

# DRAFTING THE RUSSIAN LAW ON OIL AND GAS: AN OIL INDUSTRY LAWYER'S PERSPECTIVE

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## I. INTRODUCTION

In September 1991, several corporate sponsors, including a few international oil companies, agreed to fund and participate in the University of Houston's Russian Petroleum Legislation Project<sup>1</sup> (the "UH Project"). Four Working Groups were formed on Exploration and Production (E&P) Licensing, Taxation, Conservation and Environment, and Transportation, plus a subgroup on Intellectual Property that was designed to advise the other Working Groups. The author participated as one of the reporters for the E&P Licensing Working Group. Many of those involved in the UH Project viewed it as a unique opportunity to become involved in the legislative process in the rapidly changing Soviet Union and make a contribution to that nation's new Law on Oil and Gas. Although it was anticipated that a mere handful of months would be required to complete the process, the actual task has continued for more than a year and a half. The known obstacles were daunting, but all involved embraced the opportunity enthusiastically in the hope that the burgeoning reform movement in Russia would gather enough momentum to carry the legislative process through to a successful conclusion.

The participation of several oil industry lawyers and technical experts in the UH Project, with practical international expertise, was viewed positively by both the Russians and the

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1. For a detailed description of the Project, see Jacqueline Weaver, *The History and Organization of the Russian Petroleum Legislation Project at the University of Houston Law Center*, 15 HOUS. J. INT'L L. 271 (1993). For a discussion of the Law on Oil and Gas, see Section IV.A. *infra*.

University of Houston officials, though an extremely cynical opinion was expressed by some in the press.<sup>2</sup> One critic even took the position that the oil industry "fox" was not just "watching the henhouse, but designing it too."<sup>3</sup> In reality, however, the oil industry lawyers and technical experts were wholly supportive of the UH Project's objective of helping to create a stable legal environment that could both benefit the Russian people and serve to assist in attracting foreign investments. In addition, the neutrality of the UH Project was assured by the University of Houston's leadership role through its well qualified professors, as well as by the diversity of the corporate sponsors. The oil industry representatives participated in all four of the Working Groups established by the UH Project, but the main focus of this article will be on the activities of the E&P Licensing Group.

The fundamental purpose of the academic, governmental, and industry participants was to recommend to their Russian counterparts involved in the UH Project a legislative framework based on current international practices in the oil and gas industry. Those who were involved recognized that this would require both educational and creative efforts in order to demonstrate the advantage of opening up the old Soviet system and replacing it with a more flexible system that could attract foreign investment. This view was based, of course, on the assumption that the Russians wanted to encourage foreigners to invest in their oil and gas industry.

Some of the participants had experience in dealing with the old Soviet system and realized that it might be extremely difficult to change a system that recognized the formation of joint venture companies as the only mechanism for foreign investment in any industry in the former Soviet Union. From 1987 to 1991, under the terms of Decree No. 49 on the Establishment and Operation of Joint Ventures<sup>4</sup> ("Joint Venture Law"), the Soviets permitted foreign investment to take place

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2. See Linda Himelstein, *Big Oil Plays a Big Role in Shaping Russia's Energy Laws*, LEGAL TIMES, Jan. 13, 1992, at 1.

3. *Id.* The critic's concern is that objective legislation will not be accomplished by the new Russian government. *Id.*

4. See Decree of the USSR Council of Ministers Adopted Jan. 13, 1987, *unofficially translated in* KAJ HOBBER, JOINT VENTURES IN THE SOVIET UNION, app. 3 (1989) [hereinafter Joint Venture Law].

in the oil industry only if the foreign oil companies were willing to form a joint venture company. Such joint ventures would limit the liability of foreign companies as shareholders, but also would limit the companies' ability to control the operational and commercial aspects of an investment project.<sup>5</sup>

There are several fundamental principles on which the international oil companies have traditionally insisted when making an investment, regardless of whether the host country possesses a free market economy. Such principles include the following: (1) the unfettered right to export petroleum and retain proceeds from sales abroad; (2) the ability to exert some degree of control over operational and managerial matters; (3) the flexibility to maintain a separate corporate identity, thereby acquiring rights individually in undivided interests through a contractual arrangement; and (4) the stabilization of contractual rights and the settlement of disputes by third party international arbitration.

On the other hand, the old Soviet system of joint venture companies was based on the following fundamental principles: (1) all activities and functions are performed by the joint venture company, including the sale of petroleum; (2) major issues must be decided on the basis of unanimous vote of the governing body; (3) profits are only accessible by the shareholders if dividends are declared by the governing body; and (4) the joint venture company is subject to local laws with respect to the conversion of 50% of foreign currency revenues and an additional tax of 5-15% on the repatriation of dividends.

In this article, these fundamental principles will be discussed in terms of both the international oil companies' viewpoint and the Russian drafters' apparent positions. In so doing, the relevant portions of the UH Licensing Code proposal and the latest Russian drafts of the Law on Oil and Gas will be critiqued. The conclusion of the article contains a forecast of the likely outcome of the Russian legislative process.

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5. *Id.* arts. 4-18, 21-35. The Joint Venture Law requires the formation of a joint venture company to be registered as a Russian limited liability company. There must be both Russian and foreign shareholders of the company, although the Russian ownership interest could be as low as 1%. In practice, however, the Russian governmental entities usually require no less than 50%. *Id.* art. 5.

## II. OVERVIEW OF FUNDAMENTAL PRINCIPLES

### A. *The Right to Export and Retain Proceeds Abroad*

The right to export petroleum freely and retain proceeds from sales abroad in foreign bank accounts has always been one of the main objectives of international oil companies throughout the world. The right to export has, consequently, been viewed as a minimum requirement due to its fundamental relation to the economic feasibility of any investment project. By exporting petroleum, an investor gains access to the international crude oil trading market and is not constrained by the peculiarities of the domestic market of the host country. This translates into convertible currency earnings for both the investor and the host government, and there is no requirement to declare dividends in order to gain access to profits. In addition, it gives an international oil company the option to transport the exported petroleum to its own refineries, which may add considerably to the economic feasibility of undertaking a particular development project.

Once an export sale is consummated, it is imperative that the proceeds therefrom remain in the control of the foreign investor. The establishment of a foreign bank account is basic to the right to export, and is used both for the deposit of the foreign investor's convertible currency revenues and for the payment of obligations to the host government. Such arrangements have been used successfully for decades without the imposition of the requirement to return revenues to the host country. This system also allows the foreign investor to avoid sending surplus convertible currency into the host country where it might be subject to foreign currency conversion regulations and withholding taxes (50% and 5-15%, respectively, in Russia today) if repatriated.

### B. *The Operational Control Issue*

In most cases, the international oil company is requested to invest all or the majority of the funds needed to undertake an exploration and development project. As a result, the foreign investor expects to exert a high degree of control over the manner in which the operational, managerial, and technical decisions are made. Operational control is viewed as the natural corollary to accepting the major portion of the financial risk.

Under such circumstances, the foreign investor should be free, subject to the usual environmental and operational regulations, to use its technical and managerial expertise in accordance with sound business and commercial principles. Therefore, the appointment of the operator is also viewed as an extremely critical issue in the structure of an agreement with the host government.

In most developing countries this is not much of a problem because the national oil companies do not possess all of the technology and related experience that is needed for the efficient performance of operational matters. In most developed countries it is not regarded as a major issue since there is either no national oil company, such as in the United States, or the energy ministry has the authority to appoint the operator under a production license, such as is the case in Norway.<sup>6</sup>

### C. *The Flexibility of the Investment Mechanisms*

The types of investment mechanisms that are available to a foreign investor will have an impact on its operational capabilities, as well as its prospects for profitability. If the host government employs a single system such as production sharing or a multiple system that uses production sharing and tax/royalty concessionary arrangements, the amount of flexibility that is given the foreign oil company may be the determinative factor in deciding whether to invest in a specific project.<sup>7</sup> For

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6. Act of 22 March 1985, No. 11, Pertaining to Petroleum Activities, art. 9, reprinted in EUROPE: BASIC OIL LAWS AND CONCESSION CONTRACTS 18 (1987). See generally Frants Delgaard-Knudsen, *Exploration Concessions: Contracts or Permits?: Contributions from the Norwegian Phillips/Ekofisk Case*, 5 J. ENERGY & NAT. RESOURCES L. 165, 171-72 (1987) (outlining the Norwegian legal regime for oil exploration).

7. For a discussion of the various types of international petroleum agreements that are used worldwide see KEITH W. BLINN, ET AL., INTERNATIONAL PETROLEUM EXPLORATION & EXPLOITATION AGREEMENTS: LEGAL, ECONOMIC AND POLICY ASPECTS 15-118 (1986). "The main principles of [a production sharing agreement] . . . are that the ownership and control of national resources are entrusted to the State, the [international oil companies] being granted the status of risk-taking contractors entitled to the reimbursement of their costs in case of commercial production, as well as to a share of same to remunerate their efforts." *Id.* at 48. In a tax/royalty concessionary agreement, oil companies pay the government a tax on profits plus a royalty on the value of production. *Id.* at 64. See also, James W. Skelton, *New Developments in the Evolution of International E&P Agreements*, 44 INST. ON OIL & GAS L.

example, if the investor is permitted to obtain an undivided interest in a share of the production and lift and dispose of it in its individual capacity, it will have the type of flexibility that will allow it to control the flow of revenues from the sale of such production.

The Russian Law on Subsurface Resources provides that licenses for the use of subsurface resources may be issued in connection with contractual rights and obligations "including those based on concession agreements, production sharing agreements and contracts for the performance of services (with or without risk)."<sup>8</sup> This provision establishes the principle that these three main types of contractual arrangements that are recognized throughout the world could be utilized with the granting of licenses. The Law on Subsurface Resources does not include any details about the way in which such contractual arrangements might be accomplished, which means that the New Law on Oil and Gas could be used to fill that void.

There is also the issue of the means by which rights are granted, i.e., through direct negotiation or competitive bidding or both. The most flexible system will permit negotiations and bidding to take place, depending on the physical characteristics of the area to be considered for licensing. Some areas are either so remote or involve such complex operations that negotiations may be the only way to strike a mutually beneficial deal.

#### *D. Stabilization and Dispute Resolution*

The stabilization of contractual rights and the resolution of disputes are two additional principles upon which international oil companies depend when making long term investments, especially when such investments are made in an unstable political environment that could lead to nationalization or expropriation. In the first instance, the main objective of foreign investors is to maintain the stability of their contract in such

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& TAX'N 13 (1993).

8. LAW OF THE RUSSIAN FEDERATION CONCERNING SUBSURFACE RESOURCES, art. 12 (Ernst & Young trans., May 5, 1992) (originally published in the *Russian Gazette*) [hereinafter LAW ON SUBSURFACE RESOURCES], reprinted in RUSSIA AND THE REPUBLICS LEGAL MATERIALS 4 (John N. Hazard & Vratiss Lov Pecheta eds., 1992). See also, Regulations on the Procedure for Licensing the Use of the Subsurface, effective August 15, 1992, art. 8.2, for a similar provision.

a way that subsequent legislation will not adversely affect their rights. One method of insuring such stability is the inclusion of a stabilization clause in the underlying contract that limits the applicability of laws to those in effect at the time the license is issued.<sup>9</sup> An alternative approach is to provide that the agreement is governed by accepted principles of international law, even though this approach is becoming unpopular among sovereign governments.<sup>10</sup> The use of a stabilization clause would be of great value in an international arbitration proceeding, even though it may be subject to challenge by the host government. This issue has not been addressed in any of the existing legislation related to either foreign investment or the oil and gas industry in Russia.

The Law on Subsurface Resources contains a provision on the settlement of disputes, which only refers to settlement by state governmental bodies, or by state courts or state arbitration tribunals.<sup>11</sup> A list of the types of disputes that may be brought before a state court or arbitration tribunal are listed,<sup>12</sup> but there is no mention of third party international arbitration as an alternative method of dispute resolution. There is, however, a provision in the Law on Foreign Investment in the RSFSR that permits foreign investors and state enterprises to agree to resolve their disputes through private arbitration, or to use international treaties for the settlement of conflicts related to foreign investments.<sup>13</sup> In the past, various Russian enterprises and ministries have been willing to accept international arbitration under the rules of the Arbitration Institute of the Stockholm Chamber of Commerce,<sup>14</sup> the International Chamber of Commerce<sup>15</sup> or the UNCITRAL<sup>16</sup> Arbitration Rules.<sup>17</sup> In

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9. BLINN, *supra* note 7, at 302.

10. *Id.*

11. LAW ON SUBSURFACE RESOURCES, *supra* note 8, art. 50.

12. LAW ON SUBSURFACE RESOURCES, *supra* note 8, art. 50. Listed are disputes concerning the use of underground resources, the denial or suspension of a license, and technology and environmental regulation. *Id.*

13. The Law on Foreign Investment in the RSFSR, effective July 4, 1991, art. 9, *reprinted in* RUSSIA AND THE REPUBLICS LEGAL MATERIALS, *supra* note 8 [hereinafter Law on Foreign Investment].

14. Arbitration Rules of the Stockholm Chamber of Commerce in force from 1 January 1988, *reprinted in* 1989 Y.B. COM. ARB. XIV, 251-52.

15. INTERNATIONAL CHAMBER OF COMMERCE, RULES OF CONCILIATION AND ARBITRATION, ICC PUB. NO. 447 (1988), *reprinted in* 28 I.L.M. 231 (1989).

16. United Nations Commission on International Trade Law.

17. UNCITRAL Arbitration Rules as adopted by the United Nations Com-

addition, they have been willing to accept a neutral venue for such arbitration proceedings, such as in Stockholm, Sweden.<sup>18</sup>

Because these two issues are critical to long term foreign investment in Russia, they have received a lot of attention from the E&P Licensing Group, and should be carefully considered by the Russian drafters of the Law on Oil and Gas.

### III. HANDLING OF FUNDAMENTAL PRINCIPLES BY UH PROJECT

The Proposed Licensing Code, prepared by the E&P Licensing Group in February 1992, was divided into six separate subchapters and covered a broad spectrum of topics.<sup>19</sup> The manner in which the Proposed Licensing Code addressed the fundamental issues described above is discussed in this section.

#### A. *Rights to Export and Retain Proceeds*

The E&P Licensing Group approached the right to export in a rather unusual fashion. The specific right to "export or otherwise freely dispose of Petroleum produced" from a license area was included in the description of a Production License that granted the licensee various exclusive rights.<sup>20</sup> The Production License established the essential right to export, but it required the details to be developed in contractual provisions that would be set forth in contracts<sup>21</sup>. In that regard, the Proposed Licensing Code provided that the Production License may "take the form of any agreement, including without limitation a Production Sharing License,"<sup>22</sup> thereby making it clear

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mission on International Trade Law on Apr. 28, 1976, compiled from U.N. Doc. A/CN.9/IX/CRP.1, as amended (see A/CN.9/SR.176 and A/CN.9/SR.177), reprinted in 15 I.L.M. 702 (1976).

18. Joint Venture Law, *supra* note 4, app. 3, art. III (20). "Disputes between joint enterprises with the Soviet State, cooperative, and other social organizations . . . [may] be settled . . . by agreement of the parties, in an arbitration tribunal." *Id.*

19. PROPOSED PETROLEUM CODE OF THE RUSSIAN FEDERATION, PART I, LICENSES (1992) 15 HOUS. J. INT'L L. 641 (1993) [hereinafter PROPOSED LICENSING ACT]. For a thorough analysis of all aspects of the Proposed Licensing Act, see, Gary B. Conine, *Petroleum Licensing: Formulating an Approach for the New Russia*, 15 HOUS. J. INT'L L. 317 (1993) [hereinafter *Formulating an Approach*].

20. PROPOSED LICENSING ACT, *supra* note 14, art. 6(b).

21. PROPOSED LICENSING ACT, *supra* note 14, art. 6(b).

22. PROPOSED LICENSING ACT, *supra* note 14, art. 6(b).

that the Production License itself was to be in the form of an agreement. One of the assumptions behind the drafting of such wording was that the Production License would normally be a tax/royalty concessionary type arrangement<sup>23</sup> since the Russian legal system at the time of the preparation of the Proposed Licensing Code consisted mainly of tax and royalty laws and regulations.<sup>24</sup> In addition, the E&P Licensing Group had received considerable feedback from its Russian counterparts to the effect that the use of the word "concession" carried with it negative connotations both from the Soviet experience in the 1920's, and the traditional concession system that was used in the Middle East until the 1960's.

The definition of a Licensee was structured in such a way as to make it clear that there could be one or more holders of rights under a License.<sup>25</sup> By providing that there could be multiple Licensees under a License, and that a Production License was to be an agreement unto itself, the drafters of the Proposed Licensing Code clearly intended that the Licensees could obtain and hold rights in undivided interests in their individual corporate capacities without having to form a joint company with the other Licensees. Therefore, the Licensees would have had the authority to sell produced petroleum in their individual capacities and to retain the proceeds from such sales abroad in their own bank accounts.

In addition, the E&P Licensing Group prepared a separate article relating to currency and exchange regulations.<sup>26</sup> It was expressly stated that when a Licensee is a foreign national it shall have the right to retain abroad all foreign currency proceeds generated outside of Russia, that are received from the sale of Russian crude oil.<sup>27</sup> This provision reflected the principle outlined above in Section II.A of the Proposed Licensing Code. The proposed license also would have given the foreign investor the right to re-export foreign currency funds from the

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23. See *supra* note 7.

24. Valery Kryukov & Arild Moe, *The Changing Structure of the Russian Oil Industry*, 12 OIL & GAS L. & TAX'N REV. 367, 368 (1991).

25. PROPOSED LICENSING ACT, *supra* note 19, art. 2. A Licensee was defined as "any holder or holders of rights under a License, granted in accordance with this Act, and such holder or holders and their successors and assigns."

26. PROPOSED LICENSING ACT, *supra* note 19, art. 65.

27. PROPOSED LICENSING ACT, *supra* note 19, art. 65(a).

Russian Federation free of any withholding taxes.<sup>28</sup> Such a provision was included in order to make it clear that there should be no penalty for bringing foreign currency back into Russia for the purpose of meeting local obligations or investing in other projects. Finally, the proposed Licensing Code would have provided the foreign national with the right to open foreign currency bank accounts, presumably either within or outside Russia<sup>29</sup>. Thus, the foreign investor would have had all of the rights necessary to satisfy the fundamental principle of retaining proceeds of sales of crude oil abroad in foreign bank accounts.

### B. Operational Control

The E&P Licensing Group viewed the issue of operatorship as one to be determined by the Licensees. Therefore, it was proposed that the operator should be chosen from among a group of "Co-Licensees" and that governmental representatives would be notified as to the choice.<sup>30</sup> The operator would be responsible for carrying out the Petroleum Operations in the License Area,<sup>31</sup> and would serve as the liaison between the Licensees and the "Competent Authority."<sup>32</sup> The Licensees, of course, would have to prepare a separate joint operating agreement that detailed the specific responsibilities of the operator. The strength of this provision, however, is that it provides multiple licensees with the flexibility to appoint the operator from among their own ranks based on superior financial, managerial, and technical expertise, as well as the magnitude of the investment being undertaken. Multiple Licensees would, therefore, have the opportunity to appoint a foreign investor as the operator, with the guarantee of control over most phases of the project.

### C. Flexibility

From the outset of the UH Project, the Russians stated a preference for the establishment of a system of competitive

28. PROPOSED LICENSING ACT, *supra* note 19, art. 65(b).

29. PROPOSED LICENSING ACT, *supra* note 19, art. 65(d).

30. PROPOSED LICENSING ACT, *supra* note 19, art. 60(a).

31. PROPOSED LICENSING ACT, *supra* note 19, art. 60(a).

32. PROPOSED LICENSING ACT, *supra* note 19, art. 60(c).

bidding for the award of licenses to use subsurface resources. This preference was followed in the Proposed Licensing Code inasmuch as the E&P Licensing Group recommended that Production Licenses be granted by auctions, tenders or negotiation.<sup>33</sup> A set of criteria was also offered as a means of determining when to use an auction, tender, or negotiation to grant a Production License.<sup>34</sup> Whether or not petroleum reserves were known to exist in any particular area, auctions, or tenders could be used, except that it was recommended that tenders be used for granting Production Sharing Licenses.<sup>35</sup> Production splits and several other commercial terms of a production sharing transaction require some negotiation, as is permitted under the tender system.

It was recommended that either a Production License or a Production Sharing License could be granted by negotiation, for areas where reserves of petroleum are known to exist, but "where operations will involve great difficulty or inaccessibility, or complex development operations are required."<sup>36</sup> This type of limited exception was viewed as a requirement for flexibility because there are so many discovered oil and gas fields in Russia that are in remote areas and involve complex development operations,<sup>37</sup> and because the new petroleum legislation should be designed to cover all potential circumstances. As the second exception to the rule, it was recommended that a Production License could be granted by means of negotiation in the event that there are no or very few bids at auction or responses to a tender.<sup>38</sup> Such a situation could occur in areas that are

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33. PROPOSED LICENSING ACT, *supra* note 19, art. 7(b).

34. PROPOSED LICENSING ACT, *supra* note 19, art. 7(c). The variables to be considered are as follows:

- (1) existing data relating to the area;
- (2) the prospectivity of the area;
- (3) the accessibility of the area;
- (4) the difficulty and risk involved in operations required to exploit reserves in the area; and
- (5) the complex nature of development operations in an area where known reserves exist.

*Id.*

35. PROPOSED LICENSING ACT, *supra* note 19, art. 7(d).

36. PROPOSED LICENSING ACT, *supra* note 19, art. 7(e).

37. See, e.g., *MMM Consortium Signs Agreement on Sakhalin Shelf Oil Fields*, REUTER TEXTLINE, Apr. 20, 1992, available in LEXIS, World Library, Tخته file.

38. PROPOSED LICENSING ACT, *supra* note 19, art. 7(e).

deemed to be either non-prospective or of marginal value, wherein the tool of negotiation could lead to a mutually beneficial arrangement that otherwise would not be possible.

The Proposed Licensing Code would have built-in flexibility created by the negotiation option described above, taken in combination with the proposal that a Production License be in the form of an agreement. Under the appropriate circumstances, the Proposed Licensing Code would have made it possible to negotiate a tax/royalty arrangement or a production sharing arrangement or participate in a competitive bid for a risk service contract. The E&P Licensing Group viewed such contractual arrangements as the preferred alternative to the old joint venture company method of investment. The flexibility was added to permit unusual development projects to be undertaken following negotiations, while simultaneously recommending a usable competitive bidding system for more standard exploration and production opportunities.<sup>39</sup> The E&P Licensing Group believed that by following such a system, the new petroleum legislation would be much more attractive to foreign investors than the old Soviet system.<sup>40</sup> In reality, however, the shadow of the "umbrella" nature of the Law on Subsurface Resources hung over the E&P Licensing Group's efforts regarding the inclusion of negotiations as a method of obtaining a License. One of only five actions listed in an anti-monopoly clause of the Law on Subsurface Resources prohibits government and administrative bodies from "replacing the system of competition for access to subsurface resources with direct negotiations."<sup>41</sup> An amendment of the Law on Subsurface Resources would be required to eliminate the prohibition, or the drafters could attempt to make the new Law on Oil and Gas supersede the Law on Subsurface Resources. The E&P Licensing Group took the latter approach by recommending the inclusion of a statement on the primacy of the Proposed Licensing Code as follows: "To the extent this Act is inconsistent with any other decree, law or regulation promulgated before the date this law is enacted, the

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39. See PROPOSED LICENSING ACT, *supra* note 19, arts. 24-26, for the precise methods recommended for the granting of licenses by auction, tender and negotiation.

40. For a description of the old Soviet oil industry and the changes that have taken place, see Kryukov & Moe, *supra* note 24, at 367.

41. LAW ON SUBSURFACE RESOURCES, *supra* note 8, art. 17.

provisions of this Act shall prevail.<sup>42</sup> It was an aggressive position to take, but it appeared to have the best chance of succeeding under the circumstances.

#### D. *Stability and Arbitration*

The Proposed Licensing Code covered the issues of stabilization and international arbitration in two separate articles, although there was some overlap with respect to provisions on the stability of contractual rights.<sup>43</sup> These two articles represented a compromise among the members of the E&P Licensing Group, but they also reflected principles that are generally recognized in the international oil industry.

The E&P Licensing Group utilized both methods referred to in Section II.D for ensuring the stability of contractual rights. First, it was recommended that the License be interpreted and governed by the laws of the Russian Federation "insofar as such laws are not inconsistent with principles of law applied internationally."<sup>44</sup> Thus, the objective of internationalizing the interpretation of a License could be accomplished. In addition, it was recommended that such applicable laws of the Russian Federation should only be "those laws (including tax laws) in effect on the date a License is issued."<sup>45</sup> Moreover, subsequent changes in any such laws would apply "only to the extent that they do not increase the economic burdens or reduce the rights or economic benefits of the Licensee."<sup>46</sup> Even though applicable laws on safety, conservation and environmental protection were excepted from the basic stability provision, if there were changes in such laws that increased the economic burden of the Licensee, the Competent Authority would have been obligated to meet with the Licensee to negotiate amendments to the License that would offset such burdens.<sup>47</sup> Such an approach to stability could be viewed as a wrap-around method, one that was intended to deal with every possible adverse alteration of the legal regime.

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42. PROPOSED LICENSING ACT, *supra* note 19, art. 73.

43. See PROPOSED LICENSING ACT, *supra* note 19, art. 66 (on arbitration) and art. 67 (on applicable laws).

44. PROPOSED LICENSING ACT, *supra* note 19, art. 67(a).

45. PROPOSED LICENSING ACT, *supra* note 19, art. 67(b).

46. PROPOSED LICENSING ACT, *supra* note 19, art. 67(b).

47. PROPOSED LICENSING ACT, *supra* note 19, art. 67(b).

International arbitration was the only method of dispute resolution that was recommended by the E&P Licensing Group. Even so, two options were included in an attempt to give the Russian counterparts an opportunity to choose the most acceptable variant of international arbitration. The first option would have permitted international arbitration under the Rules of Conciliation and Arbitration of the International Chamber of Commerce in Stockholm, Sweden.<sup>48</sup> The second option would have provided for international arbitration under the auspices of the Stockholm Chamber of Commerce using the UNCITRAL Arbitration Rules in Stockholm, Sweden.<sup>49</sup> Included in the second option was a provision requiring the arbitrators to "take account of principles of law applied internationally, including those laws which have been recognized by international tribunals . . . ."<sup>50</sup> This not only would have given the arbitrators express evidence of the international character of a License, but it would have also added strength to the stabilization provisions by including overlapping references to accepted principles of international law.

The E&P Licensing Group also proposed that there should be a prohibition against the nationalization or expropriation of the rights and property of Licensees "except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation in the form of freely convertible currency and following advance notice and an opportunity to discuss . . . with the responsible authorities."<sup>51</sup> The compensation was set at the "fair market value" of the property prior to the taking and must include interest at a reasonable commercial rate.<sup>52</sup> This formulation borrowed many elements from the current position of the United States on the

48. PROPOSED LICENSING ACT, *supra* note 19, art. 66 [(a)].

49. PROPOSED LICENSING ACT, *supra* note 19, art. 66[(a)].

50. PROPOSED LICENSING ACT, *supra* note 19, art. 66(c).

51. PROPOSED LICENSING ACT, *supra* note 19, art. 68 (on expropriation and compensation).

52. PROPOSED LICENSING ACT, *supra* note 19, art. 68. "Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable and be freely transferable at the prevailing market rate of exchange on the date of expropriation". *Id.* Fair market value is not defined in the code.

law of foreign relations,<sup>53</sup> with the exception of the use of the old standard of "prompt, adequate and effective" compensation versus the new test of "just compensation."<sup>54</sup> Nevertheless, the text of this provision set forth a basic requirement of international law that there must be compensation for the taking of property from a foreign investor.

These clauses of the Proposed Licensing Code would provide adequate protection from the foreign investor's viewpoint, but they may be viewed as being somewhat overreaching by the more nationalistic members of the various Russian drafting committees. In any event, such provisions reflect the types of legal protection against risk that are necessary in order to attract long term foreign investment in the international oil industry.

#### IV. THE RUSSIAN DRAFTING EFFORTS

##### A. *Transitional Problems*

The confusion caused by the forces of revolutionary change in the Russian Federation during 1992 resulted in several changes in the makeup of the group of Russians that was charged with the responsibility of drafting a new Law on Oil and Gas. In addition, various competing drafts of a new Law on Oil and Gas were prepared by several different Russian organizations. The Russians who were involved with the E&P Licensing Group served on a petroleum task force appointed by the

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53. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 712 (1987) (hereinafter RESTATEMENT).

A state is responsible under international law for injury resulting from:

- (1) a taking by the state of the property of a national of another state that
  - (a) is not for a public purpose, or
  - (b) is discriminatory, or
  - (c) is not accompanied by provision for just compensation.

*Id.*

54. *Id.* See, cmts. b, c and d. *But see* Treaty Concerning the Encouragement and Reciprocal Protection of Investment, June 17, 1992, United States - Russia, art. III, 31 I.L.M. 794 (1992) [hereinafter U.S. - Russia Bilateral Investment Treaty], which uses the old formula of prompt, adequate, and effective compensation and follows the same formula recommended by the E&P Licensing Group.

The concept "prompt, adequate and effective" compensation "has been incorporated into a substantial number of bilateral agreements negotiated by the United States" although developing states strongly resist inclusion of such language. RESTATEMENT § 712, cmt. c.

former Minister of Fuel and Energy, Vladimir Lopukhin. This task force reviewed the Proposed Licensing Code and prepared its own draft of what was entitled the Law of the Russian Federation on Oil and Gas in the spring of 1992. The Western members of the E&P Licensing Group prepared comments concerning the draft and submitted a reformulated version of the draft Law on Oil and Gas, dated July 30, 1992. At about the same time, a new Joint Parliamentary Commission ("Joint Commission"), sponsored by the Supreme Soviet's Committee on Industry and Fuel and the Committee on Ecology and Natural Resources, was established. The Joint Commission was represented by many different governmental agencies, but many of its members had served on the original petroleum task force that was associated with the E&P Licensing Group. On September 7, 1992, then Deputy Prime Minister Viktor Chernomyrdin signed a decree that formed a new Inter-Departmental Commission, for the purpose of preparing a draft of the Law on Oil and Gas,<sup>55</sup> even though the Joint Commission was still engaged in the process.

The Joint Commission published its draft of the Law on Oil and Gas on October 14, 1992, and the University of Houston hosted a conference on November 10, 1992 in Houston, Texas, to discuss its contents. This draft followed the UH Project's Proposed Licensing Code to a large extent, although there were several discrepancies and omissions that were deemed to be significant. This draft became known generally as the "Gazeyev Draft," having been named after the appointed head of the Joint Commission, Mansur Gazeyev of the Ministry of Fuel and Energy.

The drafting work of the UH Project officially came to an end on July 31, 1992, at which time the World Bank representatives began coordinating review efforts among academicians, governmental agencies, and industry representatives. Thereafter, a new oil industry group, the Petroleum Advisory Forum, was formed to monitor developments in the Russian oil and gas industry. The Petroleum Advisory Forum established a Legal and Legislative Committee, which began its work by reviewing the Gazeyev Draft of the Law on Oil and Gas. The Legal and Legislative Committee prepared comments concerning

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55. Decree of the Government of the Russian Federation No. 1648-r, Sept. 7, 1992.

the Gazeyev Draft and submitted them for consideration about the same time it became known that the Inter-Departmental Commission had produced its own draft of the Law on Oil and Gas. At that time, it was believed that there were only two competing drafts, the Gazeyev Draft and another prepared by the VNIIOENG Institute, which competition was already viewed by the press as a "battle of the drafts."<sup>56</sup> It did not become apparent immediately, but the Joint Commission had fallen out of favor and was essentially put out of business by the Inter-Departmental Commission by the end of 1992.

In January 1993, the Inter-Departmental Commission produced its first draft of the Law on Oil and Gas, which was eventually distributed to the World Bank, the Petroleum Advisory Forum and other groups, for review and comment. The first draft was known as the "Perchik Draft," having been named after the head of that drafting committee, Alexander Perchik. The members of the Petroleum Advisory Forum's Legal and Legislative Committee<sup>57</sup> reviewed the original Perchik Draft and subsequent drafts in detail and submitted written comments.

Both the Gazeyev Draft and the Perchik Draft are fairly consistent with the contents of the Law on Subsurface Resources, with some exceptions.<sup>58</sup> It is worthy to note, however, that the Gazeyev Draft followed many of the recommendations of the Proposed Licensing Code, including the option to obtain a License by means of negotiation under exceptional circumstances. This exception to the Law on Subsurface Resources was not included in the Perchik Draft. In general, the Perchik Draft represented a step backward for those who had been involved in the process of offering suggestions concerning the Law on Oil and Gas. Set forth below is an analysis of the manner in which the Inter-Departmental Commission deals or fails to deal with

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56. *Oil and Gas Law: The Battle of the Drafts Continues*, RUSSIAN PETROLEUM INVESTOR, Nov. 1992, at 21.

57. The membership of the Petroleum Advisory Forum's Legal and Legislative Committee includes legal representatives from Exxon, Conoco, British Petroleum, Chevron, Occidental Amoco, Mobil, Elf, Marathon and SIPM, many of whom participated on the UH Project's E&P Licensing Working Group. The author is Conoco's representative on the committee.

58. For a general comparison of the two drafts, see Gary B. Conine, *Petroleum Laws of the Russian Federation*, 44 INST. ON OIL & GAS L. & TAX'N 30 (1993).

the fundamental principles that are important to foreign investors.

*B. The Approach of the Inter-Departmental Commission*

Whereas in 1991 and 1992, the Russians exhibited a zest for reform and new thinking, the Inter-Departmental Commission's work reveals a tendency to return to a more conservative approach. Mr. Perchik's introduction to the draft sets the tone for the document by stating that the law "shall emphasize the uniformity of the procedure for granting the subsoil for usage and control by the state . . . ."<sup>59</sup> The introduction also describes the nature of the draft as an "umbrella type" law, which sets out general principles that are to be supplemented by detailed specifications in subsequent legislation.<sup>60</sup> Therefore, it appears that the umbrella of the Inter-Departmental Commission draft is intended to fit within the umbrella of the Law of Subsurface Resources. By taking such an approach, the drafters were forced to prepare general principles that leave many questions unanswered about the requirements for obtaining a License and operating in Russia instead of presenting specific provisions that establish a clear and unambiguous licensing system. The Commission appears to have overlooked the urgent need for specific legislation that will provide the details that are so needed in order to develop a workable licensing system for the Russian oil and gas industry.

Even though the Perchik Draft does not include any provisions for direct negotiations as a method for obtaining a License, the introductory remarks imply that there is still a possibility that the Law on Subsurface Resources will be amended by removing the express prohibition against negotiations. Here again, however, the Russian drafters plan to wait for future legislation to provide such a modification.<sup>61</sup> This "scheme" being followed by the Inter-Departmental Commission will probably fail due to the ongoing political turmoil in Moscow and the complicated legislative amendment process. A more progressive approach would have been to include conflicting

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59. Concept of the Law of the Russian Federation on Oil and Gas, draft of the Inter-Departmental Commission, received March 22, 1993, at 2 [hereinafter Inter-Departmental Commission Draft].

60. *Id.* at 5.

61. *Id.*

provisions in the Perchik Draft while simultaneously offering amendments to existing legislation that would eliminate the conflicts.

One of the primary concerns of the Inter-Departmental Commission is reflected by the placement of a section on state regulation immediately after the introductory general provisions, which reveals the high priority that the Inter-Departmental Commission places on control mechanisms. In the Gazeyev Draft, the provisions on state regulation were placed at the end of the document. As the formulation of price and tariff policy is stated as one of the objectives of state regulation, the impression is given that the state will set prices and tariffs rather than relying on the forces of a free market economy.<sup>62</sup> By placing such an emphasis on state regulation, the Inter-Departmental Commission gives a clear signal of the continuing relevance of the old Soviet system.

### 1. Inflexibility and the Joint Venture Company

Article 12 of the April 1993 draft of the Law on Oil and Gas permits either the establishment of a new legal entity or a "joint activity agreement" to be executed in order for "a group of legal entities" to obtain a License to use the subsurface, but the "holder of the license shall be the person who won the contest (auction)."<sup>63</sup> The new legal entity would have to be either a joint venture company,<sup>64</sup> or a joint stock company,<sup>65</sup> registered in Russia, although the clear preference from the Russian point of view appears to be the joint venture company. Neither the Law on Subsurface Resources nor the Regulations

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62. *Id.* art. 4.

63. Law of the Russian Federation on Oil and Gas (Apr. 1993 draft) art. 12 [hereinafter April 1993 Draft].

64. See Joint Venture Law, *supra* note 4 (setting out general provisions applicable to joint enterprises as well as provisions dealing with participants, property, rights, procedures, taxation, control, and personnel of joint enterprises).

65. See Statute on Joint Stock Companies, Decree of the Council of Ministers of the RSFSR, No. 601, Dec. 25, 1990, art. I(i) (defining a joint stock company as "an organization which is created by voluntary agreement between legal and physical entities, including foreign legal and physical persons, who combine their resources by the issuance of stock, and which has the purpose of satisfying social needs and earning a profit"); art. II(ii) (establishing that "[f]oreign legal and physical entities may also by [*sic*] founders in accordance with the laws on foreign investment.").

on the Procedure for Licensing require the formation of such a new legal entity as a prerequisite to obtaining a license.<sup>66</sup> Consequently, if a foreign investor intends to obtain an interest in the license with a Russian entity, it must first form a joint venture company with that Russian entity in accordance with the applicable laws of the Russian Federation.<sup>67</sup> There are no apparent exceptions to this rule. The only alternative available to the foreign investor is to attempt to obtain the License on its own, an impracticality in that there is usually a Russian production or geological association with which the foreign investor must deal in connection with the acquisition of a License.<sup>68</sup>

As currently drafted, Article 12 of the draft does not provide any flexibility to groups of potential licensees that desire to hold an interest in a license under a contractual arrangement in which each party would own its participating interest share of the production and would dispose of its share of the production in its individual capacity.<sup>69</sup> This type of contractual arrangement would give the individual parties access to and control of the flow of the proceeds from the sales of petroleum, and some control over managerial and operational decision making processes, if it is appointed to be the operator for the project.

None of the advantages of such a contractual arrangement is available to the investors once a Russian joint venture company is formed.<sup>70</sup> All of the operational functions are carried out through the joint venture company, such as the sale of petroleum, the payment of dividends, and the establishment of bank accounts.<sup>71</sup> As a consequence, the joint venture company serves as an obstacle to the investors' enjoyment of the benefits

66. See Law on Subsurface Resources, *supra* note 8, arts. 11-14 (detailing procedures for granting and denying licenses); Regulations on the Procedures for Licensing the Use of the Subsurface, *supra* note 8.

67. April 1993 Draft, *supra* note 63, art. 12; see Law on Foreign Investment, *supra* note 13, art. 12.

68. Kryukov & Moe, *supra* note 24, at 367.

69. See April 1993 Draft, *supra* note 63, art. 12; see also Statute on Joint Stock Companies, *supra* note 65 (describing procedure for formation of joint stock companies in Russia).

70. See *World Review: Analysis of Structures Used for Oil/Gas Exploration/Production Contracts*, BARROWS WORLD PETROLEUM ARRANGEMENTS XXXIX (1991) [hereinafter *World Review*] (analyzing the disadvantages of an incorporated joint venture).

71. Joint Venture Law, *supra* note 4, app. 3, art. II.

derived from the project because sales must be made jointly and profits cannot be shared except through the dividending process.<sup>72</sup> The joint enterprise charter will determine what range of issues require a unanimous decision of its governing body, the board of founders.

The interposition of the joint venture company between the individual investors and the flow of proceeds from sales of petroleum also creates several practical problems in terms of banking regulations and currency conversion laws. In order to establish a foreign bank account, the joint venture company must obtain a special permit from the Russian authorities, and even if it is given such a permit, it will be in the name of the joint venture company, not the individual investors.<sup>73</sup> Consequently, after payment of loans, the proceeds earned from foreign sales of petroleum will have to be brought back into Russia and placed in the joint venture company's Russian bank account, where the proceeds will be subject to currency conversion requirements, which are currently 50% of foreign currency revenues.<sup>74</sup> The remaining hard currency will be subject to the dividending process, leaving the investors with no certainty concerning the availability of hard currency when the dividends finally become available.<sup>75</sup> If the foreign investor wishes to repatriate any dividends it may receive in hard currency, such dividends will be subject to withholding taxes of 5%-15%, depending on which tax treaty is applicable.

In its pure form, the joint venture company is an inflexible investment mechanism that may not be viewed favorably by financial institutions because the foreign investor will not be seen to have any significant operational or financial control of the corporate entity. Therefore, funding from such financial institutions will be difficult to obtain unless substantial modifications can be made in the structure of the joint venture company, such as providing access to individual shares of petroleum and revenues. If an international oil company is forced to form a joint venture company to conduct petroleum operations, it will be sacrificing some of the protection from risk

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72. Joint Venture Law, *supra* note 4, app. 3, art. III(31).

73. Russian Central Bank Instruction No. 7, June 27, 1992, *as amended* by Letter No. 17, Sept. 15, 1992.

74. *Id.*

75. *Id.*

that it normally requires. These disadvantages of the joint venture company are of such critical importance that in many cases where a corporate entity is required, the shareholders make arrangements among themselves to provide direct access to the crude oil and the proceeds from sales.<sup>76</sup> As a consequence, the joint venture company's role is diluted and the shareholders act as though they are working under a contractual arrangement.

There is no flexibility with respect to the method of granting of a License either, inasmuch as Article 14 of the draft limits the means of granting Licenses to "competitions and auctions."<sup>77</sup> There is no mention of negotiations whatsoever, not even in connection with the contest (tender) system.<sup>78</sup> This approach is exactly the opposite from the one recommended by the E&P Licensing Group,<sup>79</sup> but it is fairly consistent with the Law on Subsurface Resources<sup>80</sup>.

Based on the foregoing, it is apparent that Articles 12 and 14 of the draft Law on Oil and Gas should be rewritten so as to permit two or more legal entities to have the option to cooperate through a contractual arrangement and enter into negotiations under limited circumstances, respectively, in order to obtain a License for the use of the subsurface resources.

## 2. Inconsistencies and Omissions

The new draft of the Law on Oil and Gas declares that contracts shall be used in connection with the issuance of Licenses, but does not refer to concessions, production sharing agreements or service contracts.<sup>81</sup> There is no mention of these types of agreements, even though such options are included as contractual forms in the Law on Subsurface Resources.<sup>82</sup> The omission of tax/royalty concession agreements is probably attributable to the extreme sensitivity about concessions referred to

76. *World Review: Analysis of Structure Used for Oil/Gas Exploration/Production Contracts*, *supra* note 70, at 39.

77. April 1993 Draft, *supra* note 63, art. 14.

78. *Id.*

79. See *supra* text accompanying notes 36-40.

80. LAW ON SUBSURFACE RESOURCES, *supra* note 8, art. 13.

81. April 1993 Draft, *supra* note 63, art. 17.

82. LAW ON SUBSURFACE RESOURCES, *supra* note 8, art. 12.

in Section III.A.<sup>83</sup> Nevertheless, the tax/royalty concession agreement form should be included as a contractual form because the basic Russian system currently in existence is comprised of tax and royalty laws and regulations.<sup>84</sup> The exclusion of references to the three types of agreements is inexplicable because prior drafts referred to some or all of them. This should be remedied by a return to a reference to optional contract forms. In addition, the main elements of the types of contractual arrangements that are available should be included in order to give the foreign investor an idea of what is intended.

An apparent lack of understanding concerning the ownership of and the right to use property is also revealed by a provision that gives the Licensee the exclusive right to use movable or immovable property the value of which was "reimbursed under the terms and conditions of the License" during the entire term of the License.<sup>85</sup> All such property is said to be state property,<sup>86</sup> which is a general principle of production sharing agreements and not service contracts. This is a good example of one of the problems created as a result of the Inter-Departmental Commission's decision to make the Law on Oil and Gas an umbrella type statute.

Article 17 of the draft contains a list of "general and specific requirements" that will be defined in the License, but the list is extremely general in nature.<sup>87</sup> For example, the term, "rights and obligations of parties," is too ambiguous.<sup>88</sup> Article 17 would be the correct place to list the rights of the licensee, such as the right to export its share of crude oil, the right to retain proceeds from sales abroad and the right to open foreign bank accounts. None of these essential rights has been included in the draft, revealing the lack of awareness of matters deemed important by foreign investors. These issues have been addressed by the Petroleum Advisory Forum's Legal and Legislative Committee, as well as by the other groups that have reviewed and commented on the various drafts of the Inter-Departmental Commission.<sup>89</sup>

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83. See *supra* text accompanying notes 23-24.

84. *Id.*

85. April 1993 Draft, *supra* note 63, art. 18.

86. *Id.*

87. *Id.* art. 17.

88. *Id.*

89. Among these other groups is a representative body of the World

A significant oversimplification of the latest draft is its treatment of expropriation, nationalization, and stabilization. The Law on Subsurface Resources does note the need to provide a licensing system that includes "necessary guarantees for holders of Licenses (including foreign License holders) and the protection of their rights to use subsurface resources,"<sup>90</sup> and to provide for the settlement of disputes by a court or arbitration panel.<sup>91</sup> However, these fundamental issues have been addressed by the Inter-Departmental Commission only in terms of legislation that "adversely effects the economical position of the license holder."<sup>92</sup>

A section in the latest Perchik Draft states that the procedure for resolution of disputes should be contained in the License agreement, and that the parties will have the "right to appeal to international bodies for the resolution of disputes in accordance with an international treaty valid on the territory of the Russian Federation."<sup>93</sup> This approach does not cover the situation in which there is no such applicable international agreement; and, therefore, an option should be available to refer the dispute to third party international arbitration in accordance with an agreed set of arbitration rules in a neutral country.

The Russian Federation has either recently ratified or plans to ratify the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States,<sup>94</sup> which means that the International Centre for Settlement of Investment Disputes ("ICSID") might be used in a dispute resolution clause that is prepared by the Russian drafters in the future. In fact, it should be noted that the United States-Russia Bilateral Investment Treaty includes ICSID as one of the potential choices for third party international arbitration of a dispute.<sup>95</sup>

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Bank. See *supra* note 57 and accompanying text.

90. LAW ON SUBSURFACE RESOURCES, *supra* note 8, art. 15.

91. LAW ON SUBSURFACE RESOURCES, *supra* note 8, art. 50.

92. April 1993 Draft, *supra* note 63, art. 17.

93. *Id.* art. 56.

94. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159.

95. U.S. - Russia Bilateral Investment Treaty, *supra* note 54, art. VI.3.

## V. CONCLUSION

It is disappointing to note that only one of the four fundamental principles discussed in this article has been included in the most current draft of the Russian Law on Oil and Gas. The issues concerning rights to export and retain proceeds, operational control, and flexibility of investment mechanisms have been essentially reduced to the level of irrelevancy because the Russian drafters have insisted on the utilization of a joint venture company for making foreign investments. Only a procedure for the resolution of disputes and a brief stability provision have been included in the current draft. This is in direct conflict with the Russians' expressed desire to encourage foreign investment in their oil and gas industry.<sup>96</sup>

Although the outcome of the drafting process seems obvious, some sources report that the Supreme Soviet's Committees on Industry and Energy and Ecology and the Use of Underground Resources have "decided that the original Gazeyev draft was better than the compromise version developed by the governmental commission."<sup>97</sup> The two Supreme Soviet Committees have apparently developed their own concepts along with some of those employed in the Gazeyev draft and "are taking steps to bring the parliamentary version closer to the government's draft."<sup>98</sup> Whether another competing draft will result is uncertain, but additional political intrigue will be created in the drafting process.

There is also a parallel drafting effort being undertaken by the Supreme Soviet Committee on Foreign Affairs and Foreign Economic Relations of a Law on Concessionary and Other Agreements with Foreign Investors,<sup>99</sup> which is supposed to apply to all types of natural resources in the umbrella tradition.<sup>100</sup> There are several provisions in this draft, however,

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96. *See id.* pmb1.

97. *Draft of the Law on Oil and Gas Expected to be Submitted to Parliament in March*, RUSSIAN PETROLEUM INVESTOR, Mar. 1993, at 14.

98. *Id.* at 14.

99. The Law of the Russian Federation on Concessionary and Other Agreements with Foreign Investors, draft of the Committee on Foreign Affairs and Foreign Economic Relations, May 13, 1993.

100. The proposed law would cover all legal, economic, and organizational aspects of concession agreements, production sharing agreements, and service contracts. *Id.*

that should be included in the draft Law on Oil and Gas. It is hoped that attempts will be made to ensure a closer coordination of these efforts in the future.

Thus far, the concerns of foreign investors are not being adequately addressed by the Russian drafters of the new Law on Oil and Gas. What is needed is a stable and predictable investment environment in which a legal regime defines the rights and obligations of foreign investors in a clear and unambiguous fashion. If the foreign investor is not given the opportunity to use its operational, managerial, and technical capabilities in the most cost effective manner, it is very unlikely that major investments will be made in the Russian oil and gas industry in the near future. If, as some say, a new Law on Oil and Gas is enacted by the end of 1993,<sup>101</sup> it will most likely be the result of a succession of compromises between the reformist and anti-reformist factions of the Supreme Soviet. As such, the end product will probably be even weaker than the Perchik Draft and will leave many questions unanswered and many promises unfulfilled. Although such an outcome appears inevitable, the current political turmoil could lead to a more long term view emphasizing the importance of an open, stable and equitable licensing system; and providing safeguards that are necessary for significant, long term foreign investment. The E&P Licensing Group provided the types of recommendations that would make such a system a reality, and it is hoped that the Russians' future efforts will take those recommendations into consideration. In the final analysis, the political will of the majority, whether reformist or anti-reformist, will determine whether a new, progressive system is adopted.

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101. Draft of the Law on Oil and Gas Expected to be Submitted to Parliament in March, *supra* note 97.