



**The Business & Law Readers Digest**

**Oil and Gas**

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## Ukraine's exploitation of its oil and gas deposits

The development of energy resources is a very important process for the economy of any country. Ukraine is no exception.

Ukraine is extremely wealthy in many natural resources; however at the same time it is dependant on oil and gas from other countries. Understanding the importance of these resources for the country's economy, Ukraine tends to develop its own oil and gas deposits. Lately there have been active discussions in the Ukrainian governmental bodies on the necessity to gain 'energy independence' from other countries - first of all from Russia - regarding oil and gas usage. Analysing the facts that have given rise to such discussions, one can point out a decision of the Russian government in 2007, according to which within three years the gas prices for CIS countries will be based on their fair market value. The basis will be the price for gas on the border between Germany and Poland and will constitute approximately USD 250 for one thousand cubic metres, plus transporting expenses.

Thus, Ukraine has two more years to become less dependent on foreign energy resources and this period of time must be used productively. Energy independence is planned to be achieved by decreasing oil and gas' external supplies and the subsequent greater exploitation of Ukrainian oil and gas

storage. Therefore the declarations of the Ukrainian state officials regarding the necessity to attract foreign and domestic investors to the gas and oil industry are extremely relevant. In particular, in 2007 Ukraine declared its intent to attract approximately USD 2 billion worth of investments in order to exploit the Black Sea's continental shelf. The draft programme (elaborated last year) includes three plans of action: exploitation of the shallow shelf, hydrocarbon production and the exploitation of the deep-water shelf.

Independent gas traders support this draft programme, which in five years will lead to the production of 7-15 billion cubic metres of Ukrainian gas. The adoption of this programme is one of the main incentives for the development of rivalry in Ukraine's domestic market. To this end, gas traders are interested not only in the attractiveness of foreign investments, but equally in the possibility of securing domestic ones. In 2007 they expressed their opinion on the necessity to adopt the state programme on support of Ukrainian investors.

According to the National Programme "Oil and Gas to 2010" dated 21 June 2001 (with subsequent amendments), Ukraine intends to increase the exploitation of oil and gas by approximately 1.5 times in comparison with 2005. Go-



vernment experts believe that Ukraine needs to invest USD 2.1 - 2.3 billion annually in order to achieve this goal. However, at the present time Ukraine's inability to fully exploit its natural resources and the absence of sufficient investments in the oil and gas industry has resulted in a decrease in oil and gas production. In particular, in 2007 oil production constituted 3,304,600 tons, a decline of 0.6% (19.7 thousand tons) compared to 2006. Last year gas condensate production declined by 5.7% (67.6 thousand tons) compared to 2006. The decline also touched upon the gas industry: gas production decreased by

1.2% (246.1 million cube metres) compared to 2006. Nevertheless, there exists a real chance to improve the energetic balance of the country. Hydrocarbon resources development in the Black and Azov seas, according to experts, constitute 2.3 trillion cubic metres in gas equivalent. In the opinion of some state officials and specialists in the oil and gas industry, it shall be possible within the next 10-15 years to set up not less than 15 oil and gas deposits and to increase the annual amount of natural gas production to 8-10 billion cubic metres, and oil production and condensate to 5 million tons.

## New in 2007

In 2007 certain changes and amendments were added to the legislation of Ukraine with respect to oil and gas production. In particular, according to the Law of Ukraine "On the State Budget" dated 28 December 2007, the effect of the articles of the Law of Ukraine "On oil and gas" dated 12 July 2001 concerning competition while obtaining special permission to exploit oil and gas deposits was suspended for the year 2008.

There has also been an innovation with-in legislation in this area, namely, the conception of the process of conducting an auction on the sale of special permission for exploitation of resources, based on the Resolution of the Cabinet of

Ministers "On the order of conducting auctions for the sale of special permissions for the exploitation of resources" dated 4 April 2007. For the first time the operator of such an auction was a private company. Experts consider that conducting auctions with the help of a private operator will help them to become more liberal and independent. Moreover, the terms for conducting such auctions were reduced. For example, the operator of the auction, on the basis of the decision of the auction's organiser, shall publish the official announcement in "Governmental Courier" concerning the holding of an auction not later than 30 days before the auction will be held. In previous years



this term was 45 days. After this, an applicant shall submit the application not later than 15 days after the official announcement of the conduction of the auction. During previous auctions the applicants used to have 30 days to submit their application.

Then in 2007 the amount of the advance payment - which participants have to pay before the beginning of an auction - was increased from 5% to 20% of the initial value of the lot. Moreover, a commission fee was introduced, that constitutes 1% of the initial value of the permission.

## Problems with exploitation of oil and gas deposits

The initial problem concerning the exploitation of oil and gas deposits on Ukrainian territory is the above mentioned auction, where special permissions for the exploitation of oil and gas deposits are sold. Each year the character of such auctions are changed by respective resolutions of the Cabinet of Ministers. Thus, the willing applicants may not be aware of auction conditions a reasonable amount of time before its commencement. Moreover, the organiser of the auction has to agree with other governmental bodies the list of deposits that will be sold at the auction. The auction which was to be held on 18 December 2006 has become a precedent; the first example of an auction which was cancelled when the organiser could not agree with other government authorities the list of deposits to be sold.

Another problem has been voiced by participants, that there are no grounds

for the initial price being so high. Moreover, the government does not provide the participants with any privileges for deposits located in hard-to-reach areas. Also, it is necessary to clarify that the purchase of permission for the exploitation of the particular deposit is not the final step; after receiving it one needs to obtain permission for its construction and development.

This leads to the situation whereby only one applicant submits an application for a particular deposit and as a result the permission is issued without auction. For instance, in 2005 only 12 permissions were issued through auction while 326 were given without auction. In 2006 the Ukrainian government earned UAH 118 million from the sale of the mentioned permissions; however only UAH 18 million were earned by the sale of these permissions through auctions.



## Attractiveness of oil and gas resources

It goes without saying that oil and gas are extremely important natural resources for Ukraine. At the present time Ukraine is mostly dependant on foreign suppliers, mainly Russia, with respect to these resources. Ukraine intends to become less dependant on foreign suppliers of oil and gas. It intends to increase the exploitation of its own gas

and oil deposits by 1.5 times and for this purpose to attract a great amount of foreign and domestic investments. Taking into consideration the value of oil and gas in internal and overseas markets we may conclude that exploitation of oil and gas deposits is definitely an attractive sphere for investment in Ukraine.



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