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## Overview of Ukraine's Legal Regime for Upstream Oil & Gas Sector



The period of 2012 - the beginning of 2013 has been marked by an avalanche of developments in the upstream sector, culminating on 24 January 2013 in signing the Production Sharing Agreement ("PSA") with Shell. The signing, which symbolically took place at the World Economic Forum in Davos, signifies a new era in Ukraine's energy sector ensuring exploration and production of domestic natural resources, most importantly Unconventional Resources (Shale Gas, Tight Gas, Shale Oil, etc.), as well as Black Sea development. A number of PSAs are expected to follow, both for onshore and offshore development.

As any cardinal reform, the opening up of Ukraine's upstream sector to major international investors carries numerous obstacles and risks, including geopolitical, political, environmental, legal, social, and other risks.

In particular, a strong PR campaign was initiated by certain opposition political forces against development of Unconventionals citing environmental grounds. A highlight of this campaign was introduction on 31 January 2013 by several opposition Members of the Parliament (Verkhovna Rada) of a Bill imposing a temporary Moratorium on exploration and production of Unconventionals. This Bill was later withdrawn, but replaced with Bill # 2318 proposing not only strict environmental protection measures, but also an irrelevant and burdensome requirement that each PSA must be approved by the Parliament. The fact that the battle against Unconventionals moved to the Parliament and is taking the shape of formal legislative initiatives signifies a new, more serious level.

On the positive side, Ukraine offers a legal instrument, which will help to meet the challenges and minimize risks: PSA is the most modern, stable and attractive legal and fiscal instrument available to investors in the natural resources sector.

The PSA legislation, most notably the PSA Law, was considerably amended in 2012, incorporating a long "Wish List" of various improvements proposed in the past few years by the investment and legal community, including by our firm, as well as amendments needed for the GOU to move forward on the PSAs already under negotiations and future PSAs. The amendments stopped short, however, of clarifying the legal specifics for implementing PSAs on the Continental Shelf, which in the absence of the law on Continental Shelf creates a substantial loophole in the legislation.

A new opportunity was defined for the investors to get the PSA. If before the only realistic way was through the competitive process of a PSA Tender, now the PSA Law offers an opportunity of getting a PSA through the conversion into PSA of existing Subsoil Licenses (held mostly by local

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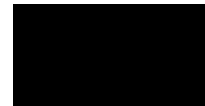
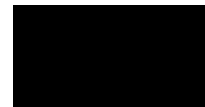
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State or private companies – License Holders). This opportunity (“PSA Conversion”) was theoretically provided by the PSA Law before, but could not be implemented because of lack of critical details, which are now defined in the PSA Law. The PSA Conversion is the most intriguing new possibility for an investor to directly negotiate a PSA with the Government of Ukraine (“GOU”) without holding a PSA Tender, provided that an agreement is reached with the local License Holder on jointly applying for the PSA Conversion.

No amount of legislative improvements, however, will make the real projects happen. Ukrainian legislation provides for various internationally-recognized investment vehicles, such as PPPs, JAAs, concessions, and indeed PSAs, but these vehicles are not always available or successful in practice. The key ingredient is the political will of GOU, and this will has been clearly demonstrated with regards to the PSAs within past two years.

The advantages provided by PSA come with the price. Clear tendencies emerged from several PSA Tenders carried out in 2012 by the GOU, focusing on Unconventionals and on the Black Sea Shelf: GOU established a practice of (i) imposing a “Local Partner”, which needs to be carried in 50-50 proportion by the investor-winner of the PSA Tender for onshore projects; and (ii) no “Local Partner” or a “Local Partner” with a smaller interest than 50%, but a large signing bonus for offshore projects.

[Click here](#) for a PDF version of the document including a more detailed summary of the current legal regime for the upstream sector.

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