The newly created company is granted a main state registration number and a taxpayer's identification number. 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) are conducted by the same authority. Following the state registration, shares in a joint-stock company must be registered by the Bank of Russia. 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 is publicly available on the webpage of the Federal Tax Service on the internet at: www.nalog.ru.

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

The predominant approach to structuring a business by foreign investors with Russian partners in Russia is still to use a non-Russian company formed in an offshore jurisdiction as a joint venture vehicle for the entire corporate structure. There are two primary reasons for this: (1) greater tax advantages and BIT protection; and (2) use of developed and predictable corporate governance rules to govern the relationship between the foreign investor and its Russian partners. Russian law allows corporate agreements between members or shareholders of Russian companies but the substantive law and, more importantly, Russian judicial practice are still untested and controversial.

ii Capital and labour restrictions

At present, the hard currency control regime is very liberal. There are no hard currency control requirements, such as government consent 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) registering of contracts with servicing banks in relation to import or loan transactions equal to or exceeding three million roubles or equivalent, and equal to or exceeding six million roubles in relation to export transactions. In addition, Russian residents are subject to rather burdensome reporting requirements.

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 or a patent. The validity of such permits or patents is generally limited to the region of Russia where they were issued. These permits must be applied for by an employer well in advance without any guarantee that they will be obtained. The term of the above permits is 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 'highly qualified specialists regime' is available in all industries, including oil and gas. At present, the main criteria that must be complied with in order to use this regime is to pay foreign employees no less than 167,000 roubles as a practical matter, each calendar month of the term of employment, and to provide evidence quarterly of such payment to the Russian authorities.

iii Fields of federal significance

Some natural resources deposits (i.e., '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 tonnes 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 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 or exploration

and development of a field of federal significance. For these purposes, control is generally defined as the acquisition (directly or indirectly) of 25 per cent or more of the shares in the 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. In addition, these acquirers are generally prohibited from acquiring control (25 per cent or more) over the above target companies. According to the most recent amendments in the Law on Foreign Investments in Strategic Companies, the above prohibitions now apply where the aggregate interest of one or several foreign states, or of separate companies controlled by one or several foreign states, exceeds the required thresholds (until recently, the law would look at the states' or companies' interests on a separate basis).

Other restrictions on the rights of foreign investors or Russian companies with foreign investments 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. Russian 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.

According to the most recent amendments to the Subsoil Law, however, restrictions to combined geological research, exploration and production on a deposit of federal significance apply to foreign investors and Russian companies controlled by foreign investors. Although not free from internal contradictions, the Subsoil Law appears to show a move towards limiting restrictions to Russian companies controlled by foreign investors (and non-Russian companies), rather than imposing restrictions on Russian companies that have a level of foreign investment that is short of 'control'.

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 Russia. 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 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 with no less than five years' experience of working on the continental shelf and with more than 50 per cent of their voting shares directly or indirectly owned or otherwise controlled by Russia. This restriction effectively prohibits any foreign investment in the Russian continental shelf other than via the Russian

state-controlled majors Gazprom and Rosneft. The prohibition specifically affects Russian Arctic oil and gas programmes. Non-Russian companies participating in these programmes do not have an interest in the deposits.

A transferee of a licence relating to a field of federal significance that is a Russian entity with foreign participation must submit evidence supporting that the transfer of the licence to the transferee is not prohibited under the Subsoil Law or, alternatively, the resolution of the government granting consent to the transfer. If the 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 field of federal significance, the government 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 these 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.

iv Anti-corruption

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 key problems that Russia faces in attempting to secure increased levels of foreign direct investment (as well as internal 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 arguably less affected by government corruption because of the dominance of state-controlled major companies.

v Export restrictions

Historically, Gazprom has had a legal monopoly to export natural gas in all its forms, including LNG. However, there had been a perception that if Russia does not adopt an active policy, it risks completely losing the global LNG market to competitors.

In November 2013, amendments to the Law on Export of Gas were adopted that allow the export of LNG, by subsoil users whose subsoil licence provides for the construction of an LNG plant as of 1 January 2013, in addition to Gazprom and its subsidiaries, and state-controlled companies whose deposits are located within territorial waters, internal seas, on the continental shelf or the Black and Azov Seas may also export LNG. The effect of this 'liberalisation' (and its obvious purpose) was to benefit Yamal LNG, its main shareholder NOVATEK and Rosneft, without restricting Gazprom's monopoly to supply natural gas through pipelines to external markets. In May 2020, the Law on Export of Gas was further amended to expand the list of potential LNG exporters. According to the amendments, the right to export LNG was granted to joint projects controlled by NOVATEK and implemented under licences obtained after 2013.

IX CURRENT DEVELOPMENTS

The new Doctrine of the Energy Safety of the Russian Federation was adopted in May 2019 by Presidential Order. It updates challenges, threats and risks to energy safety. It also determines the trends, objects and aims of government activity to guarantee energy safety. Among the stated external challenges are:

- a* contraction of the traditional export markets of energy;
- b* illegal delineation of the energy resources of Russia in the territory of third countries in the process of transportation;
- c* restrictions on Russian companies by way of sanctions; and
- d* discrimination of Russian energy companies based on changes in international regulation.

The 2035 Energy Strategy was adopted in June 2020 by the Order of the Government. It is in part based on the Doctrine of the Energy Safety of the Russian Federation. Its main objectives are determined as:

- a* quality meeting of the internal demand for energy resources, technologies and services in the energy sector;
- b* development of production of LNG, formation of an LNG cluster on the Yamal Peninsula and the Gydan Peninsula, as well as of the six petrol and gas chemical clusters, development of production and consumption of hydrogen and helium;
- c* development of the natural gas transportation infrastructure in Eastern Siberia and the Far East;
- d* development of innovative activities; and
- e* the introduction of digital technologies in government management.

In March 2020, the President adopted the Fundamentals of the State Policy in the Arctic until 2035. As the main challenge, the Fundamentals list insufficient geological research of the mineral natural resources. The following objectives are stated: (1) advanced involvement of private investors in projects on the Arctic Shelf with government control over implementation of such projects, development of infrastructure of the Northern Sea Route; (2) progressing of geological research works of hydrocarbon deposits funded by both private and government investments, development of production of LNG, gas chemical production, deep oil refining.

Also in March 2020, the federal law amending the Tax Code of the Russian Federation introduced unprecedented exemptions on the payment of the mineral extraction tax (the tax set forth at the rates from zero per cent to 5 per cent). The exemptions will apply only to the oil and gas deposits located beyond the Northern Polar Circle.

In July 2020, the Federal Law on Government Support of Economic Activities in the Russian Arctic Zone, as well as the relevant Amendments to the Tax Code of the Russian Federation and certain other federal laws, were adopted. The set of these federal laws determines the status of the Arctic zone, its border, sets up a register of residents of the Arctic zone. A resident is a company or an entrepreneur who plans into a new investment project not less than one million roubles. The Arctic zone allows a free customs zone and as a result its status is equal to a special economic zone. The residents are granted federal, regional and local tax privileges and lower rates of social security allocations. The support measures may include provision of land plots and infrastructure.

In March 2021, the government of the Russian Federation adopted a long-term programme for the development of LNG production in Russia. The programme, in part: (1) analyses the key trends in global energy consumption and measures to support LNG

production; (2) determines the resource base of promising LNG projects; and (3) considers the potential for the development of LNG production in Russia, including the segment of low-tonnage LNG production for the purposes of autonomous gasification of remote regions, as well as the development of LNG technologies.

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Natalya Morozova started at Vinson & Elkins in 1991. She was a highly respected practitioner for years, acting on 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 and natural resources sector. As of 1 January 2019, Natalya retired. From July 2021, Natalya serves as counsel at Nadmitov, Ivanov & Partners.

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ISBN 978-1-83862-807-9