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Accessing the Boom: Oilfield Services in Kazakhstan

by Victor Mokrousov, in Almaty

With new fields at both the exploration and production stages, both onshore as well as offshore in the Caspian Sea, Kazakhstan is a potential market for nearly every category of oilfield services. Depending on the oilfield service provider's risk profile and its relations with its Kazakhstan customers and partners, there are a variety of choices as to how to approach this market from a legal standpoint. This article briefly reviews some of the more important legal aspects of accessing the oilfield services market in Kazakhstan. */ continued page 5*

Mali Updates Petroleum Regime

by Mark Elliston, IHS Energy, in London

Following on from the recent successes in Mauritania's offshore sector, and the emergence of new fiscal regimes in Liberia, Sierra Leone and the Nigeria-Sao Tome Joint Development Zone, Mali became the latest West African country to promulgate an updated petroleum regime. This article summarizes the key terms on the new petroleum regime based on the 2004 Petroleum Code issued in August 2004, as well as on recently awarded blocks.

Legal Background

In August 2004, Mali issued a new Petroleum Code (Law No. 04-037) of 2 August 2004. This was followed in September 2004, by Decree No. 04-357 containing the regulations pertaining to the Code. The new Petroleum Code repealed Ordinance No. 30 of 23 May 1969, as amended by Ordinance No. 21 of 20 April 1970 (which was the old Code of 1969). We have some early indication of how these new laws will be implemented based on early awards. In 2004, five blocks under production sharing terms were awarded to Baraka Mining Ventures. In early 2005, two blocks were awarded to Sphere Investments.

The licensing authority is called (in French) Direction Nationale de la Géologie et des Mines (DNGM). The DNGM falls under the control of the Ministry of Mines, Energy and Water. Unlike many of its neighbors, Mali has no national oil company. There are two basic forms of contracts provided for in the Petroleum Code: either a production sharing contract (PSC) or a concession agreement (royalty/tax). The Baraka contracts entered into in October 2004, and those agreed by Sphere in 2005, */ continued page 2*

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were both agreed under PSC terms. Prior to the introduction of the 2004 Petroleum Code, the royalty/tax regime was the preferred contract type.

State Participation

Participation by the state is negotiable after a discovery has been declared commercial. The method for the state's participation is to be defined in the contract. The blocks awarded to Baraka were believed to have a 20% state participation. Stratic Energy's 1997 agreement provided for a 10% interest with the government carried through exploration and the option of a further 10% on commercial discovery, paying past costs.

Exploration

The right to carry out all petroleum prospecting and exploration work to any depth is granted in an Exploration Permit; there is no size limit on the exploration permit awarded.

Exploration Permits are valid for a term of four years, with two three-year extensions. However, different duration and renewal provisions may be negotiated in individual contracts. Renewals are automatic, provided that the permit holder has fulfilled its minimum financial commitment. Surrender of the permit (in part or whole) may take place on two months' notice to the Minister of Mines, Energy and Water. The permit area is required to be reduced in area on each renewal with the amount relinquished to be established in each contract. As a concrete example, Stratic Energy's 1997 contract provided for a 50% relinquishment after the first year.

Not surprisingly, Exploration Permits provide for minimum financial investments, which are negotiated for each period. It had been reported that Baraka had committed US\$51.73 million over four years covering five blocks. It was also believed that this included one well in the initial and second exploration periods, and two wells in the third period (assumed to be for each block).

The work commitments agreed for the Baraka blocks were:

Block 1	Financial Commitment	Work Programme
First year	US\$100,000	Reprocess seismic
Second year	US\$2 million	Airbourne geophysical surveys
Third year	US\$2 million	Seismic acquisition
Fourth year	US\$8 million	One well
Second three year period	US\$8 million	One well
Third three year period	US\$18 million	Two wells
Blocks 2, 3 and 4 (per block)	Financial Commitment	Work Programme
First year	US\$80,000	Reprocess seismic
Second year	US\$600,00	Airbourne geophysical surveys
Third year	US\$1 million	Seismic acquisition
Fourth year	US\$8 million	One well
Second three year period	US\$8 million	One well
Third three year period	US\$18 million	Two wells

Block 9	Financial Commitment	Work Programme
First year	US\$90,000	Reprocess seismic
Second year	US\$1 million	Airbourne geophysical surveys
Third year	US\$1.5 million	Seismic acquisition
Fourth year	US\$8 million	One well
Second three year period	US\$8 million	One well
Third three year period	US\$18 million	Two wells

By contrast, we understand that Stratic Energy’s 1997 contract provided for expenditure of US\$18 million and the drilling of one well in the first five-year exploration period.

Besides minimum financial investments, fee of 1 million CFA Francs is required for an initial exploration permit application. A renewal application fee of 1 million CFA francs is also required, and the following annual rentals are payable:

- first term (first to fourth year): 500 CFA Francs per square kilometre;
- first extension period (fifth to seventh year): 1,500 CFA Francs per square kilometre; and
- second extension period (eighth to 10th year): 2,500 CFA francs per square kilometre.

Production

Production in Malian hydrocarbon fields is carried out pursuant to an “Exploitation Permit.” If an applicant for an Exploitation Permit does not have an exploration permit, a prospecting permit will be issued for a duration of two years to enable evaluation work to be carried out. Unlike Exploration Permits, the area for Exploitation permits is not specified. Exploitation permits are valid for a term of 25 years, with two 10-year extensions. Surrender of an Exploitation Permit may take place on six months’ notice to the Minister.

Bonuses and Fees: A fee of 5 million CFA Francs is required for an initial exploitation permit application. A renewal application fee of 10 million CFA Francs is required.

Rental: The following annual rentals are payable:

- first term (first to 25th year): 1 million CFA Francs per square kilometre; and

- extension periods (after 25th year): 1 million CFA Francs per square kilometre.

Fiscal Terms

Royalty: If royalty is invoked, then it is applied under the following terms:

Production Tranche (barrels of oil per day)	Royalty Rate
< 50,000	0%
50,000 – 160,000	7.5%
160,000 – 200,000	10%
200,000 – 500,000	12.5%
> 500,000	15%

For gas production used domestically the royalty rate is 5%. For exported gas the royalty rate is 3%, and the royalty may be paid in cash or kind.

In terms of the foregoing table, it was not known if royalty was an element of PSCs. However, we believe it was not invoked in the Baraka agreements. In the 1969 Petroleum Code royalty was 12.5% for oil and 5% for gas payable in cash or kind. Stratic Energy’s 1997 contract provided for royalty of 6% on oil, 5% on exported gas and 3% on gas for domestic consumption.

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Production Sharing

The cost recovery ceiling and production split is negotiable. In the Baraka contracts production sharing was on the following basis:

Total Daily Production (barrels)	Contractor Share (%)	Government Share (%)
< 25,000	80%	20%
25,000 - 50,000	70%	30%
50,000 - 75,000	65%	35%
75,000 - 100,000	60%	40%
> 100,000	50%	50%
<i>Note: Gas not defined.</i>		

In recent contracts the cost recovery ceiling is believed to be set at 70% (Baraka) and 65% (Stratic Energy).

Taxable net profit is subject to a tax of 35% and is defined as the difference between net assets at the close and opening of the fiscal year, less any assets brought in by the operator, plus any assets which are withdrawn. Under the 1969 Petroleum Code, there was a depletion allowance of 27.5% of the value of products produced during the year,

or 50% of the net profits for the year, whichever was less.

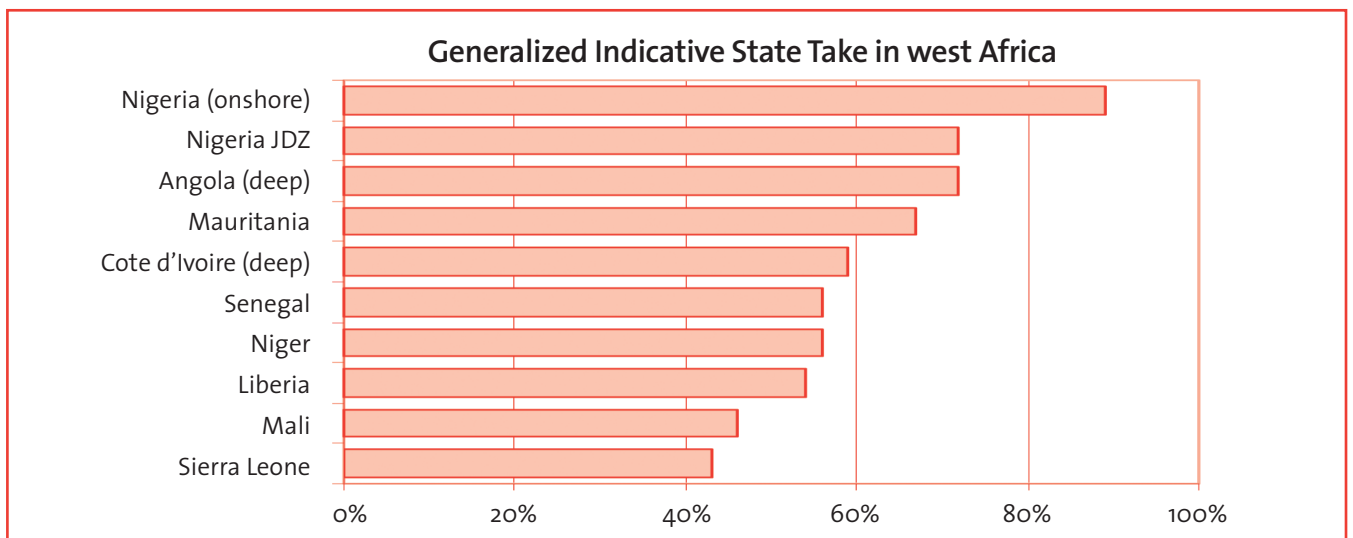
It should also be noted that Mali imposes a stamp duty on contracts to export hydrocarbons. Mali has no withholding tax, and value added tax is exempt, but training fees are required. A special tax (ISCP) is also payable on certain products.

According to this information, Baraka committed to US\$200,000 for training purposes per year per block during

the exploration period and US\$250,000 per year for a production licence.

Non-associated natural gas may be stored for sale, re-injection or utilised for commercial or industrial uses. Flaring is only permitted as a last resort.

As demonstrated in the West African State take Chart below, Mali's new petroleum regime compares quite favorably with its neighbors. (Note: US\$1 = 506.12 CFA Francs.) ☺



Amongst its West African neighbors, Mali has nearly the lowest state take.

The Oil & Gas Quarterly thanks **Mark Elliston** of **IHS Energy** for this State Take chart. The State Take chart has been derived from IHS Energy's PEPS product. PEPS is a powerful, searchable online service providing constantly updated upstream economic, fiscal and commercial data and analyses. For more information, visit PEPS at www.ihsenergy.com/products/peps/index.jsp or contact Mark.Elliston@ihsenergy.com in London.

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Accreditation

The first step is to establish a legal presence (accreditation) without which most oilfield service contracting opportunities are off limits.

Kazakhstan law provides three options for gaining accreditation, namely establishing: i) a representative office (*predstavitel'stvo*), ii) a branch (*filial*), or iii) a Kazakhstan legal entity. In selecting the appropriate form of accreditation, a service provider should take into consideration such matters as existence of liability firewalls, possible management structure and equity holding arrangements, applicable currency control rules, the governing tax regime, and licensing and work permit issues.

A representative office (“RO”) offers the most limited form of accreditation. Conceptually, the RO simply provides informational and liaison services for the parent. An RO may open bank accounts, lease office space and provide visa support, but it should not engage in commercial activities, such as rendering services with on-the-ground personnel. An RO offers no limitation of liability for its parent.

The second option for accreditation is a branch office (“Branch”). A Branch offers a more flexible form of accreditation, and can engage in most of the same activities as a legal entity described below. Like the RO, however, the Branch offers no limitation of liability for its parent.

A Kazakh legal entity (an “Entity”) is the third option for accreditation in Kazakhstan. An Entity enjoys full accreditation, and limits the liability of its parent. However, unlike an RO and a Branch, an Entity is treated as a resident for purposes of currency control regulation and, as such, has limited ability to transact in foreign currency.

Legal Entities

The two forms of Entity that an oilfield services company might consider are a limited liability company (“LLP”) or a joint stock company (“JSC”).

LLPs in Kazakhstan are analogous to limited liability companies in the West, and are preferred as the most flexible and useful form for conducting business. The transferability of a participant’s interest in an LLP is limited by certain statutory preemptive rights of the other participants, however, unlike a JSC, an LLP permits its participants to avoid the administrative burden involved in issuing shares and registering share distributions. The participants

of an LLP also have more flexibility to create an appropriate management structure.

Kazakhstan JSCs are analogous to corporations and joint stock companies in many western jurisdictions. Recently, however, JSCs in Kazakhstan have become less popular because the newly adopted *Joint Stock Company Law* abolished the closed joint stock company structure. As a result, structures based on preemptive rights of various JSC shareholders may be difficult to enforce, while the transfer of large shareholdings is subject to various formalities and constraints (known as the “30% rule” in many other jurisdictions). In addition, JSCs are required to have burdensome management structures and are subject to numerous statutory limitations on so-called “major” and “interested-party” transactions.

Licensing and Permits

The second step is to determine which licenses and permits might be required to provide a given type of oilfield services.

Service companies must attend to permit and licensing requirements prior to commencing their activity since penalties for operating without a license or permit can be severe. Unfortunately obtaining licenses and permits in Kazakhstan is usually document intensive and time consuming.

Kazakhstan has an extensive list of licensed activities and over 30 licensing bodies. For example, and in particular to the oilfield service industry, state licenses are required for planning and operation of upstream and downstream facilities, as well as drilling and construction, while certification of equipment is also mandatory.

Local Content and Procurement

Kazakhstan actively promotes the employment of Kazakhstani citizens and, unless any of the exceptions apply (such as the position of the head of a Branch), Kazakhstan law requires employers to obtain work permits for foreign labor. There is a limited number of work permits that can be granted each year, which naturally creates difficulties in obtaining these permits.

The next step is to understand how oilfield services contracts are awarded in Kazakhstan.

A variety of Kazakhstan laws affect procurement requirements and procedures, including the Subsoil Law, the Petroleum Law and the State Procurement Law. In addition, the subsoil use contracts concluded with oil companies likewise contain various requirements and procedures, just as one might find in */ continued page 6*

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the internal policies of the subsoil users (oil companies) themselves. Tender requirements for service providers are also affected by which entity is carrying out the procure-

In 2004, the Subsoil Law was amended to increase local content requirements, escalating the local content requirement from a prerequisite for operation to a condition for granting E&P rights at all.

ment, i.e. whether the operator is private, or whether the procurement falls under the category of government procurements (including by Government controlled companies and affiliates) and natural monopolies. In addition, there is an overlay of administrative oversight by Kazakhstan government agencies as well.

Aside from the obvious issues of price and quality, the Kazakhstan law-driven requirements also affect the determination of awards of service contracts in procurement tenders. Among the more important of these criteria are: special preferences to local suppliers and manufactures (i.e., local content requirements), and applicable tender requirements.

In 2004, the Subsoil Law was amended to increase local content requirements, escalating the local content requirement from a prerequisite for operation to a condition for granting “E&P” (exploration and production) use rights at all. Indeed, tender proposals by oil companies seeking subsoil (E&P) rights must specify how and to what extent the applicant will use local goods and services. Furthermore, tenders must express an additional commitment to local content by including proposals for the development of high technologies and for new production processes and pipelines locally. The PSA (production sharing agreement) Law establishes specific criteria on

local development for determining awards of PSAs: first priority is given to a participant’s proposal for high technology, second priority to a participant’s proposals for forming and using new processing and production operations and pipeline facilities and third priority is given to a participant’s proposals for the construction and joint use of infrastructure and other facilities.

Work programs must likewise include proposals on local content, addressing the use of domestic suppliers and “additional commitment” to local content as well. Subsoil use contracts may be terminated because of a contractor’s failure to comply with the work programs, including local content requirements.

Conclusion

Although every oilfield service provider will have its own considerations in accessing the Kazakhstan market, some general recommendations proved to be useful. Kazakhstan joint ventures can maximize local content while still applying foreign skills and management. The key, of course, is balancing the foreign and Kazakhstan interests in such ventures, not only economically, but also in terms of the appropriate contributions of skills and management. Given the recent changes in the Subsoil Law and related procurement procedures, no oilfield service provider will succeed in this market without a demonstrable commitment for the preferential use of local employees and facilities. ©

US Regulators Seek to Facilitate LNG Projects

by Donna Bobbish, in Washington

Following passage of the Energy Policy Act of 2005, the United States Federal Energy Regulatory Commission (FERC) has begun the process of promulgating the regulations called for by the new law. The first of these regulations establishes a formal “pre-filing” process for liquefied natural gas (LNG) projects subject to its jurisdiction. Currently, project sponsors may meet with FERC staff prior to filing an application for project approval to discuss and to receive FERC staff guidance with respect to the environmental, engineering and safety aspects of a project. Essentially, the FERC is proposing to adopt its current voluntary pre-filing process as a mandatory pre-filing process for LNG terminal facilities and associated jurisdictional pipeline facilities.

The FERC’s proposed rules require developers of new LNG terminals to initiate pre-filing procedures at least six months before filing a formal application for FERC approval of an LNG project.

The Energy Policy Act amended the Natural Gas Act to give the FERC exclusive authority to approve or deny an application for the siting, construction, expansion or operation of an onshore LNG terminal or any LNG terminal located in state waters. It also required FERC to issue, within 60 days of the law’s enactment, regulations implementing a mandatory, rather than a voluntary, pre-filing process for LNG facility authorizations.

On August 26, 2005, the FERC issued a Notice of Proposed Rulemaking (NOPR) to establish mandatory pre-filing procedures for all applicants seeking to site, construct and operate new LNG terminals and related facilities, such as pipelines, that would transport revap-

orized LNG to markets. The pre-filing procedures also would be mandatory for applicants seeking to expand existing LNG facilities, if the FERC’s Director of the Office of Energy Projects determines that significant modifications to existing LNG terminal facilities involve state and local safety considerations. The proposed rule does not, however, impose mandatory pre-filing procedures for new or expanded natural gas facilities that do not involve LNG.

The FERC’s proposed rules provide that a project sponsor may not file an application for approval of LNG terminal facilities and associated jurisdictional pipeline facilities until at least 180 days after the date that the FERC’s Director of the Office of Energy Projects issue a notice of the commencement of a prospective applicant’s pre-filing process. The proposed rule also requires that an application for LNG facilities contain all of the information specified by the FERC’s staff.

In order to initiate the proposed mandatory pre-filing process, a prospective applicant for approval of an LNG

The Energy Policy Act amended the Natural Gas Act to give the FERC exclusive authority to approve or deny an application for the siting, construction, expansion or operation of an onshore LNG terminal or any LNG terminal located in state waters.

terminal must consult with the FERC’s Director of the Office of Energy Projects and must file information concerning the design and engineering features of the proposed project, as well as information concerning the potential environmental, security and safety impacts of the project. Prospective applicants also must describe the desired schedule for the project, including the expected application filing date and the desired date for Commission approval of the project.

In order to initiate the pre-filing process, a prospective applicant for approval of an LNG terminal also must file a Letter of Intent and a

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Preliminary Waterway Suitability Assessment with the U.S. Coast Guard.

The proposed rules also set out a timetable, following the issuance of a notice commencing a prospective applicant's pre-filing process, for applicants concerning stakeholder notification and meetings, selecting third-party contractors, site visits, and submitting reports to the FERC staff.

Following receipt of comments on the NOPR, the FERC intends to issue a final rule by October 7, 2005. ☺

US Regulators Adopt Gas Quality Reporting Standards

By Donna Bobbish, in Washington

On May 9, 2005, the US Federal Energy Regulatory Commission ("FERC") amended its regulations to incorporate standards ratified by the North American Energy Standards Board (NAESB) to implement gas quality reporting requirements in order to provide greater transparency to shippers with respect to the gas quality requirements of interstate pipelines and available information on gas quality on such pipelines' systems. These new standards require a pipeline to provide a link on its Informational Posting Web Site to its gas quality tariff provisions, or a simple reference guide to such information. Additionally, a pipeline must provide on its Informational Postings Web site, in a downloadable format, daily average gas quality information for prior day(s) to the extent available for location(s) that are representative of mainline gas flow for the most recent three-month period.

The FERC stated that the NAESB standards represent "a consensus of the industry as to the minimum posting requirements for information on gas quality that are applicable to all pipelines."

In adopting the NAESB reporting standards, the FERC once again rejected requests that its rule on whether gas quality requirements established in individual pipeline proceedings should be extended to the entire industry, directing commenters to its proceeding in Docket No.

PL04-3-000, *Natural Gas Quality and Interchangeability*.

In that proceeding, on May 16, 2005, the Natural Gas Supply Association (NGSA) petitioned the FERC to issue rules to "remove the current uncertainty that exists with respect to natural gas quality and interchangeability requirements which apply to natural gas flow in interstate commerce." The NGSA submitted proposed regulations that would establish a minimum safe harbor national cricondentherm hydrocarbon dew point of 15 degrees Fahrenheit, require pipeline adoption of interchangeability specifications consisting of a 1400 Wobbe Index, 4 percent inert gas maximums and a 1.5 mole percent butanes plus limit, and require pipelines to implement tariff language that create a non-discriminatory "safe harbor" mechanism that maximizes supply and establishes the use of aggregation, blending and pairing on a non-discriminatory basis. Comments have been filed in response to NGSA's petition, but the FERC has taken no action on it yet, other than to ask the U.S. Department of Energy to take a leadership role to coordinate industry and Government research on natural gas quality and interchangeability. ☺

Oilfield Services in Russia: Running the Gauntlet

by Shane DeBeer, in Moscow

As the Oil & Gas Quarterly reported in the last edition, oil and gas production in Russia continues to increase (albeit less rapidly), although exploration lags. But in both cases, the demand for oilfield services remains robust: Russia's domestic industry has not been able to keep pace with demand. For the foreign oilfield service company, there are a number of administrative and legal barriers to be surmounted in order to access this growing market; this article considers some of the more important issues facing new entrants.

Acquiring a Company Versus Acquiring Assets

Provided that the most important assets – the contractual relations and key employees – can be transferred without significant delay, then a transfer of assets is the preferable method to acquire a Russian oilfield services

business. If we assume that a foreign investor wants to acquire the business of a target Russian company, the foreign investor can form a new Russian shell company (“NewCo”) to acquire the assets, hire the employees and enter into new service agreements with the target company’s clients. What happens to the liabilities and employees of the target company?

Liabilities

Generally, the target company’s liabilities do not follow the title to its the assets, so NewCo will not be liable for any of the target company’s obligations. This is the advantage of the acquisition of assets over the acquisition of shares, but there are factors limiting this advantage. In particular, in certain specific circumstances (for example a sale to a creditor on preferential terms, or on unfavorable terms for the seller generally) under Russian law, the court may invalidate the transaction.

Care must also be taken in the transfer of assets to ensure that the sale of an “enterprise” (entire business) provisions of Russian law do not apply. The sale of assets (unlike shares) is VATable. Thus, although as a general rule creditors do not have any legal recourse against NewCo, if the target company becomes bankrupt or there are other defects in the transaction there is a risk that the acquisition of assets could be invalidated by a Russian court.

Employees

If we assume that most of the existing employees will voluntarily agree to be employed by NewCo in the event of an asset sale as described above, most of the usual employment-related liabilities will remain with the target company and not NewCo. The time of transfer of employees from one company to another company does not have any legal significance under Russian law.

In fact, the target company and not NewCo will be liable for any damages incurred by the employees during the remaining validity of their employment contracts with the target company (Article 232 of the Russian Labor Code) (i.e., the termination of an employment

contract does not relieve the target company from liability to compensate the employees for damages incurred during the period of employment).

Under normal circumstances NewCo should not be liable to compensate the target company’s employees under the situation described above. Among other compensation, each of these employees will be entitled to receive “severance pay” equal to his/her monthly salary, or more if the employment agreement so provides, or provides for a supplemental bonus. In addition, the employee will receive his or her salary for 2 months following the redundancy date from the target company.

Purchasing versus Leasing

Equipment can also be supplied to Russian oil and gas projects via a cross-border (international) lease or a domestic lease. If the service company uses an interna-

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tional lease, it would be covered by the UNIDROIT Convention, while domestic leasing is governed by the Russian Law “On Leasing.” International leasing is not widespread in Russia, largely because of enforcement/repossession issues. Domestic leasing is now simpler and more flexible, and most important for the lessor it expressly permits the seizure of leased assets. Domestic leasing provides certain tax benefits, but it is still subject to VAT.

How to Operate Legally: Laws and Licenses

The first consideration in any services contract is the counterparty (sponsor). Even if a company other than the licensee in an oilfield is financing its operations, the contractor will often need to enter into its service/supply contract directly with / continued page 10

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the licensee because of the licensee's rights to the development site. Also, the terms of the license may restrict the licensee's ability to use contractors.

Beyond the counterparty, the primary issue for service and engineering companies is licensing requirements, as Russian law imposes licensing requirements on a wide variety of activities relating to oilfield services.

Beyond the counterparty, the primary issue for service and engineering companies is licensing requirements, as Russian law imposes licensing requirements on a wide variety of activities relating to oilfield services.

To start from the top, the fundamental Russian law regulating E&P activity is the law **"On Underground Resources"** (the "Underground Resources Law"), which imposes licensing requirements for various related activities including regional geological studies, geological surveys and site surveys, geological studies, including exploration and estimates of mineral deposits, and construction and operation of underground facilities other than for the extraction of mineral resources.

In addition, Article 24 of the Underground Resources Law provides that a separate license for dangerous activity must be obtained if the work involves dangerous conditions.

The Russian Law **"On Licensing Certain Types of Activities"** (the "Licensing Law"), in turn, mandates a license for a variety of other activities, including mine surveys, geodesic (land-surveying) activity, map-making, the use of oil and gas production equipment, including servicing oil and gas wells, and the use of flammable, hazardous or explosive industrial equipment, and the use or storage of explosive industrial materials.

Further, in addition to the Underground Resources Law and the Licensing Law, there is a separate requirement for a specialized "Oilfield Activities License." Any services related to the operation of hydrocarbon production facilities require a special license which is issued by the Federal Service For Ecological, Technological and Atomic Control ("Industry Control Service"). The Industry Control Service issues licenses for the exploitation of oil and gas production facilities for a term of 5 years, which is generally renewable. The Industry Control Service is

not permitted to exercise discretion, and must issue a license within 60 days of receiving a complete and accurate application with all of the required supporting documentation.

In addition, depending on the services provided, other licenses and permits may be needed. These include:

- ⊙ Licenses for the use of chemically hazardous industrial objects;
 - ⊙ Licenses for processing, storage and transportation of oil, gas and related products through trunk pipelines;
 - ⊙ Licenses to operate lifting equipment (mobile jib cranes) (with or without the right to perform technical maintenance and repair of third parties' lifting equipment);
 - ⊙ Licenses to operate equipment for geophysical and hydrodynamic research and well tests;
 - ⊙ Licenses to carry out maintenance of and repairs to oil and gas equipment generally;
 - ⊙ Licenses to use specialized industrial explosives (explosive seismic shooting as well as fracturing and other services in oil, gas, water and other wells);
 - ⊙ Licenses to operate oil and gas production facilities (including for drilling in oil-and-gas bearing formations with the use of perforating equipment); and
 - ⊙ Licenses to carry out any work that will "actively impact the geophysical processes and phenomena."
- And besides licenses, certain administrative approvals may be required, for example approvals for design and feasibility studies, pilot projects and

development plans, and for construction of any facilities on site.

In order to obtain any of these licenses the applicant will usually need to file the following documents with the appropriate licensing authority(ies):

- ⊙ An application indicating the title, corporate form and official address of the applicant, as well as the location of the licensed activity;
- ⊙ Copies of the foundation and registration documents of the applicant;
- ⊙ A copy of a certificate from the Russian tax authorities confirming registration of the applicant as a taxpayer;
- ⊙ A document confirming payment of the duty for the review of the application (*i.e.*, a filing fee);
- ⊙ Data on the relevant qualifications of the applicant's employees; and
- ⊙ Various technical documents according to the type of license requested.

The licensing authorities are generally required to decide whether to issue the license within 60 days of receiving a complete application with all of the supporting documentation, however delays can result in determining what constitutes "all of the supporting documentation." After the decision has been reached, the applicant must be notified immediately.

Thereafter, within three days of the date of submission of the document confirming payment of the duties for the provision of the license (the license fee), the licensing authorities must issue the document confirming the license.

What happens if the service or engineering company doesn't get all the appropriate licenses? It depends on the missing license. For example an administrative liability can be imposed in the form of a penalty in an amount ranging from 30,000 to 2,000,000 Rubles (approximately US\$1,000 to 70,000), as well as confiscation of equipment, for any of the following licensing violations:

- ⊙ engaging in entrepreneurial activities (unlicensed business) without a license;
- ⊙ using subsoil without a permit (license) or in violation of the terms of the permit (license);
- ⊙ violating the restrictive rules (or standards) or terms of a license for any activities in the internal seas, territorial waters, on the oceanic continental shelf and/or within the economic zone of Russia, including any violation of the rules for the safe exploration or development of mineral resources and drilling; and
- ⊙ violating the safety requirements / continued page 12

ALGERIA

New Hydrocarbons Law. With the introduction on July 19 of Algeria's new Hydrocarbons Law No. 04-05, foreign investment in nearly all segments of the oil and gas industry, from upstream to distribution, has been liberalized. In particular the new Hydrocarbons Law allows foreign investors to participate in almost all industry segments without partnering up with Sonatrach or another state-owned entity, as was the case previously. Other features of the new law include simplifying and conforming tender rules and clarifying the fiscal regime.

EGYPT AND LEBANON

MoU on Oil and Gas Exploration. The Egyptian and Lebanese Oil and Energy Ministers (respectively) recently signed a broad memorandum of understanding between the two countries covering, among other energy-related matters, joint cooperation in oil and gas exploration. Other matters covered in the MoU include cooperation on electricity and linking Egyptian natural gas supplies into the Lebanese distribution network, thereby bringing Lebanon into the Arab gas grid which currently runs from Egypt to Syria via Jordan.

KAZAKHSTAN

Parliament Moves to Restrict the Sale of Listed Natural Resource Companies. A bill was recently adopted by both houses of the Kazakhstan parliament providing the government with the ability to limit or prevent the transfer of shares of companies holding mineral resources (including oil and gas) in Kazakhstan, or to pre-empt such sales. This bill follows on last year's amendments to the Kazakhstan Underground Resources Law to pre-empt the sale or transfer of the assets themselves. This bill would need to be signed by the President to become law. If adopted, it could complicate the efforts of various foreign bidders to acquire some high-profile oil and gas assets. The *Oil & Gas Quarterly* will continue to follow developments on this issue in the next quarter's edition. / continued page 13

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or the terms of a license for using hazardous industrial objects.

Worse, criminal liability of varying degrees can be imposed on responsible officers, ranging from a penalty in the amount of 300,000 Rubles (approximately US \$10,500) up to imprisonment for 5 years, for engaging in entrepreneurial activities without a special permit (license) (where licensed), or in violation of the licensing requirements and conditions, if the action is found to have caused “significant damage” to human beings, organizations or the State, or, interestingly, if the offender is found to have gained significant profit from it. Not surprisingly, the offender’s Oilfield Activities Licenses can also be suspended, amended or terminated for failure to comply with the license requirements.

Geological information is presumed to be owned by the state. However, if geological information on the deposit was obtained by the licensee and paid for with the licensee’s own funds, it is treated as the property of the licensed use (the licensee).

Administrative liability (including fines) is generally imposed for failing to make timely payments of levies and taxes for subsoil use, failing to provide geological information to the appropriate agencies or failing to meet other reporting requirements.

Geological Information

Under Russian law, geological information is accorded a special status. Article 27 of the Underground Resources Law mandates that information on the geological structure of a subsurface deposit, its reserves, and its development conditions, as well as other characteristics of the deposit included in geological reports and other materi-

als, may only be owned by the state or the licensed user of underground resources, and never by a contractor or service provider.

Geological information is presumed to be owned by the state. However, if geological and other information on the deposit was obtained by the licensee and paid for with the licensee’s own funds, it is treated as the property of the licensed user (the licensee). This information must be reported to the appropriate government agencies, including the federal and territorial geological information funds. Commercial and other use of this information must likewise be coordinated with the appropriate governmental agencies.

Under the Russian Law “On State Secrets”, certain geological information (including seismic data for the oceanic continental shelf) is considered a state secret and is subject to a special confidentiality regime.

Additionally, according to Article 8 of the Russian Law “On Participation in International Informational

Exchanges,” the export of confidential information is allowed only in cases expressly provided for by the Russian government. The most important restriction is that the owner of the confidential information (*e.g.*, the operator) or its users (*e.g.*, the operator’s shareholders) may only have access to the documents containing the confidential geological information within Russia.

Certification

Almost as important as licensing, certification of foreign products and services is also required in Russia.

Certification is regulated by Russian Law No. 184-FZ, dated December 27, 2002, “On Technical Regulations” (the “Technical Law”), and certain other administrative regulations.

Certification includes confirmation of compliance of the products or services in Russia with certain standard requirements. According to the Technical Law these standard requirements are called “technical regulations,” although none have been adopted to date. At

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New Law on Concessions. Russia's new Federal Law No. 115-FZ "On Concession Agreements," adopted on July 21, aims to provide a specific framework for cooperation agreements between the state and private investors and operators to upgrade and operate a variety of transportation infrastructure, including infrastructure relating to the oil and gas industry such as ports, pipelines and related facilities. The new law includes a "model concession agreement" for some forms of concessions, with scope for negotiation of the legal and financial terms. Although concessions are generally to be awarded through open tenders, the new law does provide an exception allowing closed tenders where a concession may involve "state secrets or matters of strategic importance." A copy of an unofficial translation is available upon request from the editor.

Draft Underground Resources Law. Russia's draft Underground Resources Law (see "Russia's Licensing Regime: New and Improved" in the 2nd Quarter 2005 Edition of the Oil & Gas Quarterly) moved a step closer to adoption during the third quarter with consideration by Russia's upper house of parliament, the Federation Council, scheduled to conclude with comments provided to the Committees on Natural Resources and Subsoil by the Federation Council and the Russian "subjects" or provincial administrations.

present, the GOSTs (State Standards) are applied.

There are two types of GOSTs: i) "old" GOST - standards which were adopted during the Soviet period but still applicable; and ii) GOST R - Russian standards which were adopted since that period and are generally stricter than GOST.

Under the Technical Law, confirmation that the goods comply with GOSTs (in general) may be either mandatory or optional. Mandatory certification takes two forms: adoption of a declaration of compliance or mandatory certification.

The form of certification generally depends on the type of equipment certified based on two categories:

- ⊙ The list of products subject to mandatory certification under Resolution No. 64 of the Russian State Committee on Standardization, Metrology and Certification, dated July 30, 2002 (**Category 1**); and
- ⊙ The list of products where compliance may be confirmed by a declaration of compliance under Resolution No. 64 of the Russian State Committee on Standardization, Metrology and Certification, dated July 30, 2002 (**Category 2**).

Certification of Oilfield Services

In 2004, oilfield services were excluded from the list of goods and services subject to mandatory certification (Russian Government Resolution No. 72, dated February 10, 2004). At present, therefore, it is not necessary to confirm the compliance of oilfield services to any GOST. However, for competitive reasons it is advisable to undergo the procedure of **optional** certification. Optional certification is at the initiative of the applicant, pursuant to an agreement between the applicant and the appropriate certification authority. Optional certification can confirm compliance with national standards (for instance GOSTs), internal standards of the sponsors, optional certification systems and even with the terms and conditions of certain agreements.

Certification of Equipment

Most of the equipment used in oilfield services is subject to mandatory certification. Section 36 entitled "Petrochemical Machinery" of Category 1 contains a list of equipment subject to mandatory certification. For instance, Section 36 includes:

- ⊙ Complete drilling units for operational and deep exploration drilling (GOST 1629389); */ continued page 14*

Oilfield Services in Russia

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- ⊙ Drilling rotors for the workover of oil and gas wells (GOST 4938-78);
- ⊙ Drill bits and diamond heads and heads equipped with superhard composite materials (GOST 26474-85);
- ⊙ Electric downhole motors (GOST 15880-83);
- ⊙ Lifting units for workovers (GOST 28113-89); and
- ⊙ Oilfield wellhead and production equipment (GOST R 51365-99).

Under Resolution No. 11 of the Russian State Committee on Standardization, Metrology and Certification, dated March 17, 1998, a compliance certificate under the GOST R system for oilfield equipment subject to mandatory certification is a prerequisite to use or distribute that equipment. As a general rule, equipment manufactured in Russia must be certified by the manufacturer. Hence, if a company acquires or leases equipment made in Russia for oilfield services, the equipment is deemed to be already certified. If a company imports the equipment it must process the certification of the imported equipment itself. Some exclusions may be applicable to equipment imported under certain customs regimes.

Certification Procedure

The certification procedure is regulated by Regulations No. 11 of the State Committee on Standardization, Metrology and Certification, dated March 17, 1998.

Certification requires the following steps:

- ⊙ submission of the application for certification;
- ⊙ consideration and adoption of a decision on the application by the certifying authority;
- ⊙ verifications (document analysis, testing, production tests, etc.)
- ⊙ analysis of the results of the verification, followed by a decision on issuance (or denial) of a compliance certificate;
- ⊙ issuance of the certificate; and
- ⊙ inspection and oversight of the certified equipment in accordance with the certification schedule.

Any domestic or foreign company, or even an individual entrepreneur, can apply for certification. The certification authority is required to consider the applications and notify the applicant of its decision on the applica-

tion not later than 15 days from the date when the application was received. If the result of the examination is positive, the certification authority must issue a compliance certificate to the applicant.

Environmental, Health and Safety Issues

Environmental impact must be assessed prior to commencing any project for the use of natural resources in Russia; this is generally the operator's responsibility. Operational licenses and permits usually authorize the discharge of pollutants into the air, water and soil under a "pay-to-pollute" regime. If discharge exceeds permissible levels, the company is subject to fines calculated as a multiple of the original "fee" set for the discharge of pollutants.

Russian environmental legislation consists of numerous federal and regional regulations which often contradict one another and cannot be consistently interpreted. As a result, full environmental compliance may not always be possible. There is nothing like the US rules of CERCLA or Superfund in Russia, and environmental penalties are often nominal. Even so, it is a good idea to check for any existing court cases or documents concerning administrative proceedings for a given site or project, and contractors should pay special attention to the use of any hazardous substances (*e.g.*, asbestos).

Conclusion

Oilfield services can be inherently dangerous and potentially polluting, and so are naturally highly regulated in most jurisdictions, but Russia's overlapping administrative system presents special challenges. As with any business in Russia, patience and thoroughness are key to accessing this growing market. ⊙

Calendar of Events

- October 4 – 6:** **Kazakhstan International Oil and Gas Exhibition**, Almaty, Kazakhstan
- October 6:** *Almaty Partner Ken Mack* will give a presentation on “Legal Aspects of Oil and Gas Transactions in Kazakhstan.”
- October 11 – 13:** **Oil and Gas Transportation in the CIS and Caspian Region**, London, United Kingdom
London Partner Nabil Khodadad will give a presentation on “Financing Cross-Border Pipelines in the Caspian Region.”
- October 25 – 26:** **Russian Oilfield Services – Trends, Opportunities, Prospects**, World Trade Center, Moscow, Russia
- October 26:** *Moscow Partner Shane DeBeer* will participate in a panel discussion of legal issues involved in “Operations Support of Service Companies and Suppliers of Equipment in Russia.”
- November 3 – 4:** **Emerging Europe Energy Summit**, Vienna, Austria
London Partner Nabil Khodadad will give a presentation on “Project Financing of Cross-Border Pipelines.”
- November 9 – 10:** **The Russian and CIS Oil and Gas Investment Forum**, London, United Kingdom
London Partner Laura Brank will speak on “Legal Aspects of Financing Oil and Gas Deals in the CIS.”
- December 5 – 6:** **Upstream Investment and Oilfield Services in Russia and Kazakhstan**
Office of Chadbourne & Parke, Houston, Texas, USA
Moscow Partner Shane DeBeer and Almaty Partner Ken Mack will present seminars on upstream investment and oilfield services in Russia and Kazakhstan.
- For more information on any of the above, please contact Shane DeBeer by e-mail at sdebeer@chadbourne.com.*

What’s New At Chadbourne

Chadbourne Represents EBRD in US\$180 Million Financing for Shah Deniz Gas-Condensate Field and South Caucasus Pipeline

Chadbourne recently represented the European Bank for Reconstruction and Development in a US\$180 million loan to two subsidiaries of Lukoil Overseas for Caspian gas projects that will generate revenues for the region and help establish Azerbaijan as a significant natural gas supplier.

EBRD is lending US\$110 million to Lukoil Overseas Shah Seniz Ltd. Towards the development of the Shah Deniz gas-condensate field located in the Azeri sector of the Caspian Sea. An additional US\$70 million will go to Lukoil Overseas Shah Deniz Midstream Ltd. For the construction of the 690 Km-long South Caucasus gas pipeline. The pipeline will originate at the Sangachal terminal near Baku, cross Azerbaijan and Georgia, before discharging into Turkey’s gas distribution system. The loans will assist Lukoil Overseas in funding its 10% interest in both projects. Other investors in the consortium developing the Shah Deniz

gas-condensate field and pipeline include BP, Statoil, Total, TPAO, NICO and the State Oil Company of Azerbaijan (SOCAR).

The deal marks the second time Chadbourne has represented EBRD on the financing of a consortium member’s interest in the project. Last year, Chadbourne represented the EBRD on a US\$170 million loan facility extended to affiliates of SOCAR to assist in the financing of their interests in the same gas-condensate field and pipeline.

Chadbourne lawyers working on the deal include London office partner Nabil Khodadad and associates Robin Weston, Sasha Ferrigan and Zaur Baghirov.

“Having represented EBRD on this financing, as well as the financing recently extended to SOCAR, Chadbourne has the distinction of having acted on two out of the three limited recourse pipeline financings concluded to date in Eastern Europe and the CIS,” said Khodadad. ☺

What's New At Chadbourne

Chadbourne Establishes a Kazakhstan Office Expanding CIS and Energy Practices

Welcomes Managing Partner and Five Associates

Chadbourne & Parke LLP has opened an office in Almaty, Kazakhstan. The office, at 90 Schevchenko Street is being staffed by six attorneys all of whom were associated with Coudert Brothers in Kazakhstan.

The Almaty team, led by Kenneth E. Mack, the managing partner of the office, includes associates Victor Mokrousov, Tatiana P. Muratova, Yerzhan Kumarov, Elshat Seksembayeva, and Sergei Vataev. The establishment of the Almaty office extends Chadbourne's significant presence in the CIS where it currently has offices in Moscow, Kyiv and Tashkent, and expands its capabilities in oil and gas and infrastructure projects.

Kazakhstan is the second largest energy market in the CIS, and has grown 9% per year for the past three years. It is a major oil-exporting country, with growing reserves and production. As a result, Kazakhstan is a vital region for many major pipeline and other infrastructure projects in the CIS, as well as for the development of other industry sectors.

"With the Kazakhstan energy sector attracting many foreign companies and with its growing economy, the opening of this new office is part of our strategic plan to better satisfy the needs of our clients in the CIS," said Charles K. O'Neill, Chadbourne's managing partner. "In addition, by bringing on board Ken and his team who have extensive experience handling matters in the region, we have expanded our network in the CIS and can offer our clients increased capabilities."

Mr. Mack, 43, is a partner in Chadbourne & Parke, the affiliated

multinational partnership of Chadbourne & Parke LLP. He has spent eight years of his career in Kazakhstan and has extensive experience in the oil and gas, minerals, electric energy and telecommunications sectors. His work has included negotiating and drafting production sharing agreements, oilfield asset purchase contracts, joint venture agreements, and other contracts. Mr. Mack has been counsel to multinational companies in a variety of investment disputes with private entities in Russia and Kazakhstan. He also works on domestic and international corporate matters. Prior to his work at Coudert Brothers, Mr. Mack served as the managing attorney of Steptoe & Johnson's Almaty office. Mr. Mack received his B.A. from Hampshire College, an M.A. from Columbia University, and a J.D. from Northeastern University.

"I am excited and pleased to be joining such a preeminent law firm representing the energy and project finance areas," said Mr. Mack. "I'm looking forward to overseeing the Kazakhstan team and working with the Firm's international network of attorneys to provide the highest level of service to our clients."

"Chadbourne has handled significant transactions in Kazakhstan, especially in the oil and gas sector since we entered the CIS market in 1990," noted Laura Brank, managing partner of the Moscow office. "The opening of the Almaty office will further increase our capabilities to service our clients in the CIS, as well as globally on M&A, project finance, and other transactional matters." ☉

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