

**Legal Alert – 5 November 2012**

**IMPORTANT AND COMPREHENSIVE IMPROVEMENTS  
TO THE PSA REGIME IN UKRAINE**

The new Law "On Amendments to Selected Legislative Acts of Ukraine Concerning Execution of Production Sharing Agreements ("**PSA Amendments Law**") was recently signed by the President and is expected to take effect soon, introducing a number of important amendments into the PSA Law and a few other laws.

The PSA Amendments Law accumulates 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 Government of Ukraine ("**GOU**") to move forward on the three PSAs currently under negotiations (Olesska, Yuzivska and Skyphska). The PSA Amendments Law requires a thorough analysis, but some of its most important highlights are listed below:



ukrainian legal group  
www.rulg.com

Olimpiysky Center  
72, Velyka Vasylkivska  
Street Suite 14, Kiev  
03150

Ukraine

Phone: [380] (44) 207-1060

Fax: [380](44) 207-1064

4056 Mansion Dr., N.W.  
Washington, D.C. 20007  
USA

Phone: [1] (202) 338-1182

Fax: [1] (202) 338-4237

**1. Conversion of the existing Subsoil License into a PSA**

The long anticipated mechanism for the conversion of the existing Subsoil License into a PSA without a tender ("**PSA Conversion**") opens up for investors numerous existing projects, which are under control of local companies.

According to the current PSA Law, PSA Conversion is possible, but there is no procedure provided, and the possibility for such a PSA Conversion is expressly allowed only for the holder of the Subsoil License ("**License-Holder**"), which in most cases are Ukrainian State-owned or private companies. There is no mention of a possibility to bring an investor into the conversion and make the investor a party to the future PSA together with the License-Holder.

The PSA Amendments Law now stipulates the procedure and timeframe for the PSA Conversion, but still does not expressly allow bringing an investor, along with the License-Holder, into the PSA Conversion. Because this issue is of critical importance for investors, which intend to participate with License-Holders in the PSA Conversion, the absence of express provision in the legislation leaves a gap open to interpretation.

The PSA Amendments Law, however, elaborates on the concept of a "multilateral" PSA, and it is possible to interpret the "multilateral" PSA, as the one in which another party-investor can enter into, along with the License-Holder during the PSA Conversion. In practice GOU seems to support this interpretation. In this case the PSA will be

concluded on one side by the License-Holder and another party-investor, and on the other side by the GOU. PSA Amendments Law further adds that in such a case, after "multilateral" PSA is concluded, a new Subsoil License will be issued in the name of all investor-parties to the PSA.

## **2. Waiver of Sovereign Immunity by the State**

The PSA Amendments Law restores the provision on waiver of sovereign immunity by the State, which was stipulated in the original PSA Law, but later invalidated by the Constitutional Court. This time, the PSA Amendments Law makes such a waiver a right, but not an obligation by the State. In any case this is a major improvement in terms of strengthening international protection mechanisms available to the investors.

## **3. Separating PSAs from the PPP Law**

The Public Private Partnership ("PPP") Law was adopted much later than the PSA Law and listed PSAs as a type of PPP, which carried multiple risks for PSAs because of conflicting rules in the PPP Law and in the PSA Law. The PSA Amendments Law separates PSAs from the PPP Law, removing these risks.

## **4. Adding Unconventional Hydrocarbons**

The PSA Amendments Law added Unconventional Hydrocarbons to the list of natural resources eligible for PSAs. Furthermore, it distances PSAs made specifically for Unconventional Hydrocarbons from regular requirements, and makes sure that the parties can provide a special regime for them in the PSA itself. Thus, PSA Amendments Law allows to establish in an individual PSA specific provisions applicable to Unconventional Hydrocarbons, which may differ from the legislation applicable to conventionals, and which will prevail in case of a conflict.

## **5. Strengthening Regulatory Obligations of the State to the Investor**

The PSA Amendments Law reinforces the obligation of the State to issue a Subsoil License and various other regulatory approvals to the PSA investor(s) and expands this obligation to subcontractors, suppliers and other counterparties of the PSA investor(s).

## **6. More Flexibility for the Investors in the Multilateral PSA**

The right of the investors in the PSA to change the shape (geographical coordinates) of the Subsoil Area subject to the PSA is reinforced, and no changes to the PSA itself are needed in this case.

## **7. Clarifying and Strengthening the Role of the Operator**

The role of the Operator under the PSA is clarified and strengthened, allowing the Operator to make independent decisions with regards to day-to-day operations under the PSA.

## **8. More Flexibility for the Investors in the Multilateral PSA**

The PSA Amendments Law grants more flexibility to investors in a multilateral PSA to re-arrange their relations (for example, change their stakes in the shared production).

## **9. Automatic Granting of a Subsoil License under the PSA**

The obligation of the State to grant a Subsoil License to the investors on the basis of the PSA is reinforced and clarified, adding that no Licensing Agreement is needed.

## **10. Clarifications as to Cost-Recovery**

The PSA Amendments Law attempts to clarify investor's expenses subject to cost-recovery. In particular, it clearly states that expenses incurred before the PSA is signed are not subject to cost-recovery, but then adds "unless otherwise stipulated by the agreement". We assume therefore that this rule can be avoided and pre-PSA expenses can in fact be included into cost-recovery in an individual PSA.

## **11. GOU needs to Apply to Courts for Early Termination of a PSA**

The PSA Amendments Law requires GOU to apply to courts (or other dispute resolution forum, meaning international arbitration) in case GOU discovers substantive violations by the investor and wishes to terminate the PSA.

## **12. PSAs Exempt from Gas Export Restrictions**

By introducing amendments to the Law "On Conditions for Functioning of the Natural Gas Market" the PSA Amendments Law exempts PSAs from the gas export restrictions and price controls.

## **13. PSAs Exempt from Various Currency Control Restrictions**

By introducing amendments to currency regime legislation, the PSA Amendments Law exempts PSAs from various currency control restrictions.

### **Disclaimer**

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