

APRIL 16, 2009



ENERGY AND NATURAL RESOURCES NEWSLETTER

This NEWSLETTER has been issued to keep Vasil Kisil & Partners clients and other interested persons informed of the latest developments in the Ukrainian legislation and the firm news.

This NEWSLETTER does not constitute a legal advice or an opinion rendered upon specific request. The information below has been prepared without enquiry into any individual case and should not be treated as a substitute for detailed advice in any such case.

1. Legislation

Applying the Adjusting Ratio to the Rental Payments for Natural Gas

Pursuant to the Law of Ukraine “On Amending Certain Legislative Acts of Ukraine”, dated 03 June 2008 No. 309-VI, companies producing natural gas (including petroleum associated gas) on the basis of the special permit to use subsoil shall make rental payments to the State Budget of Ukraine for the natural gas.

However, on 25 December 2008 the Parliament made some amendments to the

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abovementioned Law that envisaged application of the adjusting ratio to such rental payments for natural gas (including petroleum associated gas) in every future tax period. The ratio value shall be calculated by the Ministry of Finance of Ukraine according to the data from the State Customs Service of Ukraine for every tax (fiscal) period by dividing the average customs value of imported natural gas (including petroleum associated gas) by the reference price for gas which equals 179.5 US Dollars per 1000 cubic meters.

The Ministry of Finance furnishes to the Ministry of Economy for every financial period the information regarding the calculated value of the adjusting ratio which is thereafter disclosed on its official web-site.

Moreover, in 2009 the ratio of 1.439 for use subsurface resources shall be applied to the normative standard payments for production of mineral deposits and to the normative standard fees for special water use in the surface water area. Similarly, the new normative standard for using subsurface resources amounting to 5 % calculated and added to the value of argillaceous rocks produced was approved with such amendments instead of the corresponding monetary value of the normative standards.

Overall Price Level for Natural Gas Consumers for the Year of 2009

The National Electricity Regulatory Commission of Ukraine approved in its Resolutions No. 195 and No. 194, dated 19 February 2009 the overall price level for natural gas in 2009 which VAT exclusive fees for transportation, distribution, natural gas supply and some other fees according to the set tariff equals to:

- UAH 2,020.25 per 1000 m³ – for industrial customers and other business entities;
- UAH 1,899.25 per 1000 m³ – for ore mining, smelting and chemical enterprises, according to the List of Ore Mining and Smelting and Chemical Enterprises;
- UAH 2,020.25 per 1000 m³ – for the institutions and organizations sponsored out of the state and local budgets.

The Commission's Resolutions No. 57, "On Adoption of the Overall Price Level for Business Customers and Other Business Entities for 2009" and No. 56 "On Adoption of the Overall Price Level for the Institutions and Organizations Sponsored Out of the State and Local Budgets for 2009", dated 29 January 2009, became ineffective with the adoption of the abovementioned Resolutions No. 195 and No. 194.

Oil-Fuel Export Is No Longer Subject To Licensing Procedures

On 11 February 2009 the Cabinet of Ministers of Ukraine adopted the Resolution No. 91, which invalidated its prior Resolution No. 2, dated 09 January 2009 "On Licensing Black Oil-Fuel Export until 01 May 2009". It is important to mention that exportation of the black oil-fuel with the following codes of the Ukrainian Classification of Foreign

Economic Activity Products (UCFAP) were the only subject to the licensing procedures: 2710.19.51.00, 2710.19.55.00, 2710.1961.00, 2710.19.63.00, 2710.19.65.00 and 2710.19.69.00.

Resolution No. 91, dated 11 February 2009 entered into force on 18 February 2009, since it was officially published in the *Uriadovyi Courier* newsletter No. 29 on the same date.

Natural Gas Pricing

The National Electricity Regulatory Commission of Ukraine (“NERCU”) adopted by its Resolution No. 35, dated 22 January 2009 the Procedure for Formation, Calculation and Approval of the Natural Gas (Including Petroleum Gas) Prices for the Gas Producing Business Entities.

The Procedure applies to all gas producing business entities and is subject to the compulsory implementation.

Natural gas prices calculated according to the Procedure shall guarantee the following for the gas producers:

- indemnification of the economically proven production costs during the planning period;
- sufficient profit for implementing the investments program (the capital investment plan) separately for each gas deposit during the planning period;
- payments of taxes and other compulsory budget payments provided for by the legislation of Ukraine.

Natural gas prices are formed in accordance with the applicable legislation of Ukraine based on annual plans for natural gas production, economically proven planned expenses specified for the resources state predetermined costs, technical-economic calculations, rates of taxation and other compulsory payments, and on the natural gas planning prices determined in the forecasting price indexes for the industrial product manufacturers for the appropriate year.

In order to form natural gas prices, business entities shall file to the NERCU an application and reasoned calculation of the price for the planning period, expected data for the price in the base period and records for the same period in the last year as sealed and certified by the director.

The decision approving the natural gas price is made by the NERCU by adopting respective Resolution. Such Resolution shall be published in the official newspaper of the NERCU. A copy of the Resolution shall be sent to the gas producer by registered mail within 3 days after the publication.

2. Events

Ukraine to Modernize Gas Transit System

On 23 March 2009 the Ukrainian government, the European Commission, the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB) and the World Bank have signed a joint declaration at an international investment conference on the modernization of the Ukrainian gas transit system.

The Declaration provides for the reconstruction of linear pipeline portion, linear telemetry and gas pumping stations, underground gas storages.

Referring to the master plan in Brussels, Ukraine plans to reconstruct a significant number of its gas compressor stations and gas pipelines and build a large number of new gas metering stations within the next seven years. By a conservative estimate it might cost from \$ 3 to \$ 7 billions.

Coal Mine Methane Recovery and Utilization:

2nd April 2009 the Committee of Verkhovna Rada on Fuel and Energy Complex, Nuclear Policy and Nuclear Safety jointly with Environmental Protection Agency, USA, Pacific National Northwest Laboratory, USA and Agency for Rational Energy Use and Ecology (ARENA-ECO) held a round table discussion on the topic “Coal Mine Methane Recovery and Utilization: incentives legal, financial and technical support”. The main purpose of the said discussion was consideration of legal and political aspects of the successful international experience in the field of extraction and use of coal mine methane and possibilities of implementation and adoption of such experience in Ukraine. During the discussion participants also considered the main provisions of the draft law “On the gas (methane) from the coal field”.

Publication of the Draft Law on Amending Certain Legislative Acts regarding the Taxation Encouraging Alternative Sources of Fuel and Energy Use for Public Consideration

The Draft Law on Amending Certain Legislative Acts regarding the **Taxation Encouraging Alternative Sources of Fuel and Energy Use** was published on the official website of the Ministry of Finance of Ukraine for public consideration. Further comments and suggestions on the Draft may be given in the written or/and e-form within the next 30 days starting from the 23 day of February, the date of its publication.

The Draft was elaborated by the Ministry in order to support business entities which use alternative sources of fuel and energy during the next 10 years of their operations; it provides a number of tax preferences for such companies.

In particular, the Draft Law allows “bonus amortization” by amending the Law of Ukraine on Corporate Profit Tax. It is expected that by 1 January 2019 it will be allowed to apply the bonus amortization to new capital funds producing energy from alternative sources for their own use.

By referring to the Law of Ukraine on VAT, the Draft Law states that by 1 January 2019 equipment supply operations, except those which are excisable, shall be exempted from tax for the entities which produce the alternative fuel and energy sources.

Furthermore, as to the Law of Ukraine on Excise and Customs Duty for the Certain Categories of the Goods (Products), the Draft Law provides that by 1 January 2014 bio fuel in proportion to the bio component contained in it shall be tax exempt.

3. Comments

Importing oil and gas exploration and production equipment into Ukraine: key problems, possible solutions



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Part 1.

Foreign investors operating in the field of oil and gas development can face numerous obstacles and legal pitfalls while trying to bring into Ukraine modern equipment for oil and gas exploration and production. In this article we shall try to describe key problems, which arise during importation of such equipment, and outline practical solutions thereof.

Mandatory import payments

In case of import of drilling equipment, rig or other special devices for oil and gas exploration and production (hereinafter – “Equipment”) the investor shall have to pay an import customs duty and 20% VAT from the customs value of the imported items. All such payments are calculated and levied on the basis of the customs value of the goods, which includes contractual value of the goods and all other expenses related to their importation, like transportation, loading, unloading, reloading, insurance, commission, brokers, and other.

In case the customs office considers that the declared customs value is undervalued, they shall increase it on the basis of available statistical data, which in majority of cases is higher than average prices. In order to avoid such situation, it is advisable to prepare expert opinion of the Chamber of commerce and industry of Ukraine on actual value of the imported Equipment.

Very often many disputes with customs authorities arise during clearance process regarding correct classification and coding of the imported merchandise. To confirm accuracy of the codes according to the UKT ZED (based on the Harmonized System) before the importation, we strongly recommend applying to the specialized agency of the State Customs Service - the Central Customs Division of Laboratory Researches and Expert



Work. The agency shall issue a preliminary decision on the products` code, which shall facilitate relations with customs authorities.

Reduced duty rates shall be applied to imports from all member states of the WTO. In such a case origin of the imported items must be proved by a certificate of origin and a zero duty rate is applied to goods under 843041, 843049 and 843143 codes.

It is advisable to declare the Equipment as a complete object rather than declaring its units separately. In such a case zero duty shall apply and there will be no need to issue different cargo customs declarations even if the units shall be transported to the place of destination separately. To this end, the Equipment is to be transported by one mode of transportation (for example only trucks or only marine transport) and only through one point of entry at the Ukrainian border.

The importer may be exempt from customs duty if the goods are imported as a contribution to the charter capital of the company with foreign investment. However, the importer will not be able to sell the Equipment within 3 years, otherwise the customs duty will be levied in full. Because this process is rather bureaucratic, envisages some limitations on use of the object of investment and, finally, zero duty rate is applied, we believe that it is not reasonable to contribute the Equipment to the charter fund.

Importation of the Equipment into the customs territory of Ukraine will be subject to 20% VAT. Upon import the investor may recover paid VAT through its Ukrainian subsidiary in form of a tax credit.

Goods under codes 8430 and 8431 are not excisable.

While importing the Equipment into Ukraine, no other customs fees shall be charged.

To be continued

Concept of the new procedure on issuing permits for subsoil use



**Artyom V.
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Recently the Ministry for Environmental Protection has prepared a new Procedure for Issuing Special Permits to Subsoil Use. In 2009 certain efforts were made to adopt such Procedure as a document with indefinite effective period. It is a positive step in terms of the regulation as it adds stability to functioning of the licensing system. However, apart from this advantage, the new Procedure may be sufficiently improved both conceptually and in separate procedural aspects of issuing special permits (primarily without tender and auction).

Today investors wish to take part in auctions for subsoil sale. However, the market of such special permits is almost in stagnation. It would be reasonable to consider possible refusal from the auction procedure in future.



In our view, the main reason is that the special permits auctions departed from a mechanism for estimating applying companies' potentials and transformed into a source of budgetary recharge. Such an approach of the government is aimed at resolving temporary financial problems and fully ignores perspectives of developing the subsoil use in Ukraine, in view of critical situation in the mining industry and urgent need to attract new investors.

Besides, it would be reasonable to create opportunities for obtaining special permits without auctions not only for social and state-funded projects, but for commercially favorable projects as well. It would be also reasonable to refuse from the concept under which state enterprises are supported and interests of private companies are almost completely ignored.

It would be also reasonable to exclude the State Tax Administration from the list of authorities empowered to submit for termination of special permits. In addition, it would be appropriate to change the procedure for control over the compliance with special permit terms, under which such control is vested in the Ministry for Environmental Protection, State Mining Supervising Authority, Ministry of Health, Ministry of Fuel and Power, Ministry of Coal Industry and local governments. It is expedient to propose to confer all of the controlling powers and authorities upon the Ministry for Environmental Protection.

Finally, it is necessary to reduce the number of governmental authorities approving special permits to subsoil use.

4. VKP News

Vasil Kisil & Partners participates in a round table discussion entitled "Ukrainian Subsoil vs. Russian Gas"

On March 10, 2009, a round table discussion entitled "Ukrainian Subsoil vs. Russian Gas" was held as part of the "Internaftagaz-2009" exhibition annually held in Kyiv. The discussion was dedicated to issues related to development of Ukrainian mining industry, domestic sales of Ukrainian natural gas, procedures for issuing special permits to develop subsoil, legal aspects of extracting industry regulation, investment attractiveness of Ukraine.

The round table participants, which this year included representatives of national companies active in the field of geology, subsoil and natural resources exploitation, public associations of gas traders, subsoil users and private companies, believe that such factors as political instability currently existing in Ukraine and constant changes of legal framework do not favor investments into the Ukrainian mining industry. Mykhailo Shchitka, Polina Zagnitko and Artem Krenbok of Vasil Kisil & Partners took



an active part in discussing the legal regulation of mining sector and expressed their opinions in respect of possible ways to optimize national laws and regulations related to the energy and mining. They pointed out that a transparent and clear legal framework is the main factor for investors, and that the market has never before been in such need of further legislative development and implementation.

As a result of the debates, the round table participants unanimously urged to activate the process of establishing and improving the legal framework regulating Ukrainian gas industry.

Vasil Kisil & Partners Participating in “Green Week” Activities

On March 20, 2009, , the European Business Association jointly with the Embassy of Belgium and Ukrainian Partnership Bureau organized the ‘Green Day’ within the framework of the Green Week Forum 2009 in Ukraine. Extended EBA Fuel & Energy Committee Meeting was dedicated to the effective energy-saving approaches and use of alternative sources of energy (bio-energy, sunlight energy, wind energy).

This important event was hosted by the EBA Kyiv-based office. The Ambassador of Belgium, some Belgium energy experts, the very famous Ukrainian pop singer Ruslana with her Wild Energy presentation joined the EBA community for interesting discussion. Top representatives of the fuel and energy companies were among the officials invited to the meeting.

It has to be mentioned that **Polina Zagnitko** and **Artyom Krenbok**, respectively senior associate and associate with **Vasil Kisil & Partners Law Firm** took an active part in the discussion raised by the vital importance of alternative energy use.

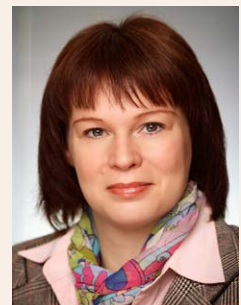
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