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# PSA's Essential Terms of Contracts: Hints for Investors

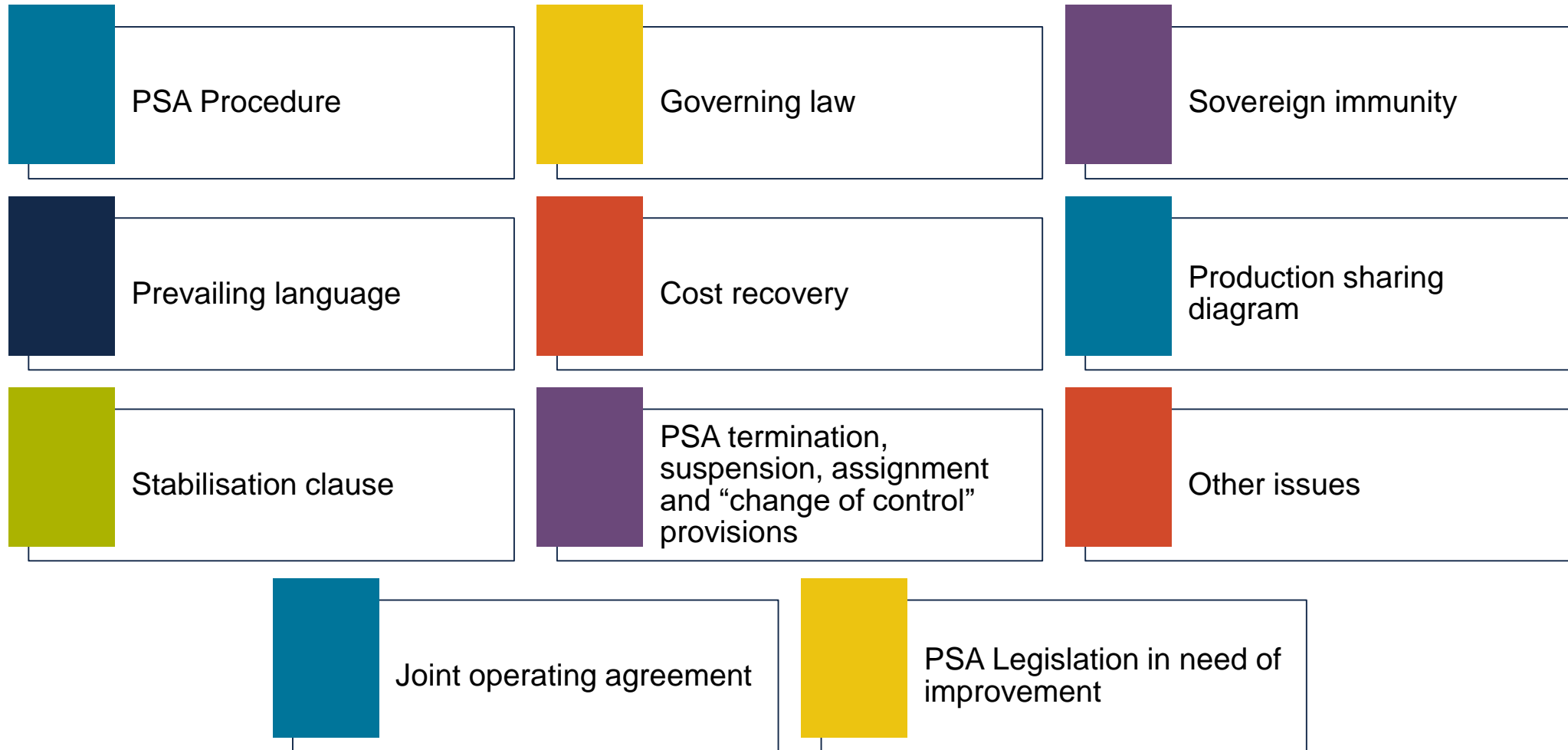
Vitaliy Radchenko  
Partner  
Energy & Projects Practice  
CMS Cameron McKenna Nabarro Olswang

Ukraine 2020: Production Sharing Agreement | 11 December 2019

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## Contents – Critical Issues and Clauses for PSAs in Ukraine

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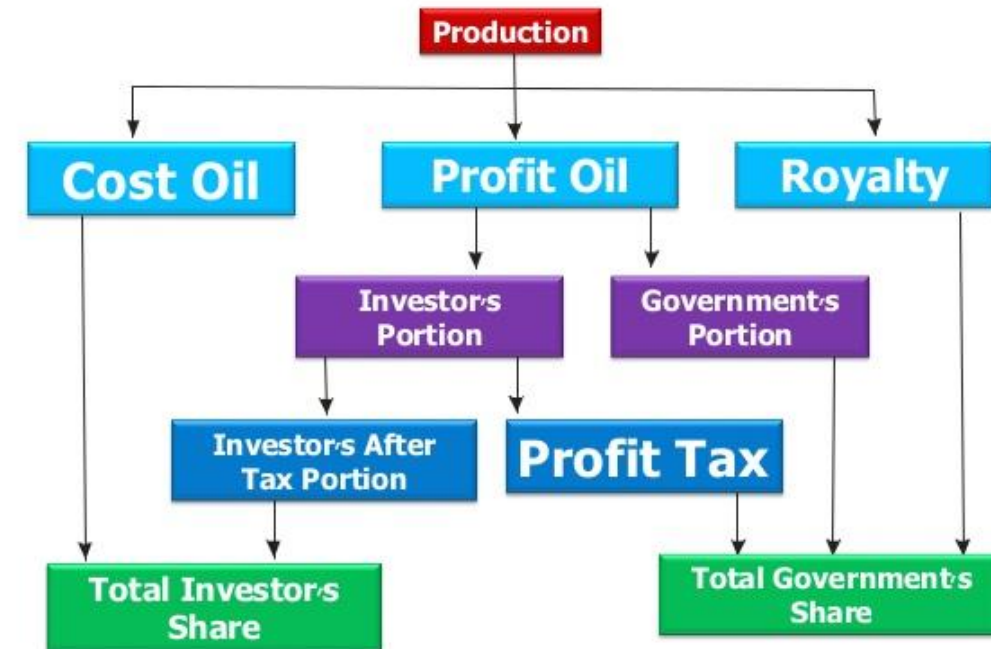
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## Features and Benefits of a PSA in Ukraine

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1. Direct long-term (50Y) contract with the State of Ukraine, represented by the Cabinet of Ministers of Ukraine
2. Higher degree of legal and tax stability, investment guarantees and protections, compared to ordinary licences
3. Flexible and highly negotiable contractual instrument
4. Not off-the-shelf or rigid standard template
5. Investor(s) undertakes at its own risk to commit certain minimum amount of investment, usually for the exploration stage of the project in exchange for exclusive right to the produce from a block and share production in certain defined share with the State

### Production Sharing



*Illustration of Sharing under PSC*

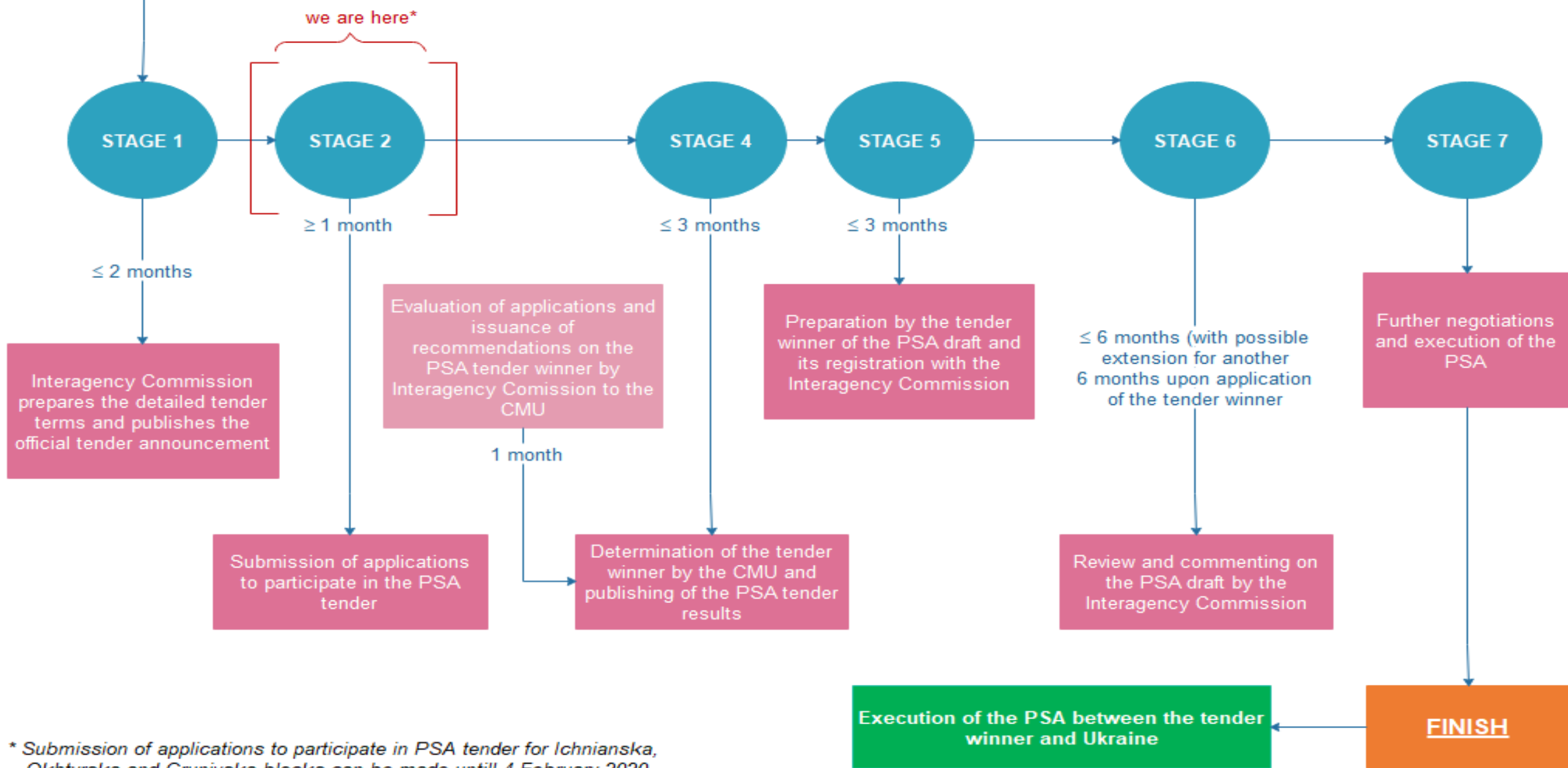
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**DAY X**

The date when CMU resolution approving decision on holding PSA tender comes into force and effect

The Cabinet of Ministers of Ukraine (the "CMU") takes a decision on holding of the PSA tender and approves essential terms of the tender




\* Submission of applications to participate in PSA tender for Ichnianska, Okhtyrska and Grunivska blocks can be made until 4 February 2020

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## Governing law

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Parties can apply to  
PSAs governing law  
other than Ukrainian

**BUT!!!:**

- foreign element is needed
- imperative norms of Ukrainian law will apply to operations within Ukraine

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## Sovereign immunity

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**PSA Law: Art 32**  
– the Government  
**MAY** waive the  
sovereign  
immunity

**It is the right,  
but not the  
obligation of the  
Government >  
so Investor must  
insist.**

**Decision of the  
Constitutional  
Court of Ukraine  
on this issue No.  
17-рп/2001  
dated 6  
December 2001**

**Waiver of  
immunity covers  
and is with respect  
to:**

- Court decisions;
- Arbitration awards;
- Interim relief;
- Enforcement of the decisions

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## Prevailing language

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English language – investors preference

**BUT!!!** – Art. 13 of PSA Law provides for:

Equal force of versions with Ukrainian prevailing in case of collisions

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## Cost Recovery

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Government is very tough on the list of expenses subject to cost recovery

PSA Law allows for recovery of costs incurred even before the PSA is executed, but those have to be after the tender was awarded to investor (e.g., geological data acquired by the investor, legal costs)

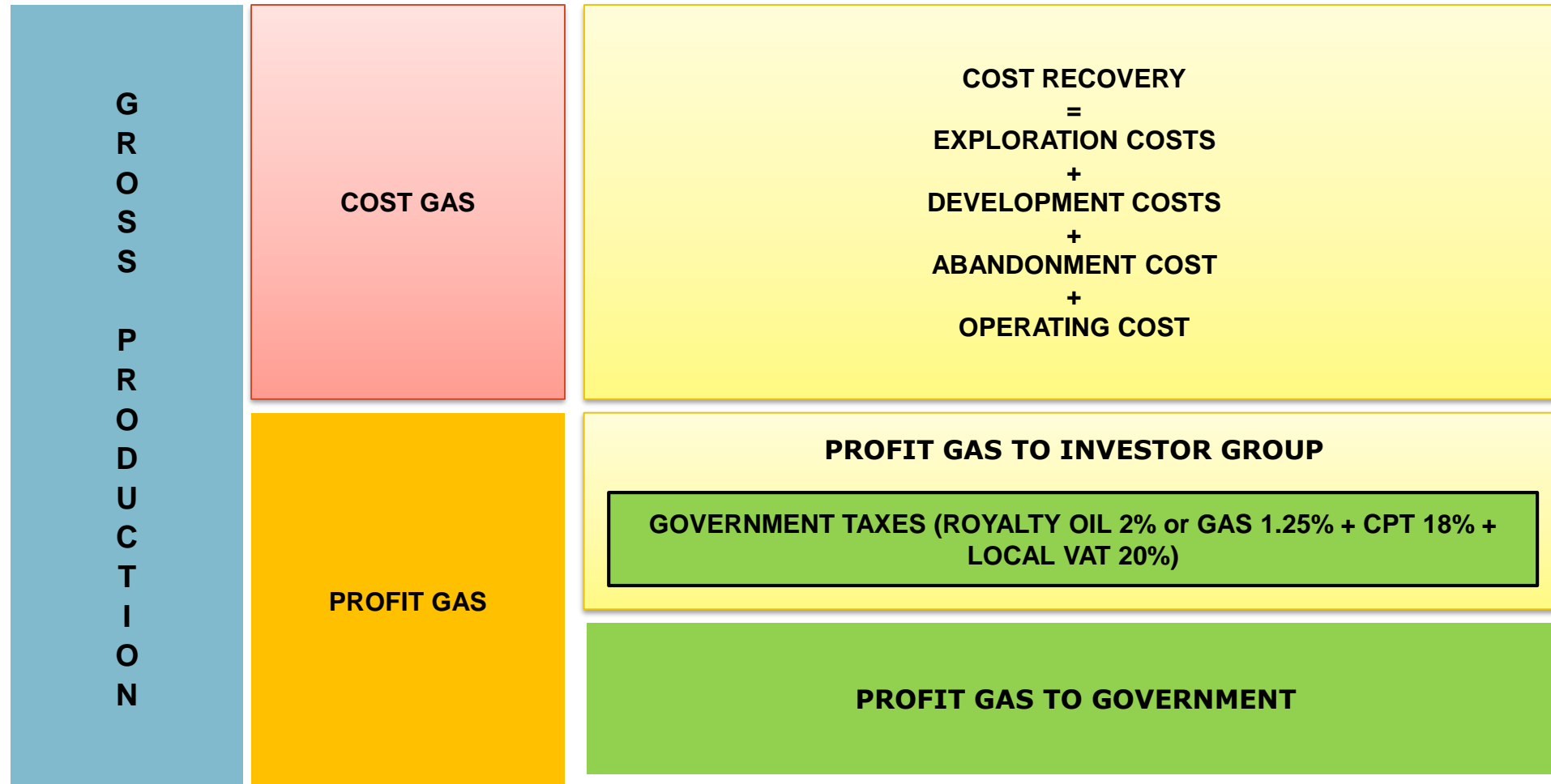
The list of expenses that can be counted towards cost recovery is still highly negotiable, with a few exceptions that are spelled by the law

Concept for cost recovery becomes a crucial point for:

- ring-fencing or
- joint accounting



# Production sharing diagram



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## Law and Taxes Stabilisation clause

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“Grandfather clause”(i.e. the investor’s protection from the adverse changes in the legislation)

Save for defense matters, health and safety, public peace, etc.

the Government insists on the narrow interpretation

**Must also cover taxes!** – *“PSA will be subject to those tax rates that were effective as of the date of signing, unless lower rates were later introduced”*

Is the change positive? Investor should decides

Protections of investments, against expropriation

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## PSA termination, suspension, assignment, “change of control” provisions

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PSA Law does not elaborate on termination, assignment and on “change of control” under PSAs, so those are usually heavily negotiated with the State

- **Termination** – general contract termination grounds under Ukrainian law or any others – up to the Parties
- **Assignment of PSA in whole or in part** - conditions:
  - Always subject to the Government’s consent
  - Sufficiency of financial and technical resources, necessary experience of the non-resident holding company
  - Amendments to the PSA
- **Change of control** – subject to the investor's consent / independent expert. Related issues:
  - Trigger for termination?
  - Disclosure of UBO in SPV?
  - Change of UBO in SPV?

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## Other issues

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### **Production valuation**

– sophisticated formula for valuation of liquids / gas production should be carefully drafted by the investor

**Marketing/sale** – off-take agreements and marketing procedures may be executed at a later stage (a number of days prior to commencement of the commercial development) and do not have to be put in the PSA

**Conversion of subsoil permits into PSAs** – subsoil permits acquired on auctions may be converted into PSAs under certain circumstances

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## Joint Operating Agreement – if you have 2+ Co-Investors (Consortium) under PSA

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JOA – may be necessary if management is performed by a number of companies

JOA is usually negotiated / signed after the PSA is executed (AIPN standard is recognised)

JOA usually regulates:

- budgets, expenses, work programs
- operating committee, voting procedures, tendering
- operations, discovery, sole risk operations, re-instatement, default, abandonment
- operator's rights, obligations and liability
- withdrawals, transfers, change of controls

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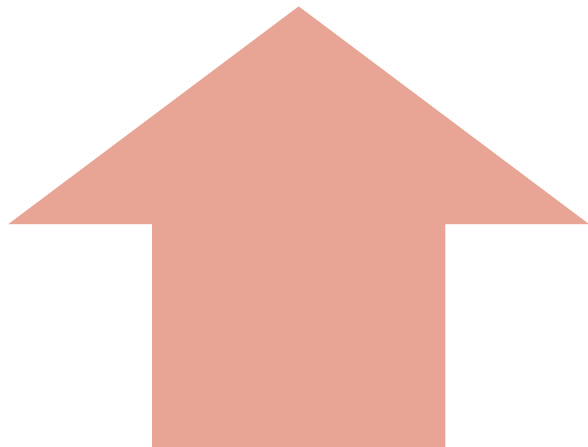
## PSA Legislation in need of improvement

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### **Changes expected in short-term (2020):**

- Cancel EIA of the PSA draft
- Cancel local council's approval
- Clarify that SPVs with PCG are also eligible tender participants



### **Medium-term improvements:**

- Improvement of licence-to-PSA conversion mechanism
- Exclusion of joint and several liability in sole risk operations
- Improvement of the currency control legislation
- Improvement of oil and gas blocks nominations for PSA tenders



**Vitaliy Radchenko**

**Partner, Energy & Projects**

**CMS Cameron McKenna Nabarro Olswang**

**T** +380 44 391 3377

**E** [vitaliy.radchenko@cms-cmno.com](mailto:vitaliy.radchenko@cms-cmno.com)

CMS Cameron McKenna Nabarro Olswang

Ukraine

38 Volodymyrska,

6<sup>th</sup> floor

Kyiv 01030

Ukraine

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