

# The International Comparative Legal Guide to: Gas Regulation 2009

A practical insight to cross-border Gas Regulation work



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# Russia

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### 1 Overview of Natural Gas Sector

1.1 A brief outline of Russia natural gas sector, including a general description of: natural gas reserves; natural gas production including the extent to which production is associated or non-associated natural gas; importation and exportation of natural gas, including liquefied natural gas (LNG) liquefaction and export facilities, and/or receiving and re-gasification facilities ("LNG facilities"); natural gas pipeline transportation and distribution/transmission network; natural gas storage; and commodity sales and trading.

**Reserves.** Natural gas is a type of strategic raw material. According to the Russian legislation, the accurate data on strategic raw material reserves is a state secret. However, the explored natural gas reserves of Russia, which are the biggest in the world, are evaluated by different experts approximately at 46-48 tcm or 25% of the world's natural gas reserves. The main natural gas reserves are located in West Siberian, Volga-Ural and Timan-Pechora oil and gas provinces and in Far East region.

**Production.** Russia produces more than 600 bcm of natural gas *per annum* or 20% of the total annual natural gas production in the world. Gazprom OJSC ("Gazprom"), the world's biggest natural gas producer and a Russian monopolist, accounts approximately for 85% of Russia's total gas production and more than 17% of the worldwide natural gas output. Pursuant to the tentative data, Gazprom's gas production accounted for 548.6 bcm in 2007 (excluding production by associated companies). The abnormally warm winter of 2006-2007 resulted in recession in demand and extraction decrease. In 2007 Russia produced about 12 million tonnes of gas condensate and 7 bcm of associated gas, only half of which was utilised.

**Importation and exportation.** Russia is the foremost natural gas supplier in the world. In 2007 Russia exported more than 250 bcm of natural gas (25% of world export). Ukraine, Germany, Turkey, Belarus, Italy, the UK and France are the main consumers of natural gas. Russia actually does not import natural gas from other countries for its domestic needs (for more accurate data please refer to Question 1.3). However, in 2007 about 60 bcm of natural gas from Central Asian countries were delivered to other countries, mainly European, through the Russian pipeline. Imports and exports of LNG are not developed in Russia. For more information please refer to Section 7.

**Current export facilities.** Yamal-Europe. The Yamal-Europe natural gas pipeline connects natural gas fields on the Yamal peninsula with Germany via Poland and Belarus. Its discharge capacity is more than 30 bcm *per annum*.

Blue Stream. This project allows supplying natural gas from Russia directly to Turkey across the Black Sea. In 2007, 9.5 bcm of natural gas was supplied to Turkey. The discharge capacity of the Blue Stream is 16 bcm *per annum*.

More than 80% of the total natural gas export supplied to foreign markets passes through the territory of Ukraine.

**Export facilities to be constructed.** Nord Stream. The Nord Stream gas pipeline is basically the new route for natural gas export from Russia to Europe. Its target markets are Germany, the UK, the Netherlands, France, Denmark, *etc.* The gas pipeline is to be run from the Portovaya Bay through the Bay of Finland and the Baltic Sea to the coast of Germany, where it will be connected to the existing gas transportation system. The large-scale environmental studies on the entire pipeline route are being finalised nowadays.

South Stream. This project is aimed to strengthen energy security in Europe. The South Stream, which is to be run under the Black Sea, will connect Russia with Europe. The total length of the undersea section is approximately 900 km, its maximum depth will exceed 2 km, and its discharge capacity will reach approximately 30 bcm *per annum*.

Pre-Caspian Gas Pipeline. The discharge capacity of this project will reach 20 bcm of natural gas *per annum*, which will provide the transportation of 10 bcm of Turkmenistan natural gas and 10 bcm of Kazakhstan natural gas through the Russian territory.

**Transportation and distribution/transmission network.** According to Article 5 of the Federal Law "On Gas Supply in the Russian Federation" ("Gas Supply Law"), dated 31 March 1999, the Russian federal gas supply system is the complex of the following systems: United Gas Supply System ("UGSS"); regional gas transportation systems; gas distribution systems; and independent companies (*i.e.* not Gazprom's affiliates). For more information please refer to Question 4.1.

The gas transportation system includes a vast network of trunk pipelines, compressor stations, and underground gas storage facilities ("UGSF"). Centralised management, extensive branching, and parallel transportation routes result in considerable reliability of Gazprom's gas transportation system and its ability to provide smooth gas supply even in the case of seasonal peak loads. Gazprom is the leader in gas distribution sector. For more information please refer to Question 5.1.

**Storage.** 25 UGSF are built in Russia, 8 of which were built in water-bearing formations and the remaining 17 are situated in the depleted gas fields. Expansion of underground gas storage capacities is Gazprom's strategic objective. 3 new UGSF are currently under construction in Russia: the first one is in the water-bearing formation of the Udmurt Reserve Compound, the second and the third ones are Kaliningradskoye and Volgogradskoye

UGSFs. The latter is the largest in Europe and Russia's first rock-salt underground gas storage with 800 mcm of working gas volume and 70 mcm of daily output. There are Gazprom's storages abroad (in the Ukraine, Latvia, Germany and Austria). Since 2005 Gazprom has been provided with a 5-year access to 50% of the Humbly Grove GS facility in the southern Great Britain. Approximately 62-65 bcm of natural gas are located in the Russian UGSF.

**Commodity sales and trading.** In 2007 more than 350 bcm of natural gas, including gas from Central Asia (100 mcm), were delivered to consumers in Russia.

**Biggest current projects. Sakhalin-1.** This oil and gas development project is situated on the northeast shelf of Sakhalin Island. The area of this project is comprised of the Chayvo, Odoptu and Arkutun-Dagi fields. The total recoverable reserves are 485 bcm. Exxon Neftegas Limited, an affiliate of Exxon Mobil Corporation, is the operator of the Sakhalin-1 Project. Other participants in the Sakhalin-1 consortium are: two Russian companies, Sakhalinmorneftegas-Shelf and RN-Astra; the Japanese company Sakhalin Oil and Gas Development Co., Ltd.; and India's ONGC Videsh Ltd. Deliveries of crude oil to international markets and natural gas to the Russian Far East were started in 2005.

**Zapolyarnoye oil and gas condensate field.** Natural gas reserves of the Zapolyarnoye field account for more than 3.3 tcm. Reserves of this field are considered as the fifth largest in the world. First gas came from the field in 2001. The first gas complex with capacity of 35 bcm of gas *per annum* was put in operation in October 2001. It is planned that about 3 million tonnes of gas condensate will be produced annually at Zapolyarnoye.

**Biggest projects under construction. Sakhalin II.** The area of the Sakhalin II project is comprised of the Piltun-Astokhskiye and Lunskoye fields located 13-16 km offshore the north-eastern coast of Sakhalin Island in the Sea of Okhotsk. The two fields contain more than 1 billion barrels (150 million tonnes) of crude oil and more than 500 bcm of natural gas in place. It is the first project performed in Russia which is based on the production sharing agreement ("PSA"). Gazprom (50% plus one share), Shell Sakhalin Holdings B.V. (27.5% minus one share), Mitsui Sakhalin Holdings B.V. (12.5%) and Diamond Gas Sakhalin B.V. (10%) are the shareholders of this project.

The first LNG plant in Russia near Korsakov town in the south of Sakhalin Island is under construction now. It is planned to produce about 10 million tonnes of liquefied natural gas *per annum*. First deliveries of LNG should take place in 2009.

**Shtokman project.** Shtokman field is located in the central part of the Russian sector of the Barents Sea shelf, about 600 km northeast to the city of Murmansk at local sea depths varying from 320 to 340 m. The field reserves account for 3.8 tcm of gas and approximately 37 million tonnes of gas condensate. Sevmorneftegaz (100% subsidiary of Gazprom) holds the license to explore, prospect and produce gas and gas condensate from the Shtokman field. Gazprom chose Total and StatoilHydro as partners to execute the Shtokman project. Gazflot (100% subsidiary of Gazprom) and the Vyborg Shipbuilding Plant signed a contract for the construction of two drilling rigs to drill production wells on the Shtokman field. The construction of the first drilling rig is due in the fourth quarter of 2010 and the second is due in the first quarter of 2011.

There are other major projects, such as Bovanenkovo Field and Yuzhno-Russkoye field.

### 1.2 To what extent are Russia's energy requirements met using natural gas (including LNG)?

According to various expert appraisements, the share of natural gas

in fuel balance of Russia is more than 55%, oil — less than 20%, coal — approximately 15%, hydropower — approximately 6%, and atomic power — approximately 4%. Such a big share of natural gas in the fuel balance is largely due to low prices on natural gas within the country. Russia does not use LNG for its domestic needs. For more information concerning LNG please refer to Section 7.

### 1.3 To what extent are Russia's natural gas requirements met through domestic natural gas production?

Taking into consideration that Russia is the world's leading natural gas producer, almost all domestic requirements are satisfied by Russian gas (more than 350 bcm in 2007) and, in incomparably lesser extent, by gas produced in Central Asia (100 mcm in 2007).

### 1.4 To what extent is Russia's natural gas production exported (pipeline or LNG)?

According to 2007 year base, the following countries are the major customers of Russian natural gas:

1. far abroad countries: Germany (34.5 bcm), Turkey (23.4 bcm), Italy (22.0 bcm), the United Kingdom (15.2 bcm), France (10.1 bcm), Hungary (7.5 bcm), Czech Republic (7.2 bcm), Poland (7.0 bcm), Slovakia (6.2 bcm), the Netherlands (5.5 bcm), *etc.*;
2. CIS and Baltic countries: Ukraine (59.2 bcm), Belarus (20.6 bcm), Kazakhstan (10.0 bcm) and Lithuania (3.4 bcm).

Russia exports more than 40% of all produced natural gas. As for LNG, please refer to Section 7.

## 2 Development of Natural Gas

**2.1 Outline broadly the legal/statutory and organisational framework for the exploration and production ("development") of natural gas reserves including: principal legislation; in whom the State's mineral rights to natural gas are vested; Government authority or authorities responsible for the regulation of natural gas development; and current major initiatives or policies of the Government (if any) in relation to natural gas development.**

#### *i. Organisational framework*

Following the Decree of the President "The Issues of the System and Structure of the Federal Executive Bodies", dated 12 May 2008, the main executive bodies responsible for elaboration and performance of the acts in the gas sector are as set forth below.

- Ministry of Natural Resources and Environment of the Russian Federation ("MPR"), with services listed below subordinated to it;
  - Federal Service for the Supervision of the Use of Natural Resources ("Rosprirodnadzor");
  - Federal Agency for the Subsoil Use ("Rosnedra"); and
  - Federal Service for the Ecological, Technological and Atomic Supervision ("Rostekhnadzor").

The following bodies may also be relevant in gas industry:

- Ministry of Economic Development of the Russian Federation;
- Federal Antimonopoly Service ("FAS");
- Federal Tariff Service ("FTS");
- Federal Customs Service;
- Ministry of Finance of the Russian Federation and Federal

Tax Service subordinated to it; and

- Ministry of Industry and Trade of the Russian Federation.

Basically, the Government of the Russian Federation (“**Government**”), MPR and Rosnedra are the federal executive bodies, which are vested with the State’s mineral rights to natural gas.

ii. *Legal/statutory framework*

Generally, the hierarchy of principal legislation in the sphere of the exploration and production of natural gas reserves is set forth as follows:

- Constitution of the Russian Federation;
- Federal Laws;
- Decrees of the President of the Russian Federation;
- Regulations of the Government of the Russian Federation; and
- Orders and Instructions of Ministries and Federal Services.

The Constitution of the Russian Federation (“**Constitution**”). The Constitution, as a top-ranked act in the abovementioned legislation hierarchy, states in Article 9 that land and other natural resources are utilised and preserved being a base for people’s existence and activity. They may be possessed in private, state, municipal and other forms of ownership. The issues concerning possession, use and disposal of the land, subsoil resources, and other natural resources are in joint competence of the Russian Federation (“**RF**”) and its constituent entities.

Federal Laws. There are a number of federal laws regulating issues of exploration, mining activity, production, transfer, and delivery of natural resources, including gas. In addition to the Gas Supply Law, there are Federal Law “On Subsoil Resources” (“**Subsoil Resources Law**”), dated 21 February 1992; Federal Law “On Production Sharing Agreements” (“**PSA Law**”), dated 30 December 1995; Federal Law “On Gas Export”, dated 18 July 2006; Federal Law “On the Continental Shelf of the RF”, dated 30 November 1995; and Federal Law “On Natural Monopolies” (“**Natural Monopolies Law**”), dated 17 August 1995. Of utmost importance in this sphere are Federal Law “On Environmental Protection”, dated 10 January 2002; Federal Law “On Competition Protection” (“**Competition Protection Law**”), dated 26 July 2006; and Federal Law “On the Procedure for Making Foreign Investments in Business Entities of Strategic Importance for the National Defence and Security of the State”, dated 29 April 2008. Certain provisions with respect to subsoil resources are enshrined in the following acts: Forestry Code of the RF, dated 4 December 2006; Land Code of the RF, dated 25 October 2001; Water Code of the RF, dated 3 June 2006; Civil Code of the RF, Criminal Code of the RF, dated 13 June 1996; and Code on Administrative Offences of the RF, dated 30 December 2001.

Decrees of the President of the RF. Of relevant importance, being the basis for existing federal executive authorities, there may be regarded the Decree of the President of the RF (“**President**”) “The Issues of the System and Structure of the Federal Executive Bodies”, dated 12 May 2008. There are certain decrees issued by the President from 1992-1998, which are not yet abolished at the moment, for instance, “On Improving Reliability of Gas Supply to the Consumers of the Russian Federation”, dated 28 December 1996, or “On Reducing Gas Prices for the Consumers in the Russian Federation”, dated 11 June 1998.

Regulations of the Government. Regulations of the Government are intended to elaborate the most important issues of the gas industry, like principles of price fixation over gas and its transfer through the territory of the RF, requirements as to the effective use of gas and rendering of gas supply services, or rules relating to the protection of gas-distributing networks.

As to the certain regulations of the Government, it would be

reasonable to mention, inter alia, “On Gas Supply Procedure to Meet the Public Utility Needs of the Citizens”, dated 21 July 2008; “On Supply of the Liquefied Natural Gas to the Internal Market in 2008”, dated 20 December 2007; “On Improvement of the State Regulation of the Gas Price”, dated 28 May 2007; or “On the State Regulation of Gas Prices and Tariffs on Gas Transportation in the Territory of the Russian Federation”, dated 29 December 2000.

Orders and Instructions of Ministries and Federal Services. These type of acts provide for detailed elaboration of the issues covered by the regulations of the Government. Mostly, the acts of the MPR concern the issues of licensing and reissuance of already obtained licenses. In respect of licenses for the use of the subsoil plots, the MPR approved the “Temporary Guidelines for Issuance of the Licenses for the Use of the Subsoil Plots for Exploration, Prospecting and Mining Operations”, dated 15 November 2002. As to the Ministry of Economic Development of the RF, it issues a number of acts on licensing of foreign economic activity, export and import of certain goods and services; for example, the order of the Ministry of Economic Development “On Approval of the Practical Guidelines on Issuance of the Export and Import Licenses”, dated 22 January 2007, which is applicable in relation to gas import and export licensing. Rosnedra, for instance, adopted an order “On Approval of the Temporary Recommendations on Determination of the License Fee for the Use of the Subsoil Resources”, dated 28 June 2005. Rospirodnadzor, being responsible for the state environmental expertise, issued an order “On Arrangement and Carrying Out the State Environmental Expertise by the Territorial Bodies of the Rospirodnadzor”, dated 22 June 2007.

iii. *Current major initiatives and policies of the Government of the RF*

The Government of the RF is planning to launch its initiatives in the sphere of gas market deregulation. The main evidence thereof is the following.

On 7 June 2008 the CEO of Gazprom, Alexey Miller, declared at the St. Petersburg International Economic Forum that Gazprom is going to start out a new stock exchange for international trading in natural gas futures. The St. Petersburg International Commodity exchange is expected to open in 2009 and is intended to work in parallel with Russia’s electronic gas forum for the domestic market.

As to the market prices, certain changes are also observed. In order to protect domestic industry and consumers, gas tariffs were fixed at levels which prevented Gazprom from making profits on domestic sales. This is to be changed. The Russian Government intends to set domestic tariffs by 2011 at the level where Gazprom may benefit equally to that of its foreign exports.

## 2.2 How are the State’s mineral rights to develop natural gas reserves transferred to investors or companies (“participants”) (e.g. licence, concession, service contract, contractual rights under Production Sharing Agreement?) and what is the legal status of those rights or interests under domestic law?

In accordance with the Subsoil Resources Law, the rights to develop natural gas reserves can be transferred to participants by license. Licenses can be awarded through auctions, tenders or, exceptionally, by the decision of the Government without an auction or a tender. The procedure of obtaining a license is subject to the Subsoil Resources Law and the Regulation on the Order of Licensing of the Subsoil Use, approved by the Supreme Council of the RF (the former name of the Russian Parliament) on 15 July 1992. The license certifies the right of its owner to use the subsoil plot pursuant to the specified object and within the indicated term. Besides, the license can be granted under the PSA if a subsoil

resources license auction, held according to the Subsoil Resources Law, has failed due to the lack of the bidders.

Further, another auction should be held in order to determine the investor who will be a party to the PSA. The major criteria for the determination of the winner in the auction is the amount of the lump sum payment for the right to use the subsoil plot.

The PSA can be concluded with regard to subsoil plots expressly provided in the federal law. Under the PSA the RF grants to the investor for a certain term exclusive rights to search, explore, and produce the subsoil resources. The agreement specifies conditions as to the use of the subsoil resources and determines the share of each party in the output. The share transferred to the investor as a makeup production amounts up to 75% or 90% of the whole value, — if mining operations are performed on the continental shelf. The PSA normally provides for specific obligations of the investor, like granting a pre-emptive right to the Russian entities to work as suppliers, contractors, shippers *etc.*, or acquisition of the majority (70%) of equipment and facilities of Russian origin.

**2.3 If different authorisations are issued in respect of different stages of development (e.g., exploration or production arrangements), please specify those authorisations and briefly summarise the most important (standard) terms (such as term/duration, scope of rights, expenditure obligations).**

Rosnedra is empowered to issue licenses to use the subsoil plots, including the continental shelf reserves in respect of different stages of gas development. There are the following types of licenses: exploration license, production license, license on construction and exploitation of the UGSF, and combined license. The issued license, its term, scope of endowed rights and expenditure amounts depend on the type of the license.

**Exploration license.** The licensee has the right to explore and assess gas deposits. This type of license does not grant a right for mineral prospecting, which is afforded under the production license. The licensee may explore solely the subsoil resource specified in the license and is not entitled to the pre-emptive right to obtain a production license with respect to this resource. The term of the license is 5 or 10 years in case of the subsoil plots of internal sea and territorial waters, and the continental shelf of the RF.

**Production license.** Production license grants rights to perform mineral prospecting and mining operations. If the subsoil plot has been already covered by the exploration license, the licensee may obtain a production license after carrying out a state expertise on geological information of the mineral reserves.

Under this type of license a licensee may explore the subsoil resources without an additional license, being obliged to agree the terms and conditions thereof with competent executive authorities. The license is issued for the term until the gas field has been exhausted. Meanwhile, a combined license may be issued, which allows to explore and produce gas for 25 years.

**License on construction and exploitation of the UGSF.** The license on the UGSF construction and exploitation, not related to the gas production, grants a right to employ certain subsoil plots for construction and exploitation of the UGSF. The licensing period is unlimited.

As to the expenditure obligations, the licensee has to pay a license fee, which is determined on the basis of “The Temporary Guidelines for Estimating the License Fee for the Subsoil Use”, dated 28 June 2005, approved by the Rosnedra. The licenses are subject to time limit extension in case exploration and assessment of the subsoil resources or mining operations are to be accomplished, or

abandonment measures are to be performed, provided there have been no violations of the license conditions.

**2.4 To what extent, if any, does the State have an ownership interest, or seek to participate, in the development of natural gas reserves (whether as a matter of law or policy)?**

The RF has an ownership interest in the development of natural gas reserves, possessing 50,002% of shares in Gazprom and approximately 75% of shares in Rosneft OJSC. There are no special federal laws on this issue. These companies were reorganized within the privatisation process held in 1990-s. Gazprom was based on the Ministry of Gas Industry of the USSR, then transformed into the State Gas Group Gazprom. Nowadays, the RF tends to strengthen its influence on the gas industry. Gas export accounts for nearly 20-25% of the Russian tax revenues, while Gazprom provides for approximately 8% of the Russian's gross domestic product.

**2.5 How does the State derive value from natural gas development (e.g. royalty, share of production, taxes)?**

The State derives value from natural gas development by way of imposing taxes and non-tax payments. There are two tax regimes: special, applicable to the investor participating in the PSA, and general, applicable to the other subsoil users.

(i) *General regime: taxes and non-tax payments levied on the subsoil user*

**Extraction tax.** The tax applicable specifically to the gas production is an extraction tax. With respect to natural gas, the tax rate is 147 rubles per 1,000 cm. In case of mining operations in contaminated gas reserves, or production of the associated gas, the tax is levied at zero rate. Gas condensate production is levied at 17.5% rate of the extracted gas condensate value.

**Other types of taxes.** The taxes connected with gas production are the following: income tax, which is equal to 24% of the entities' revenue (as of 1 January 2009 a new rate of 20% is applied); value added tax (18%); uniform social tax (26%); water usage tax; land tax (up to 1.5%); corporate property tax (up to 2.2%); and excise on straight-run gasoline (gasoline cut received as a result of natural gas processing), amounting to 2,657 rubles per tonne.

**Non-tax payments.** Under the Subsoil Resources Law, a subsoil resources user should pay a bonus (one-off payment when an event specified in the license has occurred), rentals (regular payments for the subsoil use), and fee for geological information on the subsoil resources. Also, the tender and the license fees are levied in the amounts determined by the Rosnedra. Besides, the environmental legislation imposes a duty for negative environmental impact, which is specified in the governmental regulations and the orders and instructions of the MPR.

(ii) *PSA regime: taxes and non-tax payments levied on the investor*

The activities under the PSA are subject to a special tax regime.

**Taxes.** Taxes levied on the investor are as follows: value added tax, profit tax, uniform social tax, extraction tax, water usage tax, and land tax.

**Non-tax payments.** Non-tax payments levied on the investor are almost the same as under the general regime: bonuses, rentals, fee for geological information on the subsoil resources, license and tender fees, a duty for negative environmental impact, stamp and customs duties and excise duty. Additionally, the investor is liable to refund state charges on resources exploration, and, in appropriate

cases, to make some other payments such as compensation for damage inflicted to native minorities as a result of mining operations.

## 2.6 Are there any restrictions on the export of production?

The exclusive right for gas transportation is granted to Gazprom and its wholly-owned subsidiaries under the Federal law "On Gas Export", dated 18 July 2006. This law also applies to the natural gas, transferred in liquid and gaseous forms, as was clarified by the federal executive authorities. However, the mentioned requirements do not cover the PSA executed before this law has entered into force.

## 2.7 Are there any currency exchange restrictions, or restrictions on the transfer of funds derived from production out of the jurisdiction?

General requirements as to the transfer of funds abroad are settled in the currency legislation of the RF. Currency operations, except for certain circumstances, should be performed through accounts opened with the authorised banks. Authorised banks are the agents of currency control and, hence, are entitled to transfer data on the discovered infringements committed by residents and non-residents to the Federal Service on Fiscal Control, which is entitled to impose sanctions. Alleged violations of the currency control requirements may be delayed currency payments under the contract terms or payment in violation of the terms.

Residents of the RF may open accounts without any restrictions with the banks situated in foreign states which are the participants of the Organisation for Economic Development and Co-operation or Financial Action Task Force on Money Laundering. Foreign investors may freely transfer their funds, profit or dividends in currency abroad, being entitled to guarantees and remedies provided by law.

Recently under the provision of currency legislation, now having been repealed, residents of the RF should have performed mandatory purchase of foreign exchange proceeds in the amount of 30% of the whole revenue.

The PSA Law obliges the investor to perform banking operations through special bank accounts, opened solely for the purpose of the PSA. This provision is intended to ensure state control over flow of funds. However, this specific requirement does not fully correspond to the currency legislation due to lack of detailed regulation of the investor's status in respect of currency control. The investor may be either resident or non-resident, which implies certain differences in respect of their currency status.

## 2.8 What restrictions (if any) apply to the transfer or disposal of natural gas development rights or interests?

The general rule set forth in the Russian legislation is that the license to use the subsoil plots may not be transferred to third parties. Natural gas development rights or interests may be transferred in the following cases: reorganisation or liquidation of the legal entity, possessing not less than 50% of the shares in subsidiary, continuing to perform mining operations on the subsoil plot, or acquisition of the bankrupt enterprise assets by the legal entity.

There are prohibitions on transfer of the right to use the subsoil plots of federal significance to the legal entity, if the foreign investor may dispose of not less than 10% of the shares of such entity, appoint a general director or more than 10% of the board or collegial executive body, or determine decisions taken by such

entity.

Under the PSA an investor may assign its rights and obligations to any entity or individual with state's consent, provided they possess sufficient financial and technical resources and management experience. Such assignment should be performed in written form, being a special schedule to the agreement, which is followed by re-issuance of a license.

## 2.9 Are participants obliged to provide any security or guarantees in relation to natural gas development?

There are no specific requirements in this respect. However, the PSA Law and the Regulation of the Government "On Formation and Use of the Abandonment Funds within Performance of the Production Sharing Agreement", dated 8 July 1999, stipulate that an abandonment fund is reserved with the federal executive body, which exercises rights and obligations under the PSA.

## 2.10 Can rights to develop natural gas reserves granted to a participant be pledged for security, or booked for accounting purposes under domestic law?

The Subsoil Resources Law contains general prohibition on the transfer of the subsoil license to any third parties. This implies impossibility to pledge for security or book for accounting purposes rights to develop natural gas reserves granted to a participant. Under the PSA, the investor may pledge with the state's consent its property and property rights in order to secure obligations under the contracts in connection with the PSA.

## 2.11 In addition to those rights/authorisations required to explore for and produce natural gas, what other principal Government authorisations are required to develop natural gas reserves (e.g. environmental, occupational health and safety) and from whom are these authorisations to be obtained?

In order to develop natural gas reserves it is also necessary to obtain rights to use the appropriate land plot, to perform mining allotment procedures, and to comply with the environmental, industrial safety and labourers' protection rules.

**Land rights.** Obtaining a subsoil use license is subject to prior provisional consent of the owner of the relevant land plot or the land resources management authority. As a rule, natural gas may only be extracted from the so-called "industrial land", *i.e.* land allocated for industrial use under the Land Code of the RF, dated 25 October 2001. The rights for mining operations are granted to the legal entities after accomplishing the mining allotment procedures (endowment the license holder with the geometrised subsoil plot), approval of project for land restoration and restoration of already exhausted blocks. Besides, mining activities on the subsoil plot may be commenced only after elaboration of the technical project of the subsoil plot, approval of and negotiation with the appropriate authorities and mining operations control.

**Environmental authorisations.** Under the Federal Law "On Environmental Protection", dated 10 January 2002, construction and operation of the gas production, distribution, storage and refinery infrastructure are allowed provided there are projects for land restoration and an approval of the state environmental expertise in respect of project documentation.

Environmental legislation obliges entities performing business activity to pay duties for negative environmental impact. Negative environmental impact is diverse, including air pollution, emissions

to water and soil, subsoil contamination, waste disposal, microwave, heat and other types of pollution. The procedure for calculation of the duties amount is established in the Regulation of the Government “On the Procedure for Calculation of the Duty and Its Limits for Environmental Pollution, Waste Disposal and Other Types of Negative Impact”, dated 28 August 1992.

Air pollution is allowed due to the special license, which fixes maximum admissible discharge. If an entity lacks this license or exceeds prescribed limits, then it would be subject to the fivefold rising index. As to the emissions to the water, the issued license should be scheduled with information on pollution limits for each water and drainage effluents. Regarding waste disposal, limits are determined by the competent federal executive or executive bodies of the constituent entity of the RF. In case the organisation violates ratios fixed in the license, its activity may be suspended as well as use of the subsoil plot for reasons of national security and environmental protection.

As mentioned in Question 4.2, the industrial safety requirements, including basic requirements to gas equipment exploitation, are established in the Federal Law “On Industrial Safety of the Dangerous Production Facilities”, dated 21 July 1997.

The labourers’ protection rules are specified in the Labour Code of the RF, dated 30 December 2001, and other laws and regulations adopted in accordance with it.

#### 2.12 Is there any legislation or framework relating to the abandonment or decommissioning of physical structures used in natural gas development? If so, what are the principal features/requirements of the legislation?

Abandonment and decommissioning of physical structures used in the natural gas development are generally mentioned in the Subsoil Resources Law. Facilities for mining operations and underground constructions, not connected with exploration activities, are subject to liquidation or conservation when the term of the license expired or early termination of the subsoil use occurred. The decision, to be accorded with Rostekhnadzor, on abandonment or conservation should follow the analysis of whether the subsoil resources are completely worked out or they are subject to re-exploration. The project for the abandonment or decommissioning procedures must also undergo ecological and industrial expertise and Rostekhnadzor’s approvals. All costs and expenses related to that process are borne by the license owner.

### 3 Importation / Exportation

#### 3.1 Outline any regulatory requirements, or specific terms, limitations or rules applying in respect of cross-border sales or deliveries of natural gas (including LNG).

The sole export channel mainly operates in Russia. In accordance with the Federal law “On Gas Export”, dated 18 July 2006, the sole right on natural gas export, extracted from all kinds of hydrocarbon material deposits, produced no earlier than 31 July 2006 (when the law has entered into force) and transported in gaseous or liquefied state, is granted to the organisation owning the UGSS or its 100% subsidiary. The owner of the UGSS in Russia is Gazprom (please refer to Question 4.1).

The Ministry of Industry and Trade of the RF, established in 2008, is entitled to issue licenses on exercising sole rights on gas export to the abovementioned companies. The licenses are given in the order established by the legislation of the RF on foreign-trade activity, in particular, the Provisions on Licensing in the Field of

Foreign Trade in Goods, approved by the Government on 9 June 2005. The license is not subject to transfer to other persons by the licensee. While concluding the contracts, the abovementioned companies must adhere to the non-discrimination principle and be guided by business considerations only.

At present, the licenses are issued to Gazprom and Gazprom Export LLC. Gazprom Export LLC is the largest exporter of natural gas in the world.

In respect of liquefied natural gas export, please refer to Question 7.1.

### 4 Transportation

#### 4.1 Outline broadly the ownership, organisational and regulatory framework in relation to transportation pipelines and associated infrastructure (such as natural gas processing and storage facilities).

Pursuant to the Gas Supply Law, the organisational structure of the gas transportation systems in Russia is as follows:

- 1) UGSS covering the whole territory of Russia;
- 2) regional gas supply systems; and
- 3) local gas distribution systems.

The UGSS is comprised of different production, processing, storage and transportation facilities servicing the gas transportation industry in full.

The UGSS, according to the mentioned law, shall be completely owned by a company in which the RF holds at least 50% +1 share. This company is Gazprom.

Nowadays, Gazprom virtually controls the gas transportation system in the country, with the UGSS being the largest in the world (156,900 km). The UGSS includes 155,000 km of main and branch pipelines, 268 compressor stations, six complexes of gas and gas condensate processing, and 25 underground gas storage facilities. Gazprom is constantly involved into the UGSS expansion by constructing new pipelines within the Russian territory. Since 2005, through its joint venture with BASF and E.ON, Gazprom has been constructing the huge pipeline “Nord Stream” intended to transport the gas from Russia to Western Europe.

At the core of the legislation regulating the gas transportation relations in Russia lies the Gas Supply Law. The law lays out the basics of governmental policy in relation to the gas transportation. The governance is also provided by the number of regulations promulgated by the Russian Government which are to comply with the federal legislation. Some of these regulations directly govern, *inter alia*, the relations between Gazprom and the so-called “independent companies” (the definition given by the Gas Supply Law), which are the companies not affiliated with Gazprom. These companies, principally divided into “gas suppliers”, “gas purchasers” and “gas consumers” according to their respective role, have to cooperate with Gazprom and each other by means of contracts, the terms of which are mainly determined by the federal rulings.

The provisions of the Russian Civil Code, the Subsoil Resources Law, the Competition Protection Law (the Russian central anti-trust law) and some others are to be taken into account when an independent company enters into gas transportation relations in Russia.

Gazprom also falls under the provisions of the Natural Monopolies Law, according to which the gas transporting activity is a so-called “natural monopoly”. This special regime imposes strict limits on the scope of Gazprom’s activities and the contents of its assets, prohibiting the company to obtain the means of production, which do not relate to its main business. Please, refer also to Question 8.4.

The situation regarding the monopolistic structure of ownership appears to be stable and is unlikely to change in the nearest future.

It should be noted in passing that the long-standing legislative draft “On Main Pipeline” seems to be laid on the table after the first reading in the State Duma, the lower house of the Russian Parliament.

#### 4.2 What Governmental authorisations (including any applicable environmental authorisations) are required to construct and operate natural gas transportation pipelines and associated infrastructure?

Construction and operation of gas transportation pipelines and associated infrastructure require various safety and environmental authorisations.

Before July 2005, gas transportation, storage, refinery and realisation were subject to licensing which is currently abolished. Under the Rostekhnadzor acts an entity constructing gas distribution and gas consumption equipment needs to have its project documentation approved and agreed upon by state bodies, obtain an industrial safety expert report and a license for exploitation of fire and explosive dangerous objects. Besides, executive managers and workers in a company handling a gas distribution system must have qualification confirmed by a special commission formed by the Rostekhnadzor.

Construction of the gas pipelines is subject to licensing with a competent governmental body by virtue of the Federal law “On Licensing of Certain Kinds of Activities”, dated 8 August 2001. Until recently, such activity was licensed by the Federal Agency for Construction and Housing-Utilities Complex till the Decree of the President of the RF “The Issues of the System and Structure of the Federal Executive Bodies” was issued on 12 May 2008 that prescribes these functions to be handed over to the Ministry of Regional Development. Meanwhile, an entity employing dangerous production facilities should observe the provisions of the Federal law “On Industrial Safety of the Dangerous Production Facilities”, dated 21 July 1997, which established the basic requirements to the gas equipment and its exploitation conditions.

Environmental legislation provides for effective measures on sewage treatment and processing of waste products, land restoration, reduction of negative environmental impact and reparation of losses injured when gas facilities are placed, developed, constructed and employed. Under the Federal Law “On Environmental Protection”, dated 10 January 2002, construction and operation of the gas production, distribution, storage and refinery infrastructure are allowed, given that there are projects for land restoration and a state environmental expertise with respect to project documentation.

#### 4.3 In general, how does an entity obtain the necessary land (or other) rights to construct natural gas transportation pipelines or associated infrastructure? Do Government authorities have any powers of compulsory acquisition to facilitate land access?

**Acquisition of land.** A plot of land necessary for the purposes of the construction and operation of a transportation pipeline may be obtained in a way stipulated by the civil legislation. As a general rule, the types of contracts used for the land acquisition are mainly the contract for sale and purchase and the lease contract. The latter is more frequent, since the most part of land in Russia belongs to the state which currently prefers to let it on lease rather than having it privatised.

Ordinarily, the state land or the rights to conclude a contract for the

lease thereof are alienated through the auction sale (there are some exceptions), the complicated procedure for which is established by the Land Code of the RF (Articles 29 - 34), dated 25 October 2001, and other regulations adopted by the federal, regional (*i.e.* by the constituent entities of the RF) and local authorities — depending on whose property, namely, federal, regional or municipal, such land is.

It should be noted that all the land in Russia according to the Land Code of the RF, dated 25 October 2001, is divided into categories depending on the purpose of their use. The land for gas transportation purposes is included into the category “transport lands”. In exceptional cases agricultural land (when no other route for a pipeline is possible) may also be used for such purpose. The territories registered within other categories are not allowed to be used for the construction of gas transportation infrastructure. There is an opportunity to shift a plot from one category into another, if to follow the procedure stipulated by a special federal law.

Besides, the Gas Supply Law imposes some additional duties upon the owners and possessors of the land occupied by gas transportation facilities and this creates a special legal regime for such land.

**Construction.** The procedure of obtaining building permits, which is absolutely necessary to start up any construction works, is regulated by the federal legislation and a great number of other normative acts adopted in accordance with it. This procedure is extremely complicated and time-consuming and requires a lot of technical and legal expertise. Initially, the company has to draw up the set of project documentation which is to comply with the requirements of legislation, including the Federal Law “On Environmental Protection”, dated 10 January 2002, and the PSA Law, and shall prove the feasibility of the project. This documentation is subject to strict technical, legal and ecological inspection by the executive bodies. Finally, if the documentation is approved by the authorised commission, the local agency issues the building permits.

**Compulsory acquisition.** The Civil Code of the RF and the Land Code of the RF (Article 9), dated 25 October 2001, vest the federal and regional governments with the right of compulsory acquisition of the land for state or public needs. The Government is obliged to notify in advance the legal owner of the future expropriation (usually one year’s notice) and provide compensation to him based on the market price of the land.

#### 4.4 How is access to natural gas transportation pipelines and associated infrastructure organised?

The general approach envisaged by similar provisions of the Gas Supply Law (Articles 26, 27), the Natural Monopolies Law (Article 8) and the Governmental Regulation “On Providing Access for Independent Companies to the Gas Transportation System of Gazprom OJSC”, dated 14 July 1997, is that all independent producers and suppliers of natural gas are entitled to open indiscriminate access to the Gazprom transportation facilities on equal basis.

Gazprom may not give preference to any independent company over other companies applying for the access. The terms and conditions upon which the gas transportation services are rendered shall be equal to the gas market participants and may not contradict to the anti-trust legislation.

Therefore, the contract for gas transportation is compulsory for Gazprom and it may not refuse access to its pipelines to any offeror. An independent company wishing to obtain such access shall file an application with Gazprom. The rejection of the application may be appealed by the applicant in court.

The only ground for the refusal of Gazprom to conclude the contract is the lack of free technical capacity of pipelines. In the

event of such lack, the priority is given, firstly, to the companies that supply natural gas for daily living and governmental needs and, secondly, to the companies that intend to supply gas for a longer period of time. Other applicants have to contest for the contract on the competitive basis (*i.e.*, through a tender or an auction).

At the present moment, Gazprom states that the UGSS is fully loaded and that its throughout capacity needs to be enlarged by 35 bcm. Some experts, however, say that in reality Gazprom simply does not abide by the rules of equal access to the transportation system and the independent companies that presently produce 14-16% of the total quantity of natural gas in Russia could raise it up to 30%, should Gazprom allow them to freely transport it.

In light of these facts, it is well worth mentioning that in the end of August 2008 FAS presented to the Government a draft of the Regulation on Indiscriminate Access to the Pipelines. The draft reads that Gazprom shall be bound to provide the access to the pipelines to independent companies applying for granting capacity on *pro rata* basis. Besides, the monopoly shall regularly report to the Government on the volume of free capacity of its pipelines which is not reserved for state needs and contracts in force. The Regulation, however, has not been passed by the Government. Yet it is possible that it will be adopted in 2009.

#### 4.5 To what degree are natural gas transportation pipelines integrated or interconnected, and how is co-operation between different transportation systems established and regulated?

The UGSS operated by Gazprom is a highly centralised and inviolable structure. By virtue of law no object may be separated from the UGSS. Gazprom, as its owner, may not be liquidated unless the federal law in this regard is adopted. Similarly, its shares belonging to the state may be sold or otherwise alienated only on the ground provided by a federal law.

The functional and supervisory control over the system is exercised by the Central Production and Supervisory Department of Gazprom. The importance and the dominant role of this Department is evidenced, for instance, by the fact that in the event of emergency the Department enjoys the exclusive right to enact the emergency schedules of gas supply developed by the executive authorities of the constituent entities of the RF.

#### 4.6 Outline any third-party access regime/rights in respect of natural gas transportation and associated infrastructure. For example, can the regulator or a new customer wishing to transport natural gas compel or require the operator/owner of a natural gas transportation pipeline or associated infrastructure to grant capacity or expand its facilities in order to accommodate the new customer? If so, how are the costs (including costs of interconnection, capacity reservation or facility expansions) allocated?

The independent companies bear all the expenses connected with their accommodation to the system unless it is specified otherwise in their contracts with Gazprom or its subsidiaries. For more information please refer to Question 4.4.

#### 4.7 Are parties free to agree the terms upon which natural gas is to be transported or are the terms (including costs/tariffs which may be charged) regulated?

According to the Governmental Regulation “On Providing Access for Independent Companies to the Gas Transportation System of Gazprom OJSC”, dated 14 July 1997, all contracts for gas

transportation are executed in the standard form drafted by Gazprom. Hence, Gazprom unilaterally determines terms and conditions of a contract but the price of its services, and its counterparties have no choice but to adhere to them. The said Regulation outlines, in general, the mutual obligations of the parties to the contract.

The transportation services that Gazprom renders to independent companies (producers and suppliers) as well as to purchasers, which buy gas produced by Gazprom and its affiliates at non-regulated free prices, are charged at a tariff established by the FTS on annual basis.

The FTS employs the complicated methods described in its Order “On Approval of the Procedure for Estimating Tariffs for Service on Gas Transportation via Main Pipelines”, dated 23 August 2005, to ensure the economic efficiency of tariffs in operation. There are two types of tariffs: one-rate and double-rate. In most cases the double-rate tariff is applicable. It consists of two components: the charge for shipping 1,000 cm per 100 km and the charge for using gas mains, which is approved depending on gas entry and exit points in the gas transportation system. It should also be mentioned that the rates depend on where the final consumers of gas are situated: either within the territory of the RF and the countries — parties to the treaties on Customs Union, *i.e.* CIS countries, or beyond the borders of the RF and such countries (for exports).

The tariffs in force were set by the FTS in its Order “On Approval of the Tariffs for Services on Gas Transportation via the Main Pipelines of Gazprom OJSC, entering to the United Gas Supply System, for the Independent Companies”, dated 4 December 2007, and entered into force on 1 January 2008. The rate for shipment of gas is set at 7.2 rubles per 1,000 cm per 100 km for Russian and CIS consumers and at 8 rubles for foreign consumers.

## 5 Transmission / Distribution

### 5.1 Outline broadly the ownership, organisational and regulatory framework in relation to the natural gas transmission/distribution network.

The Gas Supply Law distinguishes the gas distribution system from the UGSS and regional gas supply systems. The former is defined as “*a property industrial complex consisting of organisationally and economically connected facilities intended for the transmission and delivery of gas immediately to its consumers*”. A local gas distribution system is independent from gas supply systems and shall be owned by the Russian company closely supervised by the Government — a gas distribution company.

As far as the country’s gas transportation systems are concerned, the gas distribution systems throughout Russia are under almost total control of Gazprom. Gazprom possesses controlling stock and market share in 148 regional gas distribution companies and three companies engaged in service gas distribution systems (Gazpromregiongas OJSC, Zapsibgazprom OJSC, Tattransgas OJSC). These companies service 463,400 km (75%) of Russia’s gas distribution grids and supply gas to 75% of gasified settlements. Annual volume of gas transmission to the Russian end consumers exceeds 200 bcm.

Gazprom continues to consolidate gas distribution market, aiming, as is stated on its official web-site, “*to unify tariff policy, form investment sources for gasification of the Russian regions as well as to create conditions for liberalisation of internal gas market due to equal access to consumers of all gas producers*”.

The plan for gasification of Russian regions that Gazprom has been carrying out since 2001 was declared to be a national project by the Russian Government, and Dmitry Medvedev, the current Russian

President, was personally in charge of it as the Deputy Prime Minister. It is not doubtful, therefore, that Gazprom's expansion, executed in accordance with the plan, will carry on for a while.

The basics of regulation of gas distribution are set out in the Gas Supply Law. The relations between gas distribution companies, gas suppliers and gas consumers are also subject to the Governmental Regulation "On Providing Access for the Companies to Local Gas Distribution Networks", dated 24 November 1998, as well as numerous technical and safety standards proceeding from executive authorities. Since the regulation of this industrial sphere is referred by the Russian Constitution to the joint competence of the federal Government, Russian constituent entities and municipal authorities, regional and local legislation is also applicable.

### 5.2 What Governmental authorisations (including any applicable environmental authorisations) are required to operate a distribution network?

There is no need to obtain a special license for the operation of a local distribution network since the federal legislation does not contain such a requirement.

Regarding the other requirements, please refer to Question 4.2.

### 5.3 How is access to the natural gas distribution network organised?

The Natural Monopolies Law includes gas distribution into the category of activities which are considered as natural monopolies. Hence, a gas distribution company is not entitled to reject an offer from a gas producer (supplier) or consumer (purchaser) to conclude a contract, unless there is no technical possibility to do so.

The Governmental Regulation "On Approval of Guideline on Access for the Companies to Local Gas Distribution Networks", dated 24 November 1998, which establishes, however, four conditions upon which a contract for gas transmission through distribution pipeline network shall be made: a) the network has some free capacity which is enough to accommodate an entrant; b) there are inlet and branch pipelines leading to a gas purchaser; c) the quality and characteristics of gas supplied meet existing normative and technical requirements; and d) a gas consumer has a permit for the use of gas as fuel.

If these conditions are satisfied, a gas producer (supplier) or consumer (purchaser) may send an application for concluding a contract for gas transportation through distribution pipeline, along with a copy of a contract for gas supply attached thereto, to a gas distribution company. In the event of insufficiency of capacity, offerors involved in gas supply for daily living needs take precedence over others. Those with long-term contracts enjoy the second priority. In addition, the companies which have contracts in force have the pre-emptive right to prolong it. Other things being equal, companies are accessed to a distribution network on *pro rata* basis.

A gas distribution company considers an application within three days. If the application is allowed, the company sends a draft of the contract for gas transmission to the applicant. The contract shall be executed within one month from the day of receipt of the draft by the applicant.

### 5.4 Can the regulator require a distributor to grant capacity or expand its system in order to accommodate new customers?

There is no ruling vesting the authorities with such a right. Quite the opposite, one of prerequisites to be met for the accommodation

of a new customer is that necessary branch pipelines must be constructed by the moment the customer demands the access. Gas distribution companies merely have a duty to inform the FTS at its request about free capacity of certain sections of the local network at certain times.

The Government intends to enlarge distribution networks through Gazprom.

### 5.5 What fees are charged for accessing the distribution network, and are these fees regulated?

Yearly, the FTS sets tariffs in relation to particular regions or particular gas distribution companies. The rates vary depending on the category of end consumers (citizens or legal persons) and the quantity of gas consumed *per annum*. Presently there are dozens of the FTS orders indicating such tariffs that entered into force on 1 January 2008. For instance, for the federal unitary enterprise Mosgaz, a distribution company operating in Moscow, the tariff for gas transportation to citizens is set at 629.33 rubles *per annum*.

### 5.6 Are there any restrictions or limitations in relation to acquiring an interest in a gas utility, or the transfer of assets forming part of the distribution network (whether directly or indirectly)?

The Gas Supply Law stipulates that no more than 20% of the shares of common stock of a gas distribution company may be owned by foreign citizens and/or companies. Consequently, any transactions leading to the excess of this threshold in gas distribution companies are banned.

In addition, according to the Natural Monopolies Law, the FTS exercises control over the transactions, including, but not limited to, sales and leasing, on fixed assets belonging to a gas distribution company and used for gas distribution if their book value exceeds 10% of the company's owned capital.

Please, for further details refer also to Section 8.

## 6 Natural Gas Trading

### 6.1 Outline broadly the ownership, organisational and regulatory framework in relation to natural gas trading. Please include details of current major initiatives or policies of the Government or regulator (if any) relating to natural gas trading.

Taking into consideration physical characteristics of natural gas, it cannot be traded in the same way as other commodities. Article 539 of the Civil Code of the RF provides a special type of sale and purchase contract such as the Power Supply Contract, which also regulates gas supply issues. Under this contract, power supply organisation is obliged to provide power (natural gas) to the consumer through the connected network. It should be noted that according to this agreement a customer acquires a right to receive and use definite volume of gas but not a right of ownership over this volume of gas.

The Power Supply Contract is a public contract (Article 426 of the Civil Code of the RF). It means that the price and other conditions of such contract shall be established identically for all consumers. A gas supplier is obliged to conclude the Power Supply Contract with any consumer, if the supplier's capacity allows him to do so.

According to Article 18 of the Gas Supply Law, the priority right to conclude such contracts belongs to consumers, who use natural gas for the state and municipal needs, domestic and social needs of citizens, *etc.*

As provided by the Regulation of the Government “On the State Regulation of Gas Prices and Tariffs on Gas Transportation in the Territory of the Russian Federation”, dated 29 December 2000, the FTS sets wholesale gas prices, pipeline tariffs and other prices of gas related services. Retail gas prices within the country are based and depend on the wholesale prices.

The Federal Law “On Gas Export”, dated 18 July 2006, endowed Gazprom with an exclusive right to export gas. Gazprom exports gas mainly under long-term, 25-year agreements that typically base on the intergovernmental treaties.

Domestic natural gas trading includes two sectors: regulated (domestic, utilities, public sectors) and non-regulated (industrial sector). Gazprom is the only supplier of natural gas to the regulated sector. In cooperating with state authorities, Gazprom supports a step-by-step reduction of the regulated sector and expansion of the non-regulated one. The FTS yearly increases regulated wholesale natural gas prices: by 15% effective from 2007, by 25% effective from 2008, by 13% effective from 2009. However, they are still below the level that would provide for profitable gas sales in the domestic market.

As to the non-regulated sector, independent companies (not Gazprom’s affiliates) may supply natural gas at free prices. However, such prices are higher by 10-30% than regulated wholesale prices in appropriate regions of Russia. The non-regulated sector functions also within the electronic trading floor (*Mezhregiongaz*). For more information please refer to Question 6.2.

#### 6.2 What range of natural gas commodities can be traded? For example, can only “bundled” products (i.e., the natural gas commodity and the distribution thereof) be traded?

Natural gas as commodity cannot be traded without the “bundled” products such as distribution thereof. It is impossible to use/buy/sell natural gas without being connected to the gas transportation system. However, it is only possible to use the transportation system services for the independent natural gas producers (not Gazprom’s affiliates). Please refer to Question 4.7.

Within the experiment to sell gas on the electronic trading floor (*Mezhregiongaz*) as per the Regulation of the Government “On Carrying Out an Experiment on Realisation of Gas via Electronic Trade Floors”, dated 2 September 2006, Gazprom along with the independent gas suppliers sell natural gas at free market prices. In 2007 a total of 7.04 bcm of natural gas were sold, including 2.78 bcm of gas offered by independent suppliers and 4.26 bcm of gas supplied by Gazprom. The price indicators related to the sales on the electronic trading floor exceeded the regulated wholesale prices by an average 37% over the period. On 10 December 2007 the Government adopted the Regulation “On Continuing the Experiment to Sell Gas on the Electronic Trading Floor in 2008” that envisages an increase in Gazprom’s gas sales volumes up to 7.5 bcm.

## 7 Liquefied Natural Gas

### 7.1 Outline broadly the ownership, organisational and regulatory framework in relation to LNG facilities.

Currently, production of LNG in Russia is not developed. Nonetheless, development of LNG facilities is one of the main Gazprom’s strategic goals related to geographic diversification of gas supplies. Construction of the first LNG plant in Russia is to be finished soon (please refer to Question 1.1). It is also planned to organise production of LNG under Shtokman field project, which

will become a promising base for LNG supplies to the Atlantic Basin countries, including the USA and European countries. LNG supplies are scheduled to begin in 2014.

At the present time, Gazprom performs exchange transactions of pipeline gas to LNG. Since September 2005, Gazprom’s affiliate has supplied LNG to the USA, the UK, South Korea, Japan, India, and Mexico for a total of 0.75 million tonnes.

### 7.2 What Governmental authorisations are required to construct and operate LNG facilities?

Requirements concerning construction and operation of LNG facilities are the same as for other facilities. Please refer to Questions 4.2 and 4.3.

### 7.3 Is there any regulation of the price or terms of service in the LNG sector?

Russia does not produce LNG yet. That’s why there is no special public policy concerning LNG. However, the first LNG plant in Russia is said to start producing LNG in 2009. Please refer to Question 1.1.

However, it should be mentioned that the FTS establishes terms of the price and service on liquefied hydrocarbon gas (“LHG”). Meanwhile, many Russian acts related to LHG contain the term “liquefied gas” only. Of course, it may cause confusion as it is not clear at first sight that “liquefied gas” means LHG.

## 8 Competition

### 8.1 Which Governmental authority or authorities are responsible for the regulation of competition aspects, or anti-competitive practices, in the natural gas sector?

The competition aspects of regulation in the natural gas sector are carried out and the control over anti-competitive practices is exercised by the FAS.

Regulation of prices and price control in the area of natural monopolies’ activity fall within the competence of the FTS subordinated to the Russian Government.

### 8.2 To what criteria does the regulator have regard in determining whether conduct is anti-competitive?

The criteria of anti-competitive conduct are established in the Competition Protection Law and in the Natural Monopolies Law. The latter applies on the ground that pipeline transportation is a natural monopoly. Entities which occupy a dominating position in a product market are prohibited to preclude, limit or eliminate competition and/or to infringe interests of other persons or entities, including without limitation:

- (i) setting and maintaining of monopolistically high (or low) prices;
- (ii) withdrawal of products from circulation, resulting in a price increase;
- (iii) imposing on a counterparty contractual terms which are unprofitable for the latter or not connected with the subject matter of the agreement (unjustified requirement of a transfer of funds, property, property rights, consent to conclude a contract only on conditions of including in it provisions concerning products in which the counterparty is not interested, and other requirements);

- (iv) unmotivated reduction or termination of the output of products for which there is a demand or orders, despite the existence of a loss-free opportunity for their manufacture;
- (v) unmotivated refusal to enter into contract with individual buyers (customers) despite the existence of an opportunity for the manufacture or supply of the relevant product, fulfillment of works or rendering of services;
- (vi) setting differentiated prices (tariffs) for different persons purchasing one and the same product without valid economic, technical or other reasons;
- (vii) creating discriminatory conditions; and
- (viii) creating barriers to other economic entities' market entry (withdrawal from the market).

The said actions (or omissions to act) may be considered as allowable, if it is proven by the entities in question to the court or to the anti-monopoly authority that they are or can be beneficial for public interests.

The fixing of the gas prices and transportation services tariffs must conform to the Russian Government Regulation "On the State Regulation of Gas Prices and Tariffs on Gas Transportation in the Territory of the Russian Federation", dated 29 December 2000.

Agreements or concerted actions, concluded between economic entities operating on the same product market, are prohibited if they lead or may lead to restraint of competition. Similar criteria apply as listed above.

### 8.3 What power or authority does the regulator have to preclude or take action in relation to anti-competitive practices?

The FAS is authorised in particular to:

- 1) institute proceedings and to consider cases on the competition law violation;
- 2) compel the companies to stop actions violating competition law, abuse of the dominating position, discrimination of access to products, and eliminate the consequences of the competition law violation;
- 3) rescind agreements or amend their provisions in order to ensure other persons rights;
- 4) bring to responsibility entities violating competition law and their officials as prescribed by the Russian law; and
- 5) bring actions before court to challenge the agreements and actions violating competition law, to compel to conclude agreements, to enforce its decisions and to liquidate legal entities when prescribed by law.

Furthermore, the FAS is authorised specifically in the area of natural monopolies activity to:

- (i) make decisions binding on natural monopoly entities, connected with introducing, revising or revoking regulations or with applying regulatory methods excluding setting tariffs;
- (ii) examine cases concerning violation of the Natural Monopolies Law;
- (iii) submit to natural monopoly entities mandatory orders to cease violations of the Natural Monopolies Law, as well as mandatory orders to redress the consequences of the said violations, to enter into a consumer contract or to revise an existing contract, and to hand over to the federal budget profits derived from violations of the Natural Monopolies Law;
- (iv) make decisions regarding inclusion into the register of natural monopoly entities or removal from such register;
- (v) submit to executive authorities and agencies of local self-government mandatory orders to repeal or amend acts adopted by them that are not consistent with this law, and (or)

- mandatory orders to cease violations of the Natural Monopolies Law;
- (vi) make decisions on imposing penalties on natural monopoly entities;
- (vii) apply administrative liability in the form of warning or penalty on directors of natural monopoly entities or officials of executive authorities and agencies of local self-government; and
- (viii) appeal or bring action before court and likewise participate in court proceedings.

The FTS is authorised to establish the rules of fixing tariffs for products of natural monopolies.

### 8.4 Does the regulator (or any other Government authority) have the power to approve/disapprove mergers or other changes in control over businesses in the natural gas sector, or proposed acquisitions of development assets, transportation or associated infrastructure or distribution assets? If so, what criteria and procedures are applied? How long does it typically take to obtain a decision approving or disapproving the transaction?

Entities involved in a merger or acquisition must obtain a preliminary approval of the FAS in cases of acquiring of a blocking shareholding (25%), controlling shareholding (50%) or a shareholding excluding the opportunity to block decisions of the shareholder by third parties (75%), if the total assets value of the involved entities (together with their affiliates) according to their last balance sheets exceeds 3 billion rubles or their total proceeds for the last calendar year exceeds 6 billion rubles, whereas the assets value of the entity whose shares are acquired exceeds 150 million rubles, or if one of the involved entities is included in the state register of large market participants.

In addition, the FAS approval is necessary for acquiring assets exceeding 20% of the company's book value, if the same thresholds are met.

In order to obtain consent to the said transactions, it is necessary to file with the FAS a request and to provide appropriate information. This request can be refused if the transactions may entail negative consequences or the information contained therein, essential for passing a resolution, is false.

The FAS must take a well-grounded decision within 30 days from the receipt of the petition. Should any additional information be required for passing a resolution, the FAS may request the applicant to supply the said information and extend the deadline for review of the petition by 30 days. If no response from the FAS is received within 15 days from the expiry date of the petition review period, or if consent is rejected on the grounds deemed by the applicant as unlawful, the applicant may appeal to a court to protect his rights.

Also, certain transactions which are not subject to the FAS approval, do require notification of the FAS.

Please also refer to Question 5.6.

## 9 Foreign Investment and International Obligations

### 9.1 Are there any special requirements or limitations on acquisitions of interests in the natural gas sector (whether development, transportation or associated infrastructure, distribution or other) by foreign companies?

Gazprom shares can be acquired both by the Russian and foreign legal entities and individuals and can be traded in stock exchanges. However, the new Federal Law "On the Procedure for Making

Foreign Investments in Business Entities of Strategic Importance for the National Defence and Security of the State”, dated 29 April 2008, provides that acquiring by foreign investor (group thereof) the right to determine or block decisions of the corporate bodies of strategic companies is subject to preliminary governmental approval.

Acquisition by the foreign investor (group thereof) of shares in a strategic company which explores and/or prospects subsoil resources and produces mineral resources in a subsoil plot of federal significance, if the foreign investor controls at least 10% of such company’s shares, is subject to approval by the Government Commission for Control of Foreign Investments Realisation in the RF. The said approval is also required for acquisition of direct or indirect control over more than 5% of shares in such company by foreign states, international organisations or any entities under their control.

In addition, there is a limitation for foreign companies on holding the shares of regional gas supply and distribution system owners. By virtue of the Gas Supply Law, the participation of foreign persons or entities in such companies may not exceed 20% of the total number of common shares issued by the latter.

Subsoil use rights may be acquired by foreign citizens and legal entities, although the Russian Government may establish limitation on foreign participation in auctions or tenders on the subsoil use rights to ensure the state defence and security.

Please also see Question 2.8.

## 9.2 To what extent is regulatory policy in respect of the natural gas sector influenced or affected by international treaties or other multinational arrangements?

Russia is a party to about 100 international agreements and arrangements in the sphere of gas exploitation and transportation and cooperation in gas industry, mostly bilateral. Yet the said international instruments scantily influence Russian regulatory policy in respect of the natural gas sector.

Russia signed but never ratified the Energy Charter Treaty of 1994. The sticking point is the Protocol on Transit which current version is considered unfavourable by the Russian authorities. Russia provisionally applies the Treaty in the sense of Article 25 of the Vienna Convention on the Law of International Treaties inasmuch as it does not contradict to Russian laws and regulations. In November 2008 Russian permanent representative at the European Union affirmed that ratification of the Treaty by Russia in the near term is doubtful.

Also in 2008, Russia decided not to become party to the Agreement on a Concerted Policy in Natural Gas Transit concluded within the Commonwealth of Independent States in 1995.

## 10 Dispute Resolution

### 10.1 Provide a brief overview of compulsory dispute resolution procedures (statutory or otherwise) applying to the natural gas sector (if any), including procedures applying in the context of disputes between the applicable Government authority/regulator and: participants in relation to natural gas development; transportation pipeline and associated infrastructure owners or users in relation to the transportation, processing or storage of natural gas; and distribution network owners or users in relation to the distribution/transmission of natural gas.

Russian judicial system comprises federal courts and courts of the constituent entities of the Russian Federation. Federal courts include the Constitutional Court, the courts of general jurisdiction and the military courts, headed by the Supreme Court, and the

“arbitrazh courts”, headed by the High Arbitrazh Court of the RF. Competence in the sphere of resolving economic disputes, including the disputes in gas sector, is vested with the “arbitrazh courts” and the courts of general jurisdiction. This is applicable to the disputes between the state authorities and private entities involved in natural gas development, transportation, processing or storage, distribution and functioning of the gas sector. The arbitrazh courts were formed in 1992 and resolve commercial and other economic disputes between legal entities where individuals are not involved unless they have a status of entrepreneur. Other disputes are resolved by the courts of general jurisdiction.

Russian dispute resolution procedure in arbitrazh courts starts from examination of the case by the court of the first tier. Its judgment can be challenged in the court of the appeal tier, which reconsiders the case on the merits. The next stage is consideration of the case in the court of the cassation tier whose function is review of the application of rules of law. Finally, the said lower courts’ acts can be challenged in the High Arbitrazh Court of the RF, which overrules the judicial acts rendered in the case only if it finds that they are contrary to uniform application of law, violate human rights or public interests.

There are also a number of out-of-court (administrative) compulsory procedures of dispute resolution between state authorities and private entities.

Besides, a number of disputes may be resolved by arbitration. Arbitration is compulsory if the parties concluded a written arbitration agreement or if it is expressly provided by law or by an international treaty of Russia. Many Russian bilateral investment treaties provide that unsettled disputes are to be resolved via arbitration in an international arbitration institution or *ad hoc* with application of UNCITRAL Arbitration Rules.

### 10.2 Is Russia a signatory to, and has it duly ratified into domestic legislation: the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards; and/or the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“ICSID”)?

Russia as the legal successor of the USSR is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The Supreme Council of the USSR has duly ratified it by its decree, dated 10 August 1960. The USSR made a reservation that, with regard to awards made in the territory of non-contracting States, it will apply the Convention only to the extent to which those States grant reciprocal treatment.

Russia signed the Convention on the Settlement of Investment Disputes between States and Nationals of Other States on 16 June 1992 but did not ratify the convention. However, Russia is a party to more than 50 bilateral investment treaties which provide for settlement of investment disputes through arbitration in a permanent arbitration centre or *ad hoc* arbitration according to the UNCITRAL Rules 1976.

Russia has also adopted a Federal Law “On International Commercial Arbitration”, dated 7 July 1993, basically reproducing the UNCITRAL Model Law. This law establishes exclusive list of grounds for refusal to enforce awards rendered by international commercial arbitration tribunals and sole arbitrators.

### 10.3 Is there any special difficulty (whether as a matter of law or practice) in litigating, or seeking to enforce judgments or awards, against Government authorities or State organs (including any immunity)?

As a matter of law, there is no special difficulty in litigating against

Russian state authorities. Thus, under Article 124 of the Russian Civil Code, the RF, its constituent entities and municipal bodies take part in civil law relations on equal grounds with legal entities and individuals. Also, the validity of the acts issued by such authorities may be challenged in court. However, as a matter of practice it can sometimes be difficult to succeed in litigation against a state body or a state-controlled legal entity due to the pressure exerted by them or their affiliated persons upon the judges.

Generally, the enforcement proceedings are effected by the State Bailiff Service in accordance with the Federal Law "On Enforcement Proceedings", dated 2 October 2008. However, the enforcement of judgments against Russia, its constituent entities or municipalities is carried out by the Ministry of Finance of the RF and/or financial authorities of the appropriate level.

As for the enforcement of awards or foreign judgments against the Russian state authorities, there is an additional difficulty resulting from the judicial immunity of the state. It is to be mentioned that there is no uniform legal concept of judicial immunity of the state in Russia. Arbitrazh courts and the courts of general jurisdiction have different opinions regarding it. Although the concept applies only where the state acts as a sovereign power and not as a mere participant of the civil law relations, the courts broadly construe the notion "acting as a sovereign power": thus, purchasing some supplies or services for state needs can be construed as "acting as a sovereign power". Enforcement of an award or a foreign judgment against state is contingent upon formal waivers of the state from its immunity against filing claims at court and enforcement of the resulting award or judgment. Besides, obtaining formal waivers of the state from its immunity against seizure of state property and taking security measures are also recommended. In addition, as the High Arbitrazh Court of the RF explained, the person who signs such an agreement on behalf of the state, needs to possess appropriate powers expressly granted to him.

#### 10.4 Have there been instances in the natural gas sector when foreign corporations have successfully obtained judgments or awards against Government authorities or State organs pursuant to litigation before domestic courts?

To date, there have been no published cases when foreign corporations in the natural gas sector obtained judgments against state authorities before Russian domestic courts.

## 11 Updates

### 11.1 Please provide, in no more than 300 words, a summary of any new cases, trends and developments in Gas Regulation Law in Russia.

- In 2008, Russia formally announced its decision not to become a party to the Agreement on a Concerted Policy in Natural Gas Transit concluded within the Commonwealth of Independent States in 1995.
- Several amendments were introduced into the Subsoil Resources Law in 2008. In particular, the law established criteria of classifying the subsoil plots as being "of federal significance" with the purpose of ensuring state defence and security. Thus, all subsoil plots which contain gas deposit of not less than 50 bcm are deemed "of federal significance". In this regard, a new provision was adopted providing that if a foreign investor or a legal entity with participation of foreign investors in the course of subsoil exploration discovered a mineral deposit which meets the criteria of subsoil plots of federal significance, the Russian Government may refuse to grant the right of subsoil use in such plot or terminate such right if it finds that there is a threat to state defence and security, the expenses of the investor are to be reimbursed.
- As mentioned in Question 2.1, a Federal Law "On the Procedure for Making Foreign Investments in Business Entities of Strategic Importance for the National Defence and Security of the State" was adopted in April 2008. It provides that certain transactions in relation to strategic companies' shares are subject to the preliminary governmental approval. Thus, acquiring direct or indirect control over more than 5% shares in strategic companies which explore and/or prospect subsoil resources and produce mineral resources in a subsoil plot of federal significance by foreign states, international organisations or entities under their control is subject to approval by the Government Commission for Control of Foreign Investments Realisation in the RF.
- The Ministry of Economic Development and Trade of the RF which had been entitled, *inter alia*, to issue licenses on exercising sole rights on gas export was reorganised. Now these powers are vested with the Ministry of Industry and Trade of the RF established in 2008.
- A bill amending the Gas Supply Law, which was initially introduced to the Russian Parliament in November 2007, was examined by the Parliament Council and recommended for consideration by the Parliament in November 2008. The bill provides for the right of Gazprom to temporarily terminate or limit gas supply to certain gas consumers determined in an order to be established by the Russian Government. The bill provides that the gas supply could be temporally terminated or limited with the aim to ensure the export obligations and procurements for public needs.
- In February 2008 the High Arbitrazh Court of the RF upheld the ruling of the Uralsky District Federal Arbitrazh Court of 8 November 2007 which construed the Gas Supply Law in the sense that the right to compel the gas distribution company to enter into gas transportation contract belongs not only to the gas consumers but also to gas suppliers on the sole condition that they have facilities necessary to be granted access to appropriate gas distribution networks.

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