

PROCEEDINGS

**INVESTING IN RUSSIA UNDER THE LAW ON
PRODUCTION SHARING AGREEMENTS**

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Moderated By

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Professor Streng: I would like to convene these proceedings. I am William Streng, a professor at the University of Houston Law Center, and I am very pleased to welcome you. These proceedings deal with and examine the Russian Production Sharing Agreement (PSA) legislation and generally the subject of investing in Russia.

I would briefly like to introduce each of the three speakers and then I will provide a larger introduction as each one of them comes to the podium. On my immediate left is Jim Skelton, Corporate Counsel at Conoco; next to my left is Tom Hurley, Associate General Tax Counsel at Amoco; and to his left is Charles Fee, General Tax Counsel for Exxon Ventures CIS. All of these individuals have been actively involved for some period of time with respect to Russian petroleum investments and planned investments.

The origin of this program is partly attributable to activities of the Houston Journal of International Law, in conjunction with the University of Houston Law Center's program early in the 1990s. With the funding of the companies represented here and others, a project was initiated to assist the Soviet Union first, and subsequently, the Russian Federation, with the preparation of a system of laws to facilitate investment from outside Russia, particularly from the United States, into the energy exploration and development sector in Russia. These activities in this project included developing suggestions and recommendations concerning rules about property rights and the development of production arrangements, environmental laws, and tax laws.

Being optimistic Westerners and not really not ever considering that the concept of free markets and capitalism had never been substantially utilized in Russia, we all thought, charging ahead, that we would be able to help solve these problems with some expedition. But that obviously has proved not to be the case, which is why a few years later, seven or eight years later, we are still here examining this issue. But, thanks to the Houston Journal of International Law, that project did produce some quite successful volumes concerning this subject. These volumes reflect a history of the beginning of petroleum legislation, which started with the Soviet Union and—then with its breakup at the end of 1991—continued with the Russian Federation itself.

Now the subject that we are discussing today is primarily the production sharing agreement, a fundamental concept I

would like to identify. This is a concept that was introduced in Indonesia in the early 1970s as an alternative to the previously used concession agreement. This concept of a production sharing agreement has now spread to many countries, including Russia. While the theory underlying production sharing is really simple, obviously, its implementation is far from elementary: in application it has quite a highly complicated and individualized context, particularly in the Russian Federation.

Basically, the investor signs a contract with the host country, which grants the investor the exclusive exploration and production rights for some specified period of time. The investor agrees to conduct exploration and production (E&P) operations at its own expense, and then recovers its cost. Thereafter some degree of profit splitting occurs, with the profit splitting, in some instances increasing as the profitability increases for the party that has undertaken this financial risk.

The impetus for this type of arrangement is the need for stability in this exploration and production context. These projects require huge amounts of capital investment that is recovered only from the project after some significant period of investment and deficit cash flows for the initial period. There has been legislation, at the end of 1995, introducing a production sharing agreement concept in Russia. Jim Skelton will first provide an overview with respect to that legislation.

Jim received his L.L.M. degree in International Legal Studies from N.Y.U. in 1978. He has worked for Conoco since 1980, and he has been working on Russian legal matters since 1989. He was one of the leaders of the licensing group of the University of Houston Law Center's Russian Petroleum Legislation Project from 1991 to 1993. He is an active member of the Legal and Legislative Committee of the Petroleum Advisory Forum or PAF, about which you will hear later from Tom Hurley. Mr. Skelton is the Chairman of the Legislative Subcommittee of the Energy Committee of the U.S.-Russian Business Council. Just last night he returned from a trip, first to Moscow and then Hanoi, so we want to get him to the podium quickly before jet lag sets in. He will talk about the theory behind the PSA law and conflicts with the existing legislation. Jim, welcome to the podium.

Jim Skelton: Thank you Professor Streng. It is my pleasure to be here with you this morning, and, hopefully, I will not fall into some sort of jet lag state. I did just get back

from Hanoi, where Conoco has successfully negotiated a new production sharing arrangement. It took nine months to negotiate it, whereas we are in our ninth year of discussions in Russia. The Russians are obviously on a different time schedule from some other countries.

Most of us on the podium have worked with production sharing issues on an international basis throughout our careers. Normally, a production sharing agreement (PSA) is convenient when used in a developing country that seeks an influx of money, PSAs are usually used for conducting exploration operations, not exclusively, but almost always.

The PSA is a good device for the host country because international oil companies are willing to pay bonuses to obtain the rights, and then, of course, they will perform the operations to explore the area that is covered by the PSA. That creates an influx of capital into the economy of that country, and it also gives a great opportunity to a number of people to obtain jobs and for contractors to obtain work. The more of this type of activity the host country can generate, the more benefit it will have on its economy.

You don't find PSAs in Europe, you don't see them in North America, you do not really see them much in South America, and you do not usually see them in areas that have a lot of discovered oil. Russia is, in my view, a real exception to that rule.

My first trip to Moscow occurred in October, 1989. At that time in the Soviet Union, the main contact point for the foreign investors was the Ministry of Geology. The ministry invited us to make a presentation covering the three main types of international petroleum contracts. There were a lot of young lawyers attending from various institutes in the country. Also in attendance were a few not so young KGB agents and some Ministry of Geology people, as well as the Minister. Some wonderful questions were put forward to me and the economist who was making a presentation about the related economics issues.

It was my opinion that the Russians would look at the tax royalty system, which is the modern concession agreement, as the one that was most like their administrative law system. Unfortunately, due to the bad experience with concession agreements during the 1920s, the Russians viewed these agreements as giveaways. So, concession agreements had a bad name, and they were not interested for that reason. The attendees said, in effect, "It was black

balled, so don't talk to us about that. What else can you tell us about?"

I told them that an international oil company that wants to have equity interests in various properties is not interested in service contracts. Whereas Brown & Root or Bechtel can work under a service contract as a true contractor without an equity interest in the oil, only as compensation for their services, an oil company is usually not willing to do so. So, the PSA seemed to be the one other alternative that might interest them and, as it turned out, it did interest them a bit at the time.

The only legislation connected with foreign investment in 1989 was the Joint Venture Law, which permitted a foreign investor to own an interest in a new Russian legal entity that was formed with an existing license holder to obtain the rights to develop an oil field under a reissued license. Unlike the companies for which my fellow panelists work, Conoco entered into one of those joint venture arrangements and formed the Polar Lights Company. Therefore, I have come here with all of the baggage from that experience to tell you that the PSA approach is really a better way to make large investments in Russia.

Under the joint venture system, you have no exemptions from the tax laws or anything else. Once a foreign investor is captured within a joint venture company (JVC), it is subject to all laws, lacks stability, and is not in privity of contract with either the federal government or the local government, both of which are the ones that grant the JVC the ultimate rights through the license. By contrast, upon entering into a PSA, the foreign investor will have the host country government or the state oil company (depending on where you are) in privity of contract as the rights granting authority.

One of the things that Professor Streng mentioned earlier was the general theory of the PSA. I just want to add a little more detail to his comments. As a contractor, the foreign investor under a PSA does not own the mineral rights. As a contractor, it is not in the same position as a lease holder, for instance, and, as a consequence, it should not have to pay royalties because it does not literally own or have a claim to the oil as it comes out of the ground. The oil still belongs to the mineral rights owner, *i.e.*, the government. The contractor obtains title to the oil when it lifts it at the lifting point, wherever that may be. Normally, the lifting point will be somewhere near the border or offshore the host country

because one of the most fundamental rights under a PSA is the right to export the oil so that it can obtain revenues in hard currency.

Over the years, various countries, including Indonesia, have made PSAs more of a hybrid form of investment than it was originally intended to be. Consequently, the PSA has taken on some of the characteristics of a tax royalty scheme and, as a result, I do not believe there is any such thing as a pure PSA from a technical legal standpoint anywhere in the world. The closest thing to a pure PSA is probably the Egypt model. But many of the jurisdictions are requiring royalty payments, and they are not exempting the contractor from taxes, other than profit taxes. The reason that exemption is so important is that the contractor, in making this arrangement and taking on the sole risk and expense of the operations, is also agreeing to share the profits directly with the government through the sharing of production.

Therefore, the theory is that profit sharing should be sufficient to make it unnecessary to apply all these other taxes to the contractor. If you accept that theory, then I think you can understand some of the things that we have been working toward in Russia, although it is also a hybrid situation since royalties are applicable in Russia as well. As a matter of fact, royalties can be anywhere from 6% to 16%. That is an issue for Tom and Charlie to get into a little later.

The PSA Law became effective on January 11, 1996. The first time the words were ever published officially in Russia, however, was in February 1992, when the Law on the Subsoil (Subsoil Law) was passed. The Subsoil Law provides the only available rights granting mechanism in the Russian petroleum industry, and made more certain the application of the old Soviet command system of administrative law licensing. In doing that, it essentially enshrined the old statist, nationalist approach and made it more difficult for foreign investors and the reformist legislators to convince people that indeed there is a better way.

On Christmas Eve, 1993, President Yeltsin passed a decree—a Presidential Decree on Production Sharing and its Implementation in the Russian Federation—that was quickly dubbed the “Christmas Present” because it paved the way for the executive branch to propose this new system to the legislature. By June 1995, a draft PSA Law had been passed on the first reading. To have a draft become law it has to pass three readings in the State Duma, then it goes to the

Federation Council, which is the upper house, to be passed and signed by the President.

In the first draft, there were a number of excellent provisions that would have provided the sort of stability and predictability that foreign investors and financing institutions need in a country like Russia, which is in a volatile state of transition. Unfortunately, between that time and December 1996, the opposition legislators, who viewed PSAs as some sort of wholesale giveaway of Mother Russia's natural resources, had time to, let's say, water it down and modify that draft to the point at which it became only partially viable.

Consequently, when it came into effect in January 1996, it was apparent to the reformist legislators that a lot of other laws needed to be amended, more laws needed to be passed, and normative acts had to be enacted. The conflicts that were created by this final version of the PSA Law were so striking that most foreign investors decided they were not going to go forward under the PSA Law until these conflicts and contradictions were resolved. I am going to tell you about a few of them this morning that are near and dear to my heart because they are real issues that I have been dealing with and that I was working on when I was in Moscow earlier this month.

One of the frustrating things in the PSA Law is something that I think the legislators were very serious about. In Article 1, Section 4, it is stated in a very peculiar fashion that if any other laws exist that have different provisions than the PSA Law, the PSA Law shall apply. And then it refers back to Section 1 of Article 1, which lists the areas where the PSA Law has predominance, that is conclusion, implementation, and termination, which ought to cover everything.

Unfortunately, Russia does not have a history of the rule of law. Practically speaking, if a law provides that it will apply as opposed to conflicting laws, it doesn't mean much because what is really important is the political will behind those who are dealing with those issues. Another section in the PSA Law states that nothing in the PSA Law shall contradict the way that licenses are supposed to be issued under the Subsoil Law. Therefore, one must look to both the PSA Law and Subsoil Law to determine how a license is going to be issued. The main point here is that the application of both laws creates many pitfalls that could lead to administrative law interference with a PSA.

The second problem I want to mention is a very critical issue under the Subsoil Law, which is that the only way a license may be issued is through competitive bidding. Some sort of tender or auction procedure must be completed in order to grant a license to the winner. Actually, negotiations are expressly prohibited as a means of granting a license. In Article 6, subparagraph 4, of the PSA Law, there are exceptions presented to this rule that would permit companies to enter into PSAs through negotiations under certain circumstances.

The first exception to the no negotiations rule could occur if there is a joint decision of the federal government and the local government to permit a PSA to be used. If that joint decision is made, the investor could begin negotiating a PSA with the government as long as the original license holder is included in the investor group that is conducting the negotiations. For instance, if on January 10, 1996, the day before the law became effective, Company A held the license to the field, Company A would have to be either one of the members of a consortium or one of the owners of a newly formed entity in order to qualify under this exception in the PSA Law. Now, that's what it takes just to qualify to negotiate a PSA.

One of the main objectives of the PSA Law was to turn the Subsoil Law and the administrative law primacy upside down, whereby the PSA under the civil law in Russia would be the primary rights granting method, not the license, thereby giving the license a secondary role. The PSA Law does accomplish that to some extent. In the PSA Law, once you finalize the agreement, Article 4 would require a license to be issued within 30 days of signing. Now that sounds more like a ministerial act than the absolute rights granting method. Nevertheless, the Subsoil Law still exists and must be amended to permit negotiations and to allow licenses to be issued through the PSA Law as sort of a ministerial act. This would permit the PSA to be the primary method of granting rights between the government and the investors. Without establishing this kind of set up in a clear and unambiguous fashion, I don't think this system is ever going to work. It is up to the State Duma to amend these laws to make it work.

Let me just take you briefly through the hurdles that an investor would have to go through in order to acquire rights under a PSA through negotiations. In the first stage a foreign investor must be involved with a license holder that held the license to this area before the PSA Law became

effective. Second, it must get the federal and local authorities to agree to make a joint decision to affirmatively state that they agree to allow the field to be developed under a PSA. Third, it must get a law passed by the State Duma to include that field on a list of those fields to which the PSA Law applies. Yes, this is amazing, and it has only been accomplished for seven fields thus far. One so called Law on the List has actually been passed, and others will need to be passed in order to get other fields placed on the list of those to which the PSA Law applies. When the field is included on the list, a commission may be formed with the federal and local governments to negotiate the PSA.

Once these things are accomplished and the negotiations are completed, guess what happens next? The State Duma must pass a law approving the PSA. That is an incredible hurdle in itself, but the way the State Duma is constituted today, I doubt that any of them will pass because the opposition parties run the Duma, not the parties that favor the executive branch. Clearly, they have put up quite a lot of barriers, which is going to make it very difficult to get to the finish line.

Despite all these problems, the international oil companies are going to continue to try to climb those hurdles and get around those barriers because a tremendous amount of oil has been discovered in Russia, and one of the few ways to replace their reserves these days is to be involved in Russia, the last frontier.

I think I have run out of time. Before I stop, I would like to pose two questions, which we may or may not answer today. First, have we been expecting too much from Russia, that is, have we been unrealistic in our expectations of that country in terms of the success of its transition and the ability to change its legislation? Second, in five or ten years from now, are the same opportunities that we see today in Russia still going to be available? Thank you very much.

Professor Streng: Jim, thank you very much for your comments. We would now like to continue with this discussion from a slightly different perspective, that of the immense difficulties that currently exist with the final implementation of a PSA in Russia in a specific project. Jay Cuclis, partner at Vinson & Elkins in the Houston Office, had the enjoyable opportunity of being the managing partner of Vinson & Elkins' Moscow office from 1992 to 1995. Consequently, in this context he has been regularly exposed

on behalf of his clients to the negotiation and discussion of PSA. I would like to invite Jay to come to the podium to continue this discussion. He may even tell us about flying his favorite airline, Aeroflight.

Jay Cuclis: Thank you Professor Streng, and thank you for giving me the opportunity to speak to you today. Professor Streng has given me an introduction to a line that he has heard me use in some other presentations. Given the fact that I lived in Russia for three years, I have had many occasions to travel on Aeroflight, and I would tell people that I'm the only surviving member of the Aeroflight frequent flyer program.

You know I first started traveling to the Soviet Union in 1981. It was a very different country then. That was the time of Brezhnev, and Reagan was referring to the U.S.S.R. as the "Evil Empire." And it struck me at the time when I got back to the United States from my first trip over there, how little understanding there was in the United States for how things were in the Soviet Union. Probably the most extreme example of this was a person who asked me what had been the most interesting thing I had seen in the U.S.S.R. I had responded that the most interesting thing for me in 1981 was going to Lenin's Mausoleum in Red Square. I explained that hundreds of Soviets lined up every day to march into this small building where they had Lenin's body on display under glass, and this person looked at me incredulously and said, "John Lennon?" So, one point I wanted to make before I start a more substantive discussion was that we have made tremendous progress from 1981 to 1998, particularly in the time period from 1991 to 1998. I really started working in the Soviet Union extensively in about 1991. At that point in time there was no production sharing regime, and many companies, including Mr. Skelton's company, were negotiating joint enterprises with Soviet production associations. Those joint enterprises have been fraught with difficulties, as Mr. Skelton has alluded to, and that really set the stage for the adoption of this production sharing law regime.

What I thought I would do today is outline some of the problems with the production sharing law, then talk specifically about the proposed amendments that are winding their way through the Russian legislative process. I think Mr. Skelton has given you an excellent overview of how the production sharing law works, and he has already mentioned

some of these items as flaws in the existing legislation. I just wanted to highlight four or five items that I guess most foreign investors would call significant problems with the existing legislation.

First, there is some language in the PSA Law that suggests, or can be interpreted to read, that the Russian Government may have unilateral rights to amend the contract in the event of changed circumstances. Actually, I've got the exact language of the law here, which I might quote, which is "amendments to the production sharing agreement may be made on the demand of one party in the event that circumstances change significantly provided such changes are in accordance with the civil code of the Russian Federation." This is language that as lawyers we don't like. Obviously you could interpret that provision to read that, let's say, in the event of a change in the price of oil, which some Duma deputies have publicly stated they view as a "significant change in circumstances," if you had a major change in the price of oil, then at least according to some of the legislators in Russia, they could unilaterally modify the terms of your production sharing contract. This is obviously not a desirable result from a western oil company perspective.

Second, one of the other problems I wanted to mention was the fact that there are numerous provisions of the production sharing law that conflict with the other laws of the Russian Federation, particularly the law of the subsoil. I think Jim mentioned a couple of those specific conflicts, and there are probably a dozen or so other laws of the Russian Federation that have terms that are inconsistent with some of the terms of the production sharing law. So this creates a real aura of confusion and dueling laws, and it is difficult to sort out, which law should prevail in the context of specific conflicts. This is something that really has been a problem in the Russian Federation from the time of the dissolution of the Soviet Union at the end of 1991. At that point in time, when the Russian Federation emerged from the ashes of the Soviet Union, the Russian Federation really had not adopted comprehensive commercial legislation. So when they dissolved the Soviet Union, one of the things that the Russian Legislature did immediately was to say that all Soviet laws would remain in effect in the Russian Federation to the extent that they didn't contradict Russian legislation, until such time as those laws were replaced by Russian laws. And so you've had this kind of crazy hybrid legal system at work

in the Russian Federation, where you had old Soviet laws, you had new Russian laws, and you somehow had to sort through when a Russian law overruled a Soviet law. That kind of legislative confusion has continued, particularly in the context of the PSA legislation.

The third problem area that I wanted to highlight was the area of the waiver of sovereign immunity. As you all are probably well aware, certainly when you are dealing with international agreements with sovereign countries, one of the most important provisions that you want to see in your agreement is a waiver by the government of its right to assert a sovereign immunity defense. The PSA Law provision on this is somewhat ambiguous. In fact, this is probably something that you consistently see throughout the PSA Law. It makes a certain statement that sounds good superficially, and then it says something like "except to the then extent otherwise provided under Russian law." So there is this huge gaping hole in a lot of the provisions in the PSA Law and this concept that there may be some opportunity for the government to re-trade or pull back from concessions they appear to have made in the PSA Law by adopting other Russian legislation.

The fourth area that I wanted to highlight as a problem area involves export and import rights. Again, theoretically, under the PSA Law, raw materials are supposed to be freely exported. Obviously, the reason most of the western companies are pursuing oil and gas opportunities in Russia is that they expect and count on the ability to convert those oil and gas reserves into hard currency, which means exporting those reserves. Again, there is some reference in the law to the effect that exports may be limited pursuant to the federal law in state regulation of foreign trade activities, and under this law, the Duma has the ability to restrict exports to "protect national interests" such as the depleting of non-reproducible natural resources. That is sort of awkward English, but that is a direct translation. Of course, oil and gas can certainly be classified as a non-reproducible natural resource. On the import side, there are some gaps in the legislation making it not as clear as it could be that import tariffs are exempted from the PSA, or the PSA operator is exempt from import tariffs. I think the intent was to have exemptions in import tariffs that are quite high in Russia. So that is just another area that could stand additional clarification.

Finally, the fifth point that I wanted to refer to is the area of legislative approvals required in connection with production sharing agreements. Basically, I think this is a general proposition, and the PSA Law gives the Russian legislature too much authority to tinker with these production sharing agreements. I think Mr. Skelton has given you a good run through of how many times you have to go back to the Duma in order to get one of these kinds of projects implemented. Think of the vast nature of the Russian oil and gas reserves and contrast that with Texas' reserves. Imagine, having to go and get an act of Congress every time you wanted to develop an oil and gas field in Texas, and what that would have done to the development of our local oil and gas industry.

So, all of those areas, building on that, there really has not been a very clear procedure for how specific fields will be nominated for production sharing treatment. All of this has just lead to confusion and has resulted in an inability to develop the oil and gas reserves of Russia as expeditiously as we might have hoped. Now what I would like to do is turn to some specific amendments to the PSA Law that have been proposed. Some of them address these issues I have mentioned, but some of them are still unaddressed. In the amendments themselves, as you will see, there are new provisions that are somewhat troublesome.

There are two laws now making their way through the Duma. One law would amend the PSA Law itself to address some of these ambiguities and issues that I have mentioned. The second would amend other pieces of legislation: twelve other laws that are inconsistent or arguably inconsistent with the existing PSA Law. There is also a third draft law working its way through the Duma that would purport to speed up the process in creating PSA's and getting them approved by reducing some of the bureaucratic requirements for their implementation. I will talk in a little more detail about each of these three laws.

The first law that I believe passed its first reading on June 13, 1997, and is currently in its second reading until at least April 23, 1998, purports to address a number of the issues associated with the defects in the existing PSA Law. Essentially, it covers four or five points, I believe, which I'll go through briefly.

The first is that it limits the grounds for invalidating licenses that have been issued to PSA holders. Secondly, it clarifies the procedure for establishment of fields that will be

subject to production sharing treatment. In particular, it sets out a series of criteria that would be used for determining whether a particular oil and gas prospect should be included on the PSA list. For example, one of the criteria listed is that the reserves are extremely difficult to recover, and require significant amounts of capital and advanced technology in order to properly obtain those reserves. That would be a criterion that the Duma would be required to consider in evaluating whether the particular field qualified for PSA treatment. There is also a provision in this draft law to the effect that certain oil and gas fields would be taken out of the jurisdiction of the Duma; they would automatically be qualified for PSA treatment if, in the case of an oilfield, they would recover all reserves of less than ten million tons or, in the case of a gas field, reserves of less than ten million cubic meters. So again, you can see there are some efforts to streamline this process to take the legislature out of complete control over the adoption of these PSAs.

There are also some more nationalistic provisions in this draft amendment. I think this reflects the fact that the reformers have to compromise with the Communists and others in the Duma in order to get anything adopted, given the current make up of the legislature. There is a provision that guarantees the rights of companies, Russian companies, to participate and tender for these production sharing fields. There are also other provisions guaranteeing or requiring the development or the developer of the fields to use Russian personnel or that a certain percentage of their employees be Russian. It is not uncommon in a number of companies to see those types of requirements; the ones in the draft law seem a little stronger than what you might find in other jurisdictions. Again, I think that really reflects two things: First is the nationalistic attitude that a lot of Russians have about their oil and gas reserves. Second, Russia, unlike a lot of other countries, has an extremely well developed indigenous oil and gas industry. They have been producing oil and gas in the Soviet Union for decades. If you contrast that to some of the third world countries where you have not had that level of production history or that kind of indigenous oil and gas industry, I think the tension that is at work in Russia is that the local oil and gas industry is a significant lobby, and they believe they should get certain preferential rights with respect to the development of Russia's oil and gas reserves. Not surprisingly, this causes tensions with foreign investors who are coming in and trying to

develop those reserves. In certain other countries where you have not had that long history of development or you have not had a history of an indigenous oil and gas industry, you do not have that same level of tension. Consequently, you would have negotiations directly with the government, and you would not have twenty local oil companies competing for your project.

The other issues covered by the proposed amendment to the PSA Law deal with operational issues on how operations are going to be conducted under the PSA. The whole amendment itself is only about three pages long, and clearly does not address all of the concerns that foreign investors have raised about the PSA Law. Nevertheless, I think it would certainly be a step in the right direction if that amendment were adopted.

Now, I might talk for a minute about the second law that is working its way through the legislature. That law is called the “Law and Addendum to the Legislative Acts of the Russian Federation Resulting from the Law in Production Sharing Agreements.” I will just touch on this briefly because essentially what it attempts to do is reconcile the PSA Law with various other Russian Laws that are apparently inconsistent with the PSA Law. There are about a dozen or so that are affected. The most significant of these are those along the subsoil as the basic oil and gas law of the Russian Federation, the law in the Continental Shelf, the Foreign Trade Law, the law in Customs, and then a wide range of tax laws (probably six or seven different tax laws, all of which have some apparent conflicts with the PSA Law).

Now, the third law that I mentioned—the draft law that is in the Duma now—was introduced fairly recently on January 15, 1998. As I indicated, it is designed (at least theoretically) to cut through the bureaucracy and make the implementation of PSAs more efficient. It does several things. It sets up a PSC, a sort of super commission that would be charged with overseeing the preparation of tenders and auctions and negotiation of the production sharing contracts. It sets out the terms and conditions that would be used in auctions and tenders of some of these fields, and it sets out, at least in general terms, some procedures with respect to how these PSCs in practice would be negotiated. It is not perfect either, but again, at least it shows some level of commitment by at least the reformist element of the Russian government to try to streamline the PSA process. It will be interesting to see now if Yeltsin’s nominee, Sirgee Kiryenko,

is confirmed by the Duma. Kiryenko was formerly the Minister of Fuel and Energy, so he has that kind of background. He has fairly clear reform credentials. If Yeltsin prevails in this current showdown with the Duma, it may be that Kiryenko will be an ally of the changes that are being proposed with respect to the PSA legislation.

I might talk for a minute about the Law on the List. There is really not too much to say about this subject, as I have indicated and as Jim has indicated. In order for you to have a legally valid PSA in the Russian Federation, you have to have your field put on a list that is approved by the legislature. So far, there has only been one list approved, and that list was adopted in July 1997. It covers seven areas. Two of them are hard minerals, gold and iron deposits, and the other five are oil and gas fields. There were two areas that were grandfathered in because the production sharing agreements were executed prior to the time of the adoption of the production sharing law. At least to date, I believe there are a total of seven fields that have been qualified for this PSA treatment. There are numerous laws on lists proposing other fields that are in various states within the legislature, and it is really not clear where those are going or when those will be adopted. As you can appreciate, this is a highly political process as to which of these fields are given this kind of PSA treatment. I think time will tell as to whether or not there will be additional list laws adopted. Certainly there will be. I believe there are two or three that have been introduced just recently. Once we see how the legislature handles the current political crisis with Yeltsin, maybe the legislators will turn their attention back to the more mundane, at least from their perspective, aspects of implementing or adopting these laws on lists.

I will close by saying that, as you can tell, there are still a lot of problems in the Russian Federation relating to these production sharing laws. These ambiguities need to be addressed. Personally I am optimistic though. With time, these problems will be addressed. The Russians have only been practicing capitalists now for seven or eight years. We have had 200 plus years to get our house in order with respect to our legislation; they still have been doing this less than a decade. So, I am hopeful that with time things will move in the right direction. The Russians have an expression: "Russians are slow to harness our horses, but once we get the harness on, we love to gallop." My theory is that they are

still trying to get the harness on this whole idea of capitalism, but once they do, they'll be galloping. Thank you.

Professor Streng: As I would like to note before I introduce our two taxation speakers, the Russian tax system is regularly identified as the most important factor limiting the growth of capital investment in Russia. We discovered this early on in the University of Houston Law Center project for Russian legislation, where I participated in the tax legislation development and that continues. Initially, there was some optimism that prevailed after the implementation of the new Russian-U.S. income tax treaty. Analysts were particularly optimistic since there were provisions that would supersede domestic Russian legislation and would effectively enable the foreign tax credit availability in the United States. That enthusiasm quickly dissipated when it appeared that the Duma wanted to extract so many other types of taxes to make exploration and production projects uneconomical. So today we focus upon Article 13 in the production sharing agreement legislation. This article provides the basis for the partial replacement of taxation but not the complete replacement with production sharing. With the exceptions of certain taxes like the profits tax and some other important payments, the investor is theoretically to be exempt from additional Russian federation charges, excise taxes, levies, and certain other obligatory payments—all of which might make the project uneconomical. We recognize that ultimately taxes are just another cost of doing business, but in this context they are the most important costs that can either make or break the deal. First, to address the subject, particularly with respect to the fundamental elements of Article 13, we have with us Tom Hurley, who is as I earlier mentioned, is the Associate General Counsel for Amoco, located in Houston. He is also the Chairman of the Moscow based Petroleum Advisory Forum's PAF Tax Committee. He received his Juris doctorate degree from Duquesne University School of Law. He worked at the national office of the Internal Revenue Service for awhile. He received his Master of Law in Taxation from Georgetown and in 1980, he accepted a tax attorney position at Amoco's headquarters in Chicago. He has subsequently been on assignments with Amoco in London and now Houston. He is responsible for all of the tax matters pertaining to Amoco's oil and gas related investments in Russia and in other republics of the former Soviet Union. Please welcome Tom Hurley.

Tom Hurley: Thank you for the introduction, Professor Streng, and thank you to the Houston Journal of International Law for inviting us here today. It is a real good opportunity to share some of our experiences and many frustrations as we have talked about over the years. As Professor Streng mentioned, one of the key obstacles to investment in Russia is the extremely onerous tax regime. As Jim Skelton had mentioned, there were a couple of very brave companies back in 1990, 1991, who decided they were going to take the plunge and invest in Russia under the existing regime. A great deal of thinking and decision making goes into that kind of decision. The choice is not just pure economics: a great deal of strategic thinking and positioning goes into a decision like that. But they took the plunge and many western companies basically watched what was happening. When their project started, I believe there were four or five profit based taxes imposed upon the project. Once those projects were up and running, Russia started to enact gross revenue-based taxes, which increased the number of taxes on the projects from four or five basic taxes to somewhere in the range of twenty-five to thirty taxes, most of them based on gross revenue. These projects quickly become uneconomical. Numbers have been thrown out that the overall tax rate either approached 100% or exceeded 100%. So the tax attorneys with companies like Amoco were telling their management there was no way the company can go ahead on a project and make any money. It is simply economically impossible to do.

So right from that point, those of us who were active on the Russia project started to work with various Russian ministry people and tax experts to push the idea of using production sharing contracts. As Professor Streng mentioned in his introduction, production sharing contracts have been around since the mid-1970s and have been used in numerous places. They have been used extremely successfully. Amoco brought numerous Russians to our Egyptian operation—our largest overseas operation—which has been using production sharing contracts since the 1970s with great success both for the Egyptians and the investor. Amoco tried to hold the PSA out as something that would be attractive to Russian interests. I think after examining it, Amoco felt that the Russians would buy into the concept.

To begin the Article 13 analysis, I think it might be helpful to look at a schematic of how a production sharing

contract is supposed to look.¹ With the amount of production that comes out of a field, there is a royalty that is paid to the government at a rate ranging from 6%–16%. It is a negotiated rate. The other two areas that are most important on that first line then are compensational oil or cost oil and shared oil, which is also called profit oil. The compensation oil is also a negotiated amount. You negotiate that with the government as to how much of the production from the field can be used to compensate the investor for his costs. The compensation oil may be in the range of 80%. Some fields require higher production costs, some fields require less, but say 80% of the production goes to the investor to reimburse him for his out-of-pocket costs. The remaining amount is then shared oil, or profit oil. Of the profit oil, again, that amount is also negotiated on how it is split between the investor and the government. But the amount that goes to the investor is then left where he pays profit tax on that amount. So after the profit tax is paid, the investor is basically left with a smaller amount of investor share.

That basically summarizes the structure a production sharing contract. The oil companies stressed that there was no way they could operate under the existing tax regime. A simpler plan was necessary to get these megaprojects up and running very quickly and to benefit the economy. The World Bank was a vocal supporter of PSAs at the time and were encouraging the Russian government to adopt production sharing legislation so these projects could get up and running very quickly.

That was the theory. As Jim Skelton pointed out, the theory is not always what happens in practice. The administration of a production sharing contract is obviously a lot harder that it looks on that diagram. But it is a way of simplifying things and get the projects moving based on long-standing international practice.

So, with that as just a very brief background, I would also mention that what is not on that schematic are bonus payments. Bonus payments start before you even have production. When an investor goes into the country and wants to bid on a particular field, typically there will be a bonus payment that is paid right up front to get involved in the project. After that, there may also be bonuses paid for commercial discovery of the field, and then there may also be bonuses paid at certain production levels. If you have a

¹ See Appendix 1.

highly profitable project, you would have bonuses paid at that time also.

I am going to primarily concentrate on provisions on Article 13. There has been a tremendous amount of controversy in Russia over the use of production sharing contracts that the other speakers have mentioned. It has become an extremely political issue. It is beyond logical argument in many cases because it is just a sore point for a lot of the nationalists in the Duma, and no matter how much logic you present to them, they basically are not going to change their mind. There is also a perception in Russia that PSAs are a great giveaway to the foreign investors. As far as the western investors and the oil companies are concerned the PSA a very fair and proven mechanism for going forward with these projects.

Under Article 13 of the production sharing law, there are basically several provisions that we should just briefly touch on. As I said, the investor is going to pay royalty bonuses and profit taxes imposed on the investor's share of profit production. While the Duma debated over Article 13, the western investors, the U.S. companies in particular, were very concerned about U.S. foreign tax creditability of the profit tax that would be paid under the production sharing law, because that was not addressed under the U.S./Russia tax treaty. This would be a new provision. So, the way the production sharing law works basically is the simplified mechanism of imposing profit tax just on your share of profit oil. Well, under production sharing agreements, typically, things like interest payments on borrowing to finance a project and bonus payments would not be deductible: It's not a cost-recoverable item under the production sharing regime. Amoco was very concerned about that, and it really pushed hard to try to declare bonus payments a deductible item in computing your amount of profit oil that would be subject to tax. So that was successfully included in the production sharing laws as well.

The investor also has to pay prospecting exploration work, basically rentals, and for the use of the land, water, and other natural resources. The investor still has to pay social and medical insurance for his Russian employees. The key point that needs to be kept in mind is that the investor is exempt from all other taxes, charges, levies, and obligatory payments. The share of production that is going to the government basically replaces those. That is a point that is always controversial in our discussions with the Russians.

They point out that you are exempt from all of these taxes, and that it is not fair because everyone else has to pay them. The point is that a large share of production that goes to the government replaces all of those levies. It was meant to be that way so there would not be all of these fifty or sixty, whatever number of taxes might be imposed. We simply said, whatever you have, lump it into your share of profit oil, and that is taken care of that way.

There is another very controversial point and one that was unable to be resolved very satisfactorily. The issue is the ability of the local and regional authorities in Russia to impose taxes. I think, as many of you know, the system in Russia is not just the Russian government, the national government, if you will. It is a series of various smaller government units, like counties and cities, which also have the ability to impose tax. From a constitutional standpoint, the national government was unable to give a blanket exemption from the local governments in imposing tax on investors. But they did come up with a fairly good mechanism to try to cover that. In the event the local government imposes tax on the oil companies engaged in these projects, what happens is that the share of profit oil that would be going to the national government is reduced. The investor's share is increased to make up for this amount that has to be paid over to the local government. The national government in turn will allocate a smaller amount of budget funds to the local governments, because the local government received their share through direct taxes of the investor. So it's an internal, offsetting mechanism that is put in place. Now, how well that works in practice, of course, remains to be seen, and investors are very wary of how the implementation of that would work. Another key point in Article 13 is that the profit tax is imposed on works under the agreement. How that is defined, of course, can be very broad. People want to bring as much of their operation in Russia under the terms of the production sharing contract, including as much of the transportation that may be available, that may be necessary to move crude, to get that under a PSA-type regime. So it is basically a ring-fencing provision, for those of you who are familiar with that concept. Again, how cost recovery works in the PSA is negotiated. That has to be established in the contract. Profit tax can be paid either in kind through payments of oil, additional payments of oil, or it can be paid in cash, and there is a stabilized 35% profit tax rate. So the amount of profit tax in effect at the time of

signature is the rate that stays in effect for the life of the contract.

Next there is the value added tax (VAT). The VAT is another very controversial issue for the investors who have been in Russia. Investors basically have been paying VAT. There is a mechanism in the books providing for refunding investors for VAT. Unfortunately, that mechanism does not always work, and the Russian government has been in arrears for tens of millions of dollars for VAT refunds. Obviously, because of their economic problems they are very unwilling to refund currency on a timely basis. So, the investors in working on PSA law tried to get a provision in there again to provide for an immediate refund of VAT that is due and, in the event VAT is not immediately refunded, there is a mechanism in place where again the state's amount of profit oil is reduced by the amount of VAT that is not refunded. That is also factored in with an interest rate. So, an obvious theoretical problem is that if the local governments are imposing tax on the investor and VAT is not being refunded in a timely, it's going to be a real question as to how much profit oil is available to reimburse the investor for these other provisions they should be getting. Again, that would result in all of the state's share of profit oil not going to the government, but rather going to the investor to reimburse him for these other costs. Needless to say, the opponents to western investors will have a field day with that type of issue. So again, in theory, the mechanism is there. In practice, the mechanism may be very difficult to apply. There are also provisions exempting transactions between investor and operator from VAT and also an exemption from VAT and customs for bringing works into the country.

There is a question as to whether there is an exemption for customs duty. The way Article 13 reads, it refers to excise duties. It was everyone's understanding at the time that "excise duties" were meant to cover customs. But I think some of the companies who are trying to work there now in the Sakhalin Projects have been experiencing some problems with that. So again, that's an area that would have to be addressed, clarified, in the normative acts that have to be issued along with the production sharing law.

The PSA enabling legislation is a very critical point that needs to be kept in mind for people who are working in Russia. As was pointed out, the PSA law became effective in January of 1996, and various people in Russian government and the Duma have been asking "why aren't you moving

forward with these deals—the PSA law’s enacted, you need to get moving.” It is a very fundamental issue and the answer is not clear-cut one way or the other. The advice that various law firms have provided is that the fiscal terms of the PSA law and the tax provisions in Article 13, are not effective because the PSA law is not a tax law. You cannot change tax law through a non-tax law. You actually have to enact another tax law changing existing tax laws. So because the PSA law is not a tax law, investors are now waiting for implementing legislation or enabling legislation to be enacted to fully implement the tax provisions in the PSA law. I think we had mentioned that the draft law has already been passed in a first reading—that was passed in May of 1996. It needs to be passed in three readings in the Duma, and then it goes to the Federation Council, which is basically for lack of a better term an “upper house” in the Duma. If that were signed in the Federation Council, it would then go on to the President for signature. This enabling legislation again has gotten bogged down in tremendous political controversy. Again, it is viewed as an opportunity to change all of about eleven federal laws. Most of the keys ones, obviously from a tax standpoint, have to do with profit tax, VAT, and excise duties. Without changes to those laws, the PSA provisions are most likely not effective. There are several ways of doing this. The Duma could have gone out and amended each of those eleven or twelve laws separately. Again, that becomes rather controversial to try to do this one at a time. So the provisions were all basically put into one law, the enabling legislation, and it would be attacked that way, it would be implemented that way, through one piece of legislation, in effect changing all of these pieces of legislation.

We are still waiting for that legislation to move forward in the Duma for a second reading. It’s basically been languishing there, and part of the controversy has to do, obviously, with PSA law itself. There is still, as I said earlier, tremendous opposition to the PSA law. The tax code is also now moving along in a very positive fashion.

There have been some numerous changes to the tax code, which Charles Fee will address in his comments. And the tax code is basically also making changes to these laws I referred to—the profit law and the VAT—within the tax code. It may be a little bit of duplication of effort to try to change things in the enabling legislation, through enabling legislation, and through the tax code. But just changing the tax provisions through the tax code still will not solve the

commercial lawyers' concerns with some of these other laws that, unless they go through an enabling-type change, will still be in conflict with the PSA provisions. So the tax people might be happy if you could change all the tax laws in the tax code, but it would still leave numerous issues up in the air and in conflict with PSA law.

So, although some significant progress is being made in the legislative front, and I think people are becoming a little more optimistic, although as I said the PSA is such a controversial area now and it is so political. People, I think, are starting to wonder whether it will ever get through and whether investments may actually have to take place through a new and better tax code regime. If a tax code regime is in place that actually makes these projects economical, obviously that is another way to go; however it still does not solve numerous commercial law issues that our previous speakers had addressed. As we said, we are all cautiously optimistic that progress will be made in the next six to nine months.

Professor Streng: Now to round out our discussion with respect to economic elements, particularly taxation components of PSAs, I want to introduce Charlie Fee who has been with Exxon for a considerable period of time in a variety of positions. Early on with Exxon Research and Engineering Company in New Jersey, he worked on technology-related tax work. Subsequently, in Houston he was with Exxon Company USA, and did tax work for oil and gas downstream activities. Thereafter, he worked for Exxon Corporation in Dallas in the areas of tax audit controversy and litigation. Now he is back to Houston where he is the General Tax Counsel for Exxon Ventures, CIS, Inc. He has been working on these matters in Russia to a considerable extent, often in conjunction with his partner, Tom Hurley. Mr. Fee, welcome to the podium.

Charles T. Fee, Jr.: Thank you Professor Streng. I would like to applaud all of you who have come today. Since I started traveling to Moscow in 1995, I have come to realize that the world is an international marketplace. I have seen a very large, young, expatriate community from all over the world all living, working, and participating in the international marketplace in Moscow. So, I applaud you for coming to learn more about an aspect of the international marketplace developing in the Russian Federation.

Today I will be discussing the emerging Russian Federation Draft Tax Code (DTC) and why PSA investors are interested in the DTC? As Mr. Hurley explained to you and as Mr. Cuclis alluded to earlier, PSA Enabling Legislation was proposed in 1996. It had its first reading in 1997. Some will suggest that if the PSA Enabling Legislation is enacted that it is all that is needed for implementation of the tax provisions contained in Article 13 of the PSA Law. This opinion concerns me because if you look closely at the dates, you will see that the PSA Enabling Legislation has not progressed much since it was introduced in 1996. It is now 1998 and it has not progressed any farther than passage on first reading in 1997. The primary reason why PSA Enabling Legislation has not progressed is PSAs are a political issue. The second reason why PSA Enabling Legislation has not progressed is the development of the DTC.

Some officials in the Russian Federation government believe the DTC will supersede the need for the PSA Enabling Legislation and therefore have lost interest in PSA Enabling Legislation. The PSA Law tax provisions must be incorporated into the DTC because the DTC will either preempt the PSA Enabling Law, if the DTC is passed first, or the DTC will supersede the PSA Enabling Legislation, if the DTC is passed last.

At this point all I can really say about the DTC is that it is in a constant state of flux. It passed its first reading in June 1997 with strong Russian Federation government support. Yeltsin and Chubias made it part of the framework for the new Russian Federation economy. It has been suggested that all 600 plus pages of the DTC passed on the first reading because Yeltsin threatened to dissolve the Duma if it did not pass.

After the DTC passed on first reading, there were 4,500 amendments proposed of which 600 were proposed by the Federation Council. There was a fair amount of optimism when it was passed on its first reading and there was an expectation that it would be enacted and put into place by January 1998. The Russian Federation government was so optimistic that it based its 1998 budget on the DTC. However, it quickly became clear that the DTC was not going to be enacted by the end of 1997. It was suggested that different sections of the DTC could be broken out and the DTC could be enacted on a staggered section-by-section basis. It was also suggested that Part 1 of the DTC, which provides the basic administrative framework, could be

enacted first with various articles in Part 2, which defines specific taxes, enacted separately with different effective dates. For those of you who practice tax or study tax in the United States, you know it is not easy to implement tax legislation that has been enacted on a staggered basis. Not surprisingly, a budget crisis caused the Russian Federation government to disconnect the DTC and the 1998 budget and withdrew the DTC from consideration in November 1997. The DTC was sent back to a trilateral commission consisting of members of the Russian Federation government, the Duma, and the Federation Council to review the version proposed by the Russian Federation government as well as several other versions. The trilateral commission developed into an interfraction political group that began to look at thirteen different versions of the DTC.

My understanding is that all thirteen versions were reviewed this morning in the Duma, and that a new and revised Russian Federation government version has been passed on its first reading. The Duma took an interesting approach. The supporters of each version gave a presentation and then a vote was taken. The version that received the most votes and was passed on first reading. It was the Russian Federation government version. The Duma also passed a decree that provides for a thirty-day comment period, probably hoping that it will not get 4,500 comments or suggested amendments. In addition, the Duma permits various parts of the DTC to be voted on and enacted separately.

It is not clear what impact the recent changes in the Russian Federation government will have on ultimate passage of the DTC. Obviously, we have a newly appointed Prime Minister, Kiryankov, who is rather young for a Prime Minister at thirty-four. We will also face Duma elections in 1999, and then a presidential election in 2000 .

Having provided you with some background on the development of the DTC, I would like to spend a little time on the specifics of the DTC. The DTC introduces for the first time in the Russian Federation a published unified tax code. It provides for a coordinated administrative system with common terms and definitions. The DTC also defines the authority of federal, regional and local taxing jurisdictions. As Mr. Hurley mentioned earlier, regional and local taxing jurisdictions have broad taxing authority under a previously issued Yeltsin Presidential Decree.

The DTC reduces the number of taxes. As Mr. Hurley pointed out earlier, under the current taxation system there are a significant number of taxes. My understanding is that major taxes have been reduced by one third from about forty-five to thirty-two. In addition, the DTC provides for a reduction in some tax rates. As Mr. Hurley mentioned earlier, the current profits tax rate of 35% has been reduced to 30%. However some tax rates have increased. The VAT rate has increased from 20% to 22%. There is also a reduced focus on gross revenue-based taxes. There are two of these taxes that come to mind. There is a housing fund tax and a road fund tax. Under the housing fund tax, an investor is not taxed on housing, and under the road fund tax, an investor is not taxed on roads. Taxpayers are taxed on gross revenues or sales. Anyone engaged in commerce and generating sales is subject to these turnover taxes. My understanding is that in the current draft, the housing fund tax has been eliminated, and the road fund tax is being phased out over the next several years.

The DTC also increases the number of deductions for Profits Tax purposes. Unfortunately, it has been difficult to explain to Russian Federation Duma members, Ministry of Finance and State Tax Service personnel the concept of deductible “ordinary and necessary” business expenses. As a result, not all “ordinary and necessary” business expenses are deductible and the deductibility of some business expenses is limited by “norms”.

In addition, the DTC also introduces the concept of tax accounting, separate and apart from financial accounting, and recognizes the concept of accrual based accounting.

From a PSA perspective, it is very important that the DTC fully addresses and implements the PSA Law tax regime. The drafters of the DTC had decided that it was politically inadvisable to create a separate article or section specific to PSA tax regimes. The drafters were afraid that it would be too easy for the opponents of PSAs to carve out a PSA specific article or section. Therefore, the drafters of the DTC decided to interweave the provisions of Article 13 of the PSA Law throughout the DTC, as necessary. This approach, requires that PSA investors and operators review each tax identified in the DTC very carefully to ensure that provisions applicable to the PSA tax regime are in compliance with the terms of Article 13 of the PSA Law. While this approach makes it a little bit more difficult for the opponents of PSAs to carve out the PSA Law tax regime, it also makes it a little bit more

difficult to make sure that the PSA tax regime is fully implemented and PSA investors are fully protected.

The DTC also fails to provide for any real tax stability for multi-billion dollar, long-term investments against future increases in tax rates or the number of taxes or a return to taxes based on gross revenue rather than net income. For those of you in the audience who are comfortable with the U.S. taxation, you might say, "What do investors expect? No government is going to give investors tax stability or protect investors from increasing taxes or an increased tax rate." And while that may be true, based upon Mr. Skelton's and Conoco's experience oil and gas investors are concerned that once an investor initiates a long-term multi-billion dollar investment, the need for budget revenue will force an increase in the number of taxes, an increase in the tax rates, and a return to taxes based on gross revenue. As Mr. Skelton and Mr. Hurley pointed out, increased taxes, rates, and taxes based on gross revenue can totally eliminate an investor's profit.

The DTC process makes it very clear that the Russian Federation is more budget driven than investment driven. While investors understand the need for the Russian Federation government to be budget driven, there appears to be a lack of interest in the investments needed to fund future budgets. Based on the DTC, it would appear that the Russian Federation government is focusing too much on today's and not enough on tomorrow's budget needs.

Finally, PSA Investors must be concerned with timely implementation. PSA Investors can be very optimistic and say the DTC will be enacted and fully implement the PSA Law tax regime. Unfortunately, PSA Investors find that timely implementation is key but does not flow automatically from enacted legislation. Implementation is a slow process in the Russian Federation. A law can be enacted, but without instructions to the local tax authorities on how that law should work, the provisions of the law will not be implemented. Enactment of the DTC will require implementing Normative Acts which are similar to U.S. Treasury Department regulations as well as extensive training. There is a concern that if the DTC is enacted; there will be an expectation that investments will flow immediately. Realistically, I would have to say that investments will not flow quickly until investors have some certainty that the DTC or the PSA Enabling Legislation implementing the PSA Law

tax regime will be implemented on a consistent basis as drafted.

In closing, what we, as tax professionals find is that the Russian Federation is a learn-as-you-go environment. Taxation is in a state of flux, and investors and taxpayers must be flexible, quick to change, and willing to learn as you go. And while I applauded all of you for coming today, I would also applaud all of the young Russians that I have met in the Russian Federation within the last couple of years. I find them to be incredibly bright, quick, hard working, and eager to learn and become part of the international marketplace. Thank you.

Professor Streng: Thank you very much, Mr. Fee. We have a few minutes for questions before we adjourn for lunch. Does anybody have a question? Yes, sir, in the back.

Audience: After the fall of the U.S.S.R., I have heard and seen that there were Russian programs developed to take American lawyers into Russia or the outlying states, and to help rewrite, as I understood, their laws or their constitutions. Today, what effect did those efforts have on Russia, were those efforts successful, and are they reflected in the current legislation you were talking about this morning?

Professor Streng: Who wants to pick that up, Tom?

Mr. Hurley: I can address that on the tax side there have been numerous work groups made up of lawyers, economists, and academic folks who have really assisted in numerous areas, on the Draft Tax Code, for example. And if you see the latest version of the Draft Tax Code, for better or worse there are many concepts in there that look like the U.S. Internal Revenue Code. A lot of us cringe when we see two volumes of the code and seven or eight volumes of regulations. But some of the concepts on gross income, deductions, business expenses, that type of thing are all there. So I think it is a positive impact that these advisers have had over the years. The Russians are very apprehensive about the advice that they get. They are out getting advice from numerous law firms, accounting firms, and universities, etc. They basically take in all this information and come up with their own decisions on how they want to implement it and what they want to go with. But there certainly has been

a very positive role and reaction from the work done by the U.S. folks.

Professor Streng: Mr. Boatwright, you had a question?

John Boatwright: I'm John Boatwright. I'd like to thank all the panelists for their comments and participation today. I have two general questions. First of all, the term of the agreements conducted under the PSA, after recovery cost, how long are these scheduled to last, and what sort of terms do you negotiate for extension of the agreement? And my second question: I understand that the parallel area of concern is the transportation grid, particularly the pipeline network. What efforts do your companies or your clients put forth in that regard to ensure safe and efficient transportation of a product once it is out of the ground? Thank you.

Professor Streng: Who's going to be first?

Mr. Cuclis: All right. Well, I think with respect to the term for the production sharing agreement, that is really covered in the existing production sharing law which says the term is going to be set out in the agreement itself. I think it is for a maximum period, consistent with what the license will be issued for. I was going to look at the exact language. Yeah, basically it has to be consistent with whatever the license is issued for--the development of the oil and gas reserves. I guess typically, Jim, it is for twenty-five years I guess five years for exploration and, what, twenty years for development?

Mr. Skelton: Right.

Mr. Cuclis: For a total of twenty-five years.

Professor Streng: Is there one last question?

Audience: You say that you have encountered ice and have opposition controls. Do you expect any changes as a result of the upcoming elections?

Professor Streng: A political question. Anybody want to comment?

Mr. Hurley: I think the information that we hear—and again, that is just through the press, the same place everyone else gets it—is that there is no big shift in store for how the Duma is comprised right now, that the makeup of the Duma is pretty much the way it is going to be for the foreseeable future.

Professor Streng: With that, we must close our morning session. I would like very much again to thank all of our speakers for their participation, contributions, and the very valuable information they have provided us this morning.

Appendix 1

Schematic Representation of Production Sharing

