

Ukraine

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1 Overview of Natural Gas Sector

1.1 A brief outline of Ukraine's natural gas sector, including a general description of: natural gas reserves; natural gas production including the extent to which production is associated or non-associated natural gas; import and export of natural gas, including liquefied natural gas (LNG) liquefaction and export facilities, and/or receiving and re-gasification facilities ("LNG facilities"); natural gas pipeline transportation and distribution/transmission network; natural gas storage; and commodity sales and trading.

Ukraine's proven natural gas reserves are evaluated at 900 billion cubic metres ("bcm") (0.5 per cent of the world's proven reserves). They are mainly concentrated in three regions: the Carpathians (Western Ukraine); Dnipro-Donetsk (Eastern Ukraine); and offshore Ukraine (in the Black and Azov Seas). The Dnipro-Donetsk basin is the most productive region at the moment, accounting for 90 per cent of domestic hydrocarbons production (8,482 bcm of the estimated recoverable resources).

Ukrainian unconventional gas opportunities have now attracted significant interest from the world's major oil and gas companies – in 2012 Eni (Italy) purchased 50.01 per cent of Westgasinvest (which holds subsurface rights to nine shale gas licence areas in the Lviv Basin of Ukraine). The Ukrainian Government has already held two tenders for production-sharing agreements ("PSAs") relating to shale and tight gas opportunities in the Oleska (awarded to Chevron) and Yuzivska (awarded by Shell) areas. A PSA between Shell and the Government of Ukraine was executed in January 2013, a PSA with Chevron is expected to be signed this year.

Offshore Ukraine is not well explored. Nevertheless, offshore areas are considered to be attractive for foreign investors. They contain approximately 30 per cent of potential hydrocarbon reserves, and at present only the State-owned Chornomornaftogaz has live operations there. Certain offshore blocks have been awarded to foreign investors: an ExxonMobil-led consortium won a tender to operate deepwater offshore area (Skifska) – the relevant PSA should be signed by the end of 2013. Early in 2013 Vanco and the Government of Ukraine came to an amicable settlement with respect to the development of another offshore area (Prykerchenska), a PSA for which has been signed in 2007. Now the parties are to agree upon the work programme.

Producing 20 bcm of natural gas per year, Ukraine manages to cover about 37 per cent of domestic natural gas consumption. Ninety per cent of domestic production is undertaken by the State-owned oil and gas monopoly Naftogaz and its subsidiaries. The rest

is produced by private producers and through farm-in agreements with State-owned companies.

The main gas export routes of Russian gas to European countries pass through the territory of Ukraine. There are three main pipeline corridors: the Braterstvo Pipeline (Urengoy-Pomari-Uzhgorod); the Progress Pipeline (Yamburg – western border of Ukraine); and the Soyuz Pipeline (Orenburg – western border of Ukraine).

The natural gas transmission system of Ukraine consists of 38,550 km of pipelines, including 22,160 km of main (high pressure) pipelines with a capacity of 288 bcm per year at the point of entry and 179 bcm per year at the exit point. The majority of the natural gas transmission infrastructure in Ukraine is State-owned and operated by Naftogaz's subsidiary Ukrtransgaz.

Ukraine has 13 gas storage facilities with an aggregate capacity of 34 bcm.

Ukraine has no LNG terminals at present. Construction of the first LNG terminal – in the Odessa region – is a Government priority. Recently the US Company Excelerate Energy confirmed the technical feasibility of placing the Floating Storage Regasification Units (FSRU with the annual capacity of 5 bcm) in the port of Yuzhnyi. Soon the negotiations on lease of the FSRU will commence and the units are expected to be installed in the port next year.

1.2 To what extent are Ukraine's energy requirements met using natural gas (including LNG)?

Natural gas is the main component of Ukraine's primary energy supply and in 2010 has accounted for about 43 per cent of total energy consumption, compared to an average world figure of 21 per cent. This makes the Ukrainian economy one of world's most energy-intensive economies. According to the statistical data of 2010 other sources include: coal and turf (28 per cent); nuclear (uranium) (18 per cent); oil (10 per cent); and renewables (1 per cent).

Ukraine neither imports, nor produces, LNG but the Ukrainian population primarily consumes LPG and CNG produced in Ukraine. However, LNG consumption is expected to grow rapidly once construction of the new LNG terminal is completed. Ukraine is engaged in negotiations with Qatar, Azerbaijan, Turkey and South Korea with respect to future LNG supplies to the country.

However, Ukraine may face resistance from Turkey. Turkey controls the Bosphorus and Dardanelles Straits, which connect the Black Sea and Mediterranean Sea. Turkish officials warned that they may deny right of passage to LNG tankers bound for Ukraine due to increased tanker traffic and environmental and safety risks.

1.3 To what extent are Ukraine's natural gas requirements met through domestic natural gas production?

Ukraine's domestic production covers up to 37 per cent (20.2 bcm in 2012) of its total natural gas consumption, which amounted to 54.7 bcm in 2012. The rest is satisfied from natural gas imported by Naftogaz (24.4 bcm in 2012) and by OstChem (8.4 bcm) from Gazprom (Russia).

In 2013 Ukraine aims to reduce volumes of the gas imported from Russia by increasing the share of European gas – in 2013 Naftogaz intends to import up to 1.3 bcm from RWE (through the territories of Poland and Hungary).

1.4 To what extent is Ukraine's natural gas production exported (pipeline or LNG)?

In 2012 the export of natural gas from Ukraine was minimal (less than 90 mcm per year), due to the introduction of high export duties, a restrictive licensing regime and quotas. These export volumes relate to Naftogaz's supply to Poland.

2 Overview of Oil Sector

2.1 Please provide a brief outline of Ukraine's oil sector.

Ukraine has 395 million tonnes of proven oil reserves and 850 million tonnes of potentially recoverable reserves. Most of these are located in the Dnipro-Donetsk basin. The six largest fields together provide about one-fifth of Ukraine's oil production.

Undiscovered oil resources are estimated to be 2.3 billion barrels, with 1.3 billion barrels of oil and 927 million barrels of gas condensate. Over 86 per cent of those potential reserves are located in the Dnipro-Donetsk basin.

Ukraine's oil transportation system consists of the Druzhba main pipelines in the west and Trans-Dnipro main pipelines in the east. The Druzhba corridor is one of two main export routes for Russian oil to Central European refineries. It has a maximum capacity of 1.2 million b/d. The Trans-Dnipro corridor transports oil from Russia to the Lisichansk, Kremenchug, Kherson and Odessa oil refineries in the south and east of Ukraine. The system has a total length of 2,400 kilometres and a capacity of 2.1 million b/d.

2.2 To what extent are Ukraine's energy requirements met using oil?

According to the statistical data of 2010 oil meets about 10 per cent of Ukraine's energy requirements, making it the fourth resource after natural gas, coal and uranium.

2.3 To what extent are Ukraine's oil requirements met through domestic oil production?

Ukraine is a net importer of oil, meeting only around one-third of its demand from domestic production. The main source of crude imports is Russia.

Oil production in Ukraine amounted to 3.3 million tonnes in 2012. The majority of oil production is carried out by Naftogaz's subsidiaries (3.1 million tonnes). The volume of production is lowering one year after another due to depletion of the explored oil reserves. A future production growth is expected to come from the development of the biggest oil deposits – the Subbotina field in the

Black Sea (explored and developed by Chornomornaftogaz, with a planned extraction volume of 0.5 million tonnes), which is expected to begin in 2015.

2.4 To what extent is Ukraine's oil production exported?

In recent years, none of Ukraine's oil production has been exported, owing to changes in the licensing regime and the introduction of quotas. In 2013, the export quota for oil is still zero.

3 Development of Oil and Natural Gas

3.1 Outline broadly the legal/statutory and organisational framework for the exploration and production ("development") of oil and natural gas reserves including: principal legislation; in whom the State's mineral rights to oil and natural gas are vested; Government authority or authorities responsible for the regulation of oil and natural gas development; and current major initiatives or policies of the Government (if any) in relation to oil and natural gas development.

The development of natural gas and oil reserves is governed by a number of industry-focused legal acts, namely:

- the Subsoil Code of Ukraine (the "Subsoil Code"), No. 132/94-BP of 27 July 1994;
- the Law of Ukraine "On Oil and Gas" No. 2665-III of 12 July 2001 (the "Oil and Gas Law");
- the Law of Ukraine "On Product Sharing Agreements," No. 1039-XIV of 14 September 1999 (the "PSA Law"); and
- the Law of Ukraine "On Basic Principles of the Natural Gas Market Functioning" No. 2467-VI, dated 8 July 2010 (the "Gas Market Law").

Article 13 of Ukraine's constitution provides that the Ukrainian nation is the sole owner of the land, subsoil, air, water and other natural resources located within the territory of Ukraine, including its continental shelf and in its exclusive maritime zone. The underlying principle of Ukraine's oil and gas legislation is that, although the Ukrainian nation must remain the owner of the subsoil, it can grant rights to use the subsoil and, once a mineral extracted by a subsoil user reaches the surface, ownership can pass to the subsoil user.

The main State authorities involved in the development of natural gas are:

- the Verkhovna Rada or parliament – which passes primary legislation;
- the Cabinet of Ministers of Ukraine ("CMU") – which passes secondary legislation implementing the primary legislation;
- the Ministry of Energy and Coal Industry – which is responsible for allowing the production stage to commence; and
- the State Geology Service of Ukraine – which issues special permits (licences) to subsoil users (see the following section).

Current major initiatives of the Government are as follows: (i) holding tenders for production-sharing agreements (which relate in particular to the development of unconventional gas deposits and the exploration of the Black Sea shelf); (ii) further development of the PSA legislation (including important modifications to the PSA Law, Land Code, Tax Code, etc.); (iii) diversification of energy supply (by promoting Ukrainian gas production and substituting Russian gas with the one imported from Europe); and (iv) reform (liberalisation) of the gas market based on Ukraine's commitments

to the Energy Community (in particular Naftogaz' subsidiaries are to be reorganised into separate entities and deprived of certain monopoly rights).

3.2 How are the State's mineral rights to develop oil and natural gas reserves transferred to investors or companies ("participants") (e.g. licence, concession, service contract, contractual rights under Production Sharing Agreement?) and what is the legal status of those rights or interests under domestic law?

Any investor (whether foreign or Ukrainian) wishing to conduct exploration and/or production activities in a particular area requires a licence (called a "special permit") in order to begin work. These are issued by the State Geology Service of Ukraine. The special permit can be obtained under one of two different regimes for subsoil use in Ukraine: (1) licensing; and (2) production-sharing.

The licensing regime

Under the licensing regime, the special permits are usually purchased by the investor at an auction held by the Government. The following are notable exceptions to the need for an auction:

- where an investor already holds a special permit allowing exploration in a particular area, and, having fulfilled its obligations under this permit, wishes to proceed to development of the area; and
- if the holder of a special permit relating to a particular area wishes to conduct exploration in an adjoining area, the area to which the special permit relates can be extended by up to 50 per cent.

The PSA regime

Under the PSA regime, the special permit is awarded to an investor as a result of it entering into an agreement with the Ukrainian State, acting through the Government, to share any hydrocarbons extracted by the investor in a particular area. As a rule, PSAs are executed with the winner of a competitive tender, to the investor offering the most attractive terms of cooperation with the State. There is also an option for the subsoil users working under the licensing regime to switch to the PSA without any tender procedures.

The PSA regime is generally the more attractive one to foreign investors, as an investor under a PSA enjoys significant benefits, including tax privileges, a "stability" clause protecting it from adverse changes in legislation, and help from the State in obtaining the necessary permits and authorisations (including the special permit for the relevant subsoil area) to perform the PSA.

3.3 If different authorisations are issued in respect of different stages of development (e.g., exploration appraisal or production arrangements), please specify those authorisations and briefly summarise the most important (standard) terms (such as term/duration, scope of rights, expenditure obligations).

A special permit (see question 3.2) must be obtained for each stage of development. The term of a special permit depends on the operations it covers, as indicated below:

- (a) geological survey, including pilot commercial development of fields: up to five years for onshore operations and 10 years for offshore operations;
- (b) production (extraction) of mineral resources: up to 20 years for onshore operations and 30 years for offshore operations; and
- (c) a combined permit for both of the above stages: up to 20 years for onshore operations and 30 years for offshore operations.

The lifetime of a special permit associated with a PSA may be up to 50 years (which is also the maximum term of a PSA without extensions).

Each special permit is supplemented by a "licensing agreement" between the subsoil user and the Ukrainian State. This licensing agreement establishes the basic rights and obligations of the special permit holder, including the minimum investment obligations, the timeframes and goals of the work programme, and environmental protection requirements.

3.4 To what extent, if any, does the State have an ownership interest, or seek to participate, in the development of oil and natural gas reserves (whether as a matter of law or policy)?

The position of the State differs according to the regime under which development takes place.

The licensing regime

As a matter of policy from year to year, substantial numbers of special permits are usually awarded to State oil and gas companies on a preferential basis. There is no requirement for the State to hold an interest in a special permit awarded to a private company.

The PSA regime

Under the PSA Law, the State receives a share of production under a PSA. The PSA Law states that the investor's share cannot be over 70 per cent at the cost-recovery stage. At the profit-production stage, the practice in previous PSA tenders shows that the State's share is likely to be at least 15 per cent (for unconventional gas projects) and 20 per cent (for oil and gas production).

Examples of PSA tenders held in 2012 demonstrate that the State may also require that the investor develop an area jointly with a State-owned company. This company is likely to be entitled to 50 per cent of the investor's share in profit production. This structure applies in the PSAs relating to the Oleska and Yuzivska areas. In these areas, Shell and Chevron will be working with joint ventures between State-owned Nadra of Ukraine (90 per cent) and SPK-Geoservice (10 per cent).

3.5 How does the State derive value from oil and natural gas development (e.g. royalty, share of production, taxes)?

Under the licensing regime the State derives value through taxation. The principal mechanisms for taxing oil and gas development are as follows:

- (a) Corporate Profit Tax ("CPT") at 19 per cent in 2013 and 16 per cent in 2014 and onwards.
- (b) The subsoil use charge (royalty), which is paid according to the volume and type of hydrocarbons produced and their effective or estimated price. A different rate of taxation applies in respect of oil, condensate or natural gas, the depth at which hydrocarbons are extracted and the area in which the deposits are located. As of 1 January 2013, the rate for oil and condensate can vary between 17 and 39 per cent of the URALS oil price, while the rate for natural gas can vary between 11 and 25 per cent of the average customs value of gas imported in Ukraine.
- (c) VAT, which will be 20 per cent until 2014 and 17 per cent thereafter.

In addition, the payroll (social) withholding with the rate between 36.76 per cent and 49.7 per cent is withheld by the subsoil users from the employees' salaries.

The PSA regime

The above taxes (CPT, the subsoil use charge, VAT), as well as payroll withholding and excise tax (levied on import of excisable goods) also apply to the production-sharing regime. However, the investor enjoys the following taxation privileges for the duration of the PSA:

- (i) the investor may pay CPT in kind, if the PSA provides for this;
- (ii) the investor enjoys a lower rate of subsoil use charge (2 per cent of the URALS price and 1.25 per cent of the average customs value of gas);
- (iii) in certain cases VAT is levied at a zero rate, as for instance, during import or export of equipment needed to carry out operations under the PSA;
- (iv) profits received under the PSA are exempt from the profit repatriation tax; and
- (v) accrual of any other taxes and mandatory payments is substituted by the State's share of profit production.

3.6 Are there any restrictions on the export of production?

Please refer to questions 4.1 and 5.1.

3.7 Are there any currency exchange restrictions, or restrictions on the transfer of funds derived from production out of the jurisdiction?

In general, a transfer of funds out of Ukraine requires a licence from the National Bank of Ukraine. The notable exceptions to this rule are:

- funds transferred to pay for goods, works, services, etc. (this does not include payment for securities);
- repatriation of a foreign investment and the income/profit derived from this foreign investment (e.g., dividends, liquidation proceeds); and
- the payment of interest on a loan and repayment of the body of the loan.

If a payment for services to a non-resident is over EUR 100,000, this payment must be approved by the State agency Derzhzovnishinform before the funds can be transferred abroad. The agency verifies whether the amount to be paid is in line with market prices. Ukrainian law provides for a long list of exceptions. For example, no price valuation statement will be required when a payment is made for financial, travel, communication, freight, and forwarding services supplied from abroad, provided that Ukrainian entities have respective licences to carry out relevant business activities.

A further connected restriction of relevance to a foreign investor requires goods and services exported out of Ukraine to be paid for by the receiving foreign entity within 90 days of the date of export. An investor wishing to export oil and gas production would have to ensure payment by its foreign partner within the 90-day period, or face heavy financial penalties.

The investors under the PSA regime, however, are exempted from many of the above restrictions and may freely transfer funds received from their hydrocarbon operations into, and out of, Ukraine.

3.8 What restrictions (if any) apply to the transfer or disposal of oil and natural gas development rights or interests?

The licensing regime

Article 14 of the Oil and Gas Law prohibits the holder of a special permit from any assignment or transfer of the subsoil use rights, as

well as contributing them in kind either in the capital of subsidiary companies or the joint activity. Notwithstanding that, the special permit holders are entitled to transfer special permits (as a result of introducing amendments thereto) to a new legal entity (i.e., subsidiary company, joint venture, etc.) provided that the share of the "original" permit holder in a new entity exceeds 50 per cent at the time of such transfer and the equipment, property and other assets needed to continue operations under the special permit were successfully transferred to the new entity.

The PSA regime

The PSA Law allows an investor to assign its rights and obligations, subject to the State's consent. In case of a conversion of special permit to the PSA, the special permit holder may apply for the conversion jointly with other co-investors, having no rights in such special permit.

3.9 Are participants obliged to provide any security or guarantees in relation to oil and natural gas development?

The licensing regime

Special permit holders are not required to provide any bank or parent-company guarantees to the State authorities.

The PSA regime

A guarantee of some sort may be required of participants in a PSA tender. Ukrainian law does not provide for a set of standard terms for such guarantees.

3.10 Can rights to develop oil and natural gas reserves granted to a participant be pledged for security, or booked for accounting purposes under domestic law?

The licensing regime

The Oil and Gas Law does not yet allow special permit rights to be pledged or booked for accounting purposes. At the same time, the pledge of minerals (including those which are to be produced by the subsoil user in the future) is not prohibited.

A new draft of the Subsoil Code (which is expected to be adopted in the nearest future) provides for an option of pledging the rights under special permits for financing purposes.

The PSA regime

The PSA Law does not make provision for rights under a PSA to be pledged or booked. Theoretically, it could be done with consent from the State.

3.11 In addition to those rights/authorisations required to explore for and produce oil and natural gas, what other principal Government authorisations are required to develop oil and natural gas reserves (e.g. environmental, occupational health and safety) and from whom are these authorisations to be obtained?

PSA and licensing regime

Under both regimes, the following key authorisations must be obtained (amongst others):

- Land acquisition – documents evidencing land use rights, obtained from local authorities.
- Construction works – (i) documents setting out the city-planning requirements to be reflected in the project design, issued by local city-planning and architectural bodies; (ii) approval of the construction project design by local authorities; and (iii) a permit allowing construction and a

declaration that the works have been completed, issued by the State Architectural and Construction Inspectorate.

- Regulatory – (i) a special permit obtained from the State Geological Service; (ii) a permit to begin hazardous works and to operate hazardous equipment, issued by the State Service for Mining Supervision and Industrial Safety; (iii) permits and quotas for waste generation and disposal, and air pollution, obtained from the local representative bodies of the State Department for Ecology and Natural Resources; (iv) an environmental impact assessment approved by the local representative bodies of the Ministry of Environment and Natural Resources and the State Sanitary-Epidemiological Service; and (v) mining allotment when operations reach the production stage issued by the State Service for Mining Supervision and Industrial Safety.

The PSA regime

Under the PSA regime, investors enjoy certain privileges. It is much easier to obtain documents evidencing land use rights as the investor is allocated land and the corresponding subsoil plots together. The State also ensures the issue of the necessary authorisations relating to mining and construction.

3.12 Is there any legislation or framework relating to the abandonment or decommissioning of physical structures used in oil and natural gas development? If so, what are the principal features/requirements of the legislation?

Ukrainian legislation with regard to abandonment and decommissioning is pretty scarce. According to the Subsoil Code and Oil and Gas Law, abandonment and decommissioning are carried out under the control, and upon the consent, of the Committee for Industrial Safety and local authorities. The subsoil user must ensure that no damage is done to people, property and the environment.

3.13 Is there any legislation or framework relating to gas storage? If so, what are the principle features/requirements of the legislation?

In Ukraine, underground storage facilities (“USF”) are owned by the State. They are operated by Naftogaz’s subsidiary Ukrtransgaz, which holds the necessary licence, issued by the National Commission on State Regulation of the Energy Sector (“NERC”). Ukrtransgaz is also a holder of the special permit for construction and operation of USF (for a period of 50 years), issued by the State Geological Service.

The Gas Market Law requires Ukrtransgaz to ensure that each player in the gas market has equal access to the USF and that gas storage rules are followed.

The storage of gas by Ukrtransgaz is conducted under a gas storage agreement negotiated between Ukrtransgaz and the customer on the basis of the standard form agreement developed by the NERC.

The gas storage tariffs are approved by NERC. Currently they stand at UAH 18 (USD 2.25) per month per 1,000 cm for storage services and UAH 7.5 (USD 0.9) per 1,000 cm for pumping gas in or out.

4 Import / Export of Natural Gas (including LNG)

4.1 Outline any regulatory requirements, or specific terms, limitations or rules applying in respect of cross-border sales or deliveries of natural gas (including LNG).

Export

Since 2006, the export of natural gas has been subject to mandatory licensing. The licences are issued by the Ministry of Economy of

Ukraine, subject to including the relevant volumes in the annual Prognostic Balance of the Natural Gas Input and Output (which is subject to CMU approval). Export volumes remain insignificant: during recent years, the export of natural gas from Ukraine has not exceeded 90 million cm (exported by Naftogaz to Poland).

Oil and gas produced in the context of a PSA are not subject to export restrictions.

Import

Since October 2012, any company licensed to carry out natural gas supply operations in Ukraine may import the natural gas for further supply to consumers. In 2013, the natural gas is imported not only by the above-mentioned companies but also by private VETEK (East European Fuel and Energy Company) and DTEK Naftogaz.

5 Import / Export of Oil

5.1 Outline any regulatory requirements, or specific terms, limitations or rules applying in respect of cross-border sales or deliveries of oil and oil products.

Export

Similarly to natural gas, the export of oil is subject to a licensing and quota regime, with a quota of zero in 2012 and 2013.

The export of oil products is not subject to licensing in Ukraine. In 2011 Ukraine exported 1.7 million tonnes of oil products (+44 per cent in comparison to 2010). There are still no official figures for 2012, however, due to the suspension of operations by Lisichansk (the biggest exporter) and the low level of the national production (1.63 million tonnes of gasoline and 1.36 million tonnes of diesel fuel), the export volumes are expected to be next to nothing.

Import

The import of oil and oil products is not subject to licensing. Import operations must comply with the decree of the Ministry of Finance “On Customs Formalities at Pipelines and Power Lines”, which sets out in detail the customs clearance procedure, timeframes and a list of the relevant customs points. Due to shut down of the biggest oil refineries, only 1.5 million tonnes (-72.7 per cent in comparison to 2011) of oil were imported in Ukraine in 2012.

In 2012 Ukraine imported diesel fuel and gasoline mostly from: (i) Belarus (0.96 million tonnes of gasoline and 2.83 million tonnes of diesel fuel); (ii) Lithuania (0.51 million tonnes of gasoline and 0.15 million tonnes of diesel fuel); (iii) Russia (1.29 million tonnes of diesel fuel); and (iv) Romania (0.28 million tonnes of gasoline).

6 Transportation

6.1 Outline broadly the ownership, organisational and regulatory framework in relation to transportation pipelines and associated infrastructure (such as natural gas processing and storage facilities).

The principal legislation applying to natural gas transportation is the Law of Ukraine “On Pipeline Transport” No. 192/96-BP, dated 15 May 1996 (the “Pipelines Law”).

The existing transport network is owned by the State. Article 7 of the Pipelines Law prohibits the privatisation of the State-owned enterprises that operate it. Only two State-owned companies, namely (Ukrtransgaz and Chornomornaftogaz) hold licences to transport gas through the main pipelines.

A subsidiary of Naftogaz, Ukrtransnafta, is responsible for the transportation of oil through the main oil pipelines.

The company PrykarpatZakhidTrans is responsible for the transportation of oil products. It is a subsidiary of the Southern-Western Open JSC for the Transportation of Oil Products through Pipelines (reportedly owned by Russia).

Modernisation of the UGTS is one of the most ambitious initiatives of the Ukrainian Government. However, it is still unknown whether the EU or Russia would be willing to support Ukraine in this project. In the meantime the Ukrainian parliament is working on the necessary legal framework (for example – the draft laws permitting lease and/or privatisation of the Ukrainian UGTS).

6.2 What Governmental authorisations (including any applicable environmental authorisations) are required to construct and operate oil and natural gas transportation pipelines and associated infrastructure?

Under article 13 of the Pipelines Law, the design, construction, operation and maintenance of pipelines can only be undertaken by licensed entities. The relevant licences are currently held only by the entities mentioned in question 6.1. There are currently no private pipelines operators.

A private company could construct and own main pipelines in Ukraine. However, it might be required to transfer their operation and maintenance to the entities mentioned in question 6.1 unless it obtains the licences and permits required to carry out those activities itself.

The current state of things might change, as according to the recent amendments to the PSA Law, the PSA investors are now entitled to construct and also operate pipelines in Ukraine. The PSA Law does not establish any specific requirements and/or authorisations needed therefor.

6.3 In general, how does an entity obtain the necessary land (or other) rights to construct oil and natural gas transportation pipelines or associated infrastructure? Do Government authorities have any powers of compulsory acquisition to facilitate land access?

If the site of a planned pipeline or related infrastructure is on State-owned or municipal land, then the Land Code of Ukraine authorises the Government body or local authority that owns the land to lease it for this purpose without the need for a land auction.

In the case of privately-owned land, the Land Code allows the owners or users of this land to create easements over it for the purpose of constructing and operating a pipeline. These easements can be created either by contract, by operation of law, or by a court decision.

Governmental authorities cannot expropriate land from landowners. However, the Government and local authorities may purchase land for the purpose of constructing and operating transport networks (including pipelines), subject to the owner's consent, and on the basis of public need. They must contact the owner of the land at least one year before the land is purchased.

6.4 How is access to oil and natural gas transportation pipelines and associated infrastructure organised?

Gas

In general, companies may connect only to the local distribution pipelines. In the event that there is no capacity available for connection to such pipelines, companies are allowed to apply to connect to the main gas transportation pipelines.

A party wishing to use either the local or the main gas pipelines must submit an application to the relevant operator (either a local pipeline operator, or Ukrtransgaz for main pipeline access). The latter is obliged to grant access on a non-discriminatory basis, and cannot deny access without grounds. In response to an application, the operator approves the planned volumes to be transported and provides the customer with the technical specifications for interconnection. For further detail on the organisation of access to gas transportation pipelines, please see question 6.6.

Oil

As for access to pipelines for oil and oil products, the procedures are set out in technical regulations which are not publicly available.

6.5 To what degree are oil and natural gas transportation pipelines integrated or interconnected, and how is co-operation between different transportation systems established and regulated?

Gas

The Ukrainian gas pipelines are components of the Ukrainian Gas Transportation System ("UGTS"). While general operation of the UGTS is performed by Naftogaz, the day-to-day management of gas flow and pipeline maintenance is undertaken by Ukrtransgaz. Ukrtransgaz's centre of operations co-ordinates the co-operation between the different parts of the system.

Oil and oil products

The Ukrainian oil transportation pipelines connect Ukrainian oil refineries and ensure the export of Russian crude oil to the EU. The system is operated by Ukrtransnafta.

Oil products are transported by Prykarpatzakhidtrans via two main corridors (from Ukraine to Hungary and the Slovak Republic), which are parts of the international system for transportation of oil products (connecting Russia, Belarus and Ukraine with the EU).

6.6 Outline any third-party access regime/rights in respect of oil and natural gas transportation and associated infrastructure. For example, can the regulator or a new customer wishing to transport oil or natural gas compel or require the operator/owner of an oil or natural gas transportation pipeline or associated infrastructure to grant capacity or expand its facilities in order to accommodate the new customer? If so, how are the costs (including costs of interconnection, capacity reservation or facility expansions) allocated?

Gas

Under a new law that came into effect on 1 January 2013, Ukrtransgaz is obliged to grant capacity and to expand the gas transportation system to accommodate demand. If it does not do so, it could be forced to do so by a court decision at the request of the NERC.

In the event that there is limited capacity and Ukrtransgaz is unable to accommodate all demand, however, it must observe the following order of priority in granting capacity: (i) market players that supply gas to households, State-financed organisations and companies that provide heating and hot water services; and (ii) customers with the longest-term contracts in place with Ukrtransgaz. Other customers will be granted access in proportion to the capacity they originally booked with Ukrtransgaz.

Ukrtransgaz levies a fee for connection to gas pipelines. The fee covers connection costs and contributes to the cost of new infrastructure. Where a connection requires new infrastructure to be built and the fee does not cover this cost in full, Ukrtransgaz can

use funds from fees paid by other customers connecting to the same securing point. It may also receive financial assistance from the customer, but this must be repaid within five years.

Oil

As noted in question 6.4, regulations governing access to oil pipelines are not publicly available.

6.7 Are parties free to agree the terms upon which oil or natural gas is to be transported or are the terms (including costs/tariffs which may be charged) regulated?

Gas

The parties must agree the terms for gas transportation using a standard gas transportation agreement approved by the NERC. There is little scope for deviation from the standard terms. The prices for gas transportation are set by the NERC and are non-negotiable (recently the average tariff was decreased down to UAH 93.90 (USD 11.60) per 1,000 cm). The local tariffs for transportation of the natural gas (as established by the NERC) differ from one region to another and now vary between UAH 0.90 (USD 0.11) and UAH 250.2 (USD 30.89) per 1,000 cubic metres transported.

Oil and oil products

There is no standard oil (or oil products) transportation agreement publicly available. The prices for transportation services are established by the NERC and are non-negotiable. The prices vary according to region and transportation route. For oil transportation, they do not exceed UAH 51 (USD 6.40) per tonne; for oil products, UAH 88 (USD 11) per tonne.

7 Gas Transmission / Distribution

7.1 Outline broadly the ownership, organisational and regulatory framework in relation to the natural gas transmission/distribution network.

There are two major segments of gas consumers in Ukraine:

- 1) residential customers, heat generation plants and organisations funded by State or municipalities; and
- 2) industrial and commercial customers.

There are two major categories of gas supplier in Ukraine:

- (a) regulated tariff suppliers; and
- (b) non-regulated tariff suppliers.

Regulated tariff suppliers known as “Obligazets” primarily deliver natural gas to residential customers, Government-funded organisations and organisations providing social services. Starting from July 2012 they are considered to be the “guaranteed gas suppliers” (i.e., suppliers by default) for all of the categories of consumers (save for large industrial consumers and heat-producing companies). They usually operate in specific regions of Ukraine, where they lease the gas distribution networks.

The ownership structure of the Obligazets is ambiguous due to their chaotic history of privatisation. Currently, the State, as represented by Naftogaz, holds blocking and controlling stakes in a number of them, however Naftogaz mostly fails to exercise operational control, leaving this to private businessmen. As a result, the Government took the decision to sell its stakes and, according to the recent CMU Resolution, Naftogaz intends to transfer the blocking stakes in 37 Obligazets and controlling stakes in Kyrovogradgaz and Cherkasygas to the State Property Fund for further privatisation in 2013.

The “guaranteed gas supplier” for large industrial consumers and heat-producing companies is Naftogaz. However, industrial and commercial customers prefer to receive gas from the non-regulated tariff suppliers that are independent licensed gas traders. Please refer to section 8 for more information on them.

7.2 What Governmental authorisations (including any applicable environmental authorisations) are required to operate a distribution network?

Historically, private gas traders have not operated gas distribution networks, nor have they supplied gas to households, Government-funded organisations or social services in Ukraine. This is because companies supplying gas at a regulated tariff are required by law either to own or to lease the gas distribution networks. Obligazets operating these networks must hold licences issued by the NERC and comply with numerous safety regulations.

7.3 How is access to the natural gas distribution network organised?

The procedure is similar to the one described in questions 6.4 and 6.6 above. The only real difference is that the party wishing to obtain access to the distribution network and connection services must enter into a contract with the local gas distributor (Obligaz) rather than Ukrtransgaz.

7.4 Can the regulator require a distributor to grant capacity or expand its system in order to accommodate new customers?

Again, the position with respect to requiring the Obligazets to grant capacity is similar to the position with respect to Ukrtransgaz described in question 6.6.

7.5 What fees are charged for accessing the distribution network, and are these fees regulated?

The fees are charged on a similar basis to that described for connection to gas pipelines in question 6.6.

7.6 Are there any restrictions or limitations in relation to acquiring an interest in a gas utility, or the transfer of assets forming part of the distribution network (whether directly or indirectly)?

There are no restrictions on the acquisition of shares in a gas utility, save for those relating to competition law matters (please see section 11 on this point). This stands in contrast to the restrictions on pipeline ownership. Indeed, complete privatisation of Ukrainian Obligazets is ongoing and the next round is very likely to happen in the nearest future.

8 Natural Gas Trading

8.1 Outline broadly the ownership, organisational and regulatory framework in relation to natural gas trading. Please include details of current major initiatives or policies of the Government or regulator (if any) relating to natural gas trading.

Currently there are about 300 companies licensed to supply gas at non-regulated tariffs in Ukraine. They are either large industrial

companies or traders. Large industrial companies buy gas for their own needs. The traders are usually private companies or joint ventures that supply gas to the industrial sector.

Despite the fact that these gas traders are deemed to supply gas under “non-regulated tariffs”, the NERC still sets price caps on the natural gas supplied to industrial and commercial customers. The cap is currently fixed at UAH 3,459 (USD 427) per 1,000 cm (before VAT and extra charges) which is 1.4 per cent lower in comparison to the previous years.

Gas traders must hold a licence to supply gas at non-regulated tariffs. Licences are issued by the NERC.

8.2 What range of natural gas commodities can be traded? For example, can only “bundled” products (i.e., the natural gas commodity and the distribution thereof) be traded?

The range of natural gas commodities that may be traded in Ukraine include natural gas (including coal bed methane and types of unconventional gas) and compressed natural gas. Ukrainian law does not have a concept of “bundled” products in gas trading.

9 Liquefied Natural Gas

9.1 Outline broadly the ownership, organisational and regulatory framework in relation to LNG facilities.

Ukraine has no LNG terminals at present. Construction of the first LNG terminal – in the Odessa region, near the port of Yuzhnyi – is a Government priority. The terminal will be built in two phases. Phase 1 is due to be completed by 2016. By the end of this phase the Floating Storage Regasification Units (“FSRU”) with capacity to process 5 bcm of natural gas per year will be installed in the water area of the port and connected to the gas pipelines. Phase 2 (construction of the shore-based terminal for tanker unloading, reservoirs and storage facilities) is due to be completed in 2018, and will increase the terminal’s capacity to 10 bcm a year. The Ukrainian Government plans to hold a stake of around 25 per cent in the project. The natural gas for the Ukrainian LNG-terminal is expected to be supplied from Qatar and Azerbaijan (through the Turkish Straits). Currently the Government is negotiating terms and conditions for FSRUs lease, the units are expected to be installed in 2014.

9.2 What Governmental authorisations are required to construct and operate LNG facilities?

Ukrainian law does not specifically provide for the construction and operation of LNG facilities. The authorisations generally required for construction projects will apply here.

9.3 Is there any regulation of the price or terms of service in the LNG sector?

Ukrainian law makes no specific provision with respect to the price or terms of service in the LNG sector.

9.4 Outline any third-party access regime/rights in respect of LNG Facilities.

Again, Ukrainian law does not make specific provision for this.

10 Downstream Oil

10.1 Outline broadly the regulatory framework in relation to the downstream oil sector.

There are six oil refineries in Ukraine: Odessa Refinery (owned by VETEK); Lisichansk Refinery (Rosneft); Kherson Refinery (Alliance Oil); Kremenchug Refinery (Ukratnafta and Privat Group); Drogobych Refinery (Privat Group); and Nadvirna Refinery (Privat Group). Of these, Lisichansk and Kremenchug are the largest. The refineries’ total primary processing capacity is 51.1 million tonnes of oil per year.

The refining of crude oil and sale of oil products is not subject to licensing in Ukraine. Many of the downstream oil sector’s operations are governed by the regulations in the Instructions on Acceptance, Transportation, Storage, Sale and Accounting of Oil and Oil Products, dated 20 May 2008. Retail sales of oil products by fuel filling stations must comply with the Rules for Retail Sales of Oil Products dated 20 December 1997, which regulate how filling stations are operated and receive, store and sell oil products.

10.2 Outline broadly the ownership, organisation and regulatory framework in relation to oil trading.

Oil traders fall into two categories: State-owned; and privately-owned traders. State-owned companies are licensed and can only sell the oil they produce at auctions – a process that lacks transparency.

In contrast, private oil producers may sell crude oil directly to oil refineries. They are not required to follow the auction procedure, nor even hold a licence. Each oil producer determines the price of its crude oil independently. Despite their being no need for them to hold auctions, some still prefer to do so.

11 Competition

11.1 Which Governmental authority or authorities are responsible for the regulation of competition aspects, or anti-competitive practices, in the oil and natural gas sector?

The Antimonopoly Committee of Ukraine (“AMC”) is responsible for enforcing competition law in Ukraine.

In Ukraine, natural gas transportation, distribution and storage are considered to be natural monopolies. As such, the NERC is responsible for regulating them. The NERC’s functions include approving and setting tariffs, establishing the licensing requirements for activities in this sector, and monitoring and controlling them.

11.2 To what criteria does the regulator have regard in determining whether conduct is anti-competitive?

Ukrainian law prohibits the abuse of market dominance and anti-competitive concerted practices.

Although holding a dominant position is not, of itself, prohibited in Ukraine, companies having a 35 per cent or greater market share usually fall under the scrutiny of the Ukrainian competition authorities. Abuse of a dominant position is treated as one of the hard-core violations of competition law, triggering significant financial penalties on infringers. Abusive behaviour would include: (i) setting high prices that would be unsustainable in a competitive market; (ii) limiting the supplies of goods on the market when there

are no alternative sources of supply; and (iii) excluding competitors from the market.

11.3 What power or authority does the regulator have to preclude or take action in relation to anti-competitive practices?

The AMC has a wide range of functions and powers, in particular:

- to monitor and control companies' compliance with competition law;
- to review applications and to investigate suspected infringements;
- to decide whether or not the actions of an entity violate competition law;
- to apply to the competent authorities to withdraw the licences of companies that have violated competition law; and
- to impose fines of up to 10 per cent of revenue.

For its part, the NERC is authorised:

- to issue instructions and to impose binding resolutions on entities in the natural gas sector; and
- to impose financial penalties and apply sanctions on entities that have violated competition law (e.g., by withdrawing their licence).

11.4 Does the regulator (or any other Government authority) have the power to approve/disapprove mergers or other changes in control over businesses in the oil and natural gas sector, or proposed acquisitions of development assets, transportation or associated infrastructure or distribution assets? If so, what criteria and procedures are applied? How long does it typically take to obtain a decision approving or disapproving the transaction?

AMC clearance is required for a transaction if it would result in the market share of the parties (including their affiliates) exceeding 35 per cent.

AMC clearance is also required for the acquisition of 100 per cent of the shares in a company, if the parties to the transaction meet all of the following financial thresholds:

- the worldwide assets or sales of all of the parties to the transaction (including their group entities) exceed EUR 12 million in the financial year preceding the transaction;
- the worldwide assets or sales of at least two parties to the transaction (including their group entities) exceed EUR 1 million each in the financial year preceding the transaction; and
- the Ukrainian assets or sales of at least one party to the transaction (including its group entities) exceed EUR 1 million in the financial year preceding the transaction.

Clearance can be obtained in an average of 45 days (for simple cases) to 4.5 months (for complex cases).

12 Foreign Investment and International Obligations

12.1 Are there any special requirements or limitations on acquisitions of interests in the natural gas sector (whether development, transportation or associated infrastructure, distribution or other) by foreign companies?

There are, in general, no specific requirements or limitations with respect to foreign companies acquiring interests in Ukrainian oil and gas companies. Foreign companies may also participate in the tenders that are part of the ongoing privatisation process in this

sector, unless they fall into one of the following categories:

- legal entities registered in offshore zones and countries black-listed as non-cooperative in the global fight against money laundering and terrorist financing; and
- companies or joint ventures in which either the Ukrainian State or a foreign State have an interest greater than 25 per cent (including via State-owned enterprises).

12.2 To what extent is regulatory policy in respect of the oil and natural gas sector influenced or affected by international treaties or other multinational arrangements?

The regulatory policy in this sector is influenced by relations with the EU and the IMF.

EU

Policy is affected by Ukraine's obligations under agreements with the EU, in particular the Energy Charter Treaty and the Protocol on Accession of Ukraine to the Energy Community.

These have spurred a reorganisation of Naftogaz to break up its monopoly over the gas market. A law passed in April 2012 provided for the Naftogaz subsidiaries controlling gas storage and transportation to become separate entities. In October 2012 Naftogaz' monopoly over the supply of imported gas was abolished. However, in 2013 the reforms slow down and the debates are still ongoing in the parliament with respect to further steps. According to the Ukraine-EU arrangements the requirements of the third energy package must be implemented in Ukraine prior to January 2015.

In September 2013 the Ukrainian Government approved a draft of the association agreement with the EU, which would provide for the mutual access to commodity markets. The draft association and free-trade agreement had been on hold since March 2012 and this is the first step towards Ukraine membership to the EU. However, it is still unclear whether the EU will sign the association agreement with Ukraine at the third Eastern Partnership Summit in Vilnius, due to take place in November 2013. The EU is pushing for a reform of the judiciary and the electoral laws in Ukraine, and release from prison of former Prime Minister Yulia Tymoshenko.

IMF

The IMF has urged Ukraine to raise gas prices for households on a number of occasions, as part of a programme to reduce State subsidies in the domestic gas market. So far this has been rejected by Ukraine. In addition IMF insists on reduction of the budgetary funding of Naftogaz. The State-run monopoly received more than USD 6 billion of subsidies from 2009 to 2012 as regulated gas prices and expensive Russian energy imports led to losses. This policy prevented Ukraine from balancing its budget over the past decade.

13 Dispute Resolution

13.1 Provide a brief overview of compulsory dispute resolution procedures (statutory or otherwise) applying to the oil and natural gas sector (if any), including procedures applying in the context of disputes between the applicable Government authority/regulator and: participants in relation to oil and natural gas development; transportation pipeline and associated infrastructure owners or users in relation to the transportation, processing or storage of natural gas; downstream oil infrastructure owners or users; and distribution network owners or users in relation to the distribution/transmission of natural gas.

Disputes in the oil and gas sector mostly fall within the jurisdiction of the administrative and commercial courts. Disputes with

Government authorities and regulators are considered by local administrative courts. Commercial disputes between private companies or between private companies and utilities are considered by the commercial courts.

The PSA Law provides that disputes under a PSA should be considered by the Ukrainian courts unless the parties agree otherwise in the PSA. The parties are therefore free to decide that disputes should be resolved by foreign courts or by international arbitration.

13.2 Is Ukraine a signatory to, and has it duly ratified into domestic legislation: the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards; and/or the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID")?

Yes. The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards was ratified by the Soviet Union in 1960, and by Ukraine in 1961. Ukraine ratified the ICSID in 2000.

13.3 Is there any special difficulty (whether as a matter of law or practice) in litigating, or seeking to enforce judgments or awards, against Government authorities or State organs (including any immunity)?

The enforcement of foreign judgments used to be problematic in Ukraine in cases where there were no treaties in place providing for enforcement. However, in 2010, the Code of Civil Procedure was amended to allow enforcement based on the reciprocity principle. Reciprocal enforcement is now presumed to exist, unless otherwise proved by the respondent.

Ukraine also has a long history of enforcing court decisions made in countries that are signatories to the Minsk Convention on Civil, Family and Criminal Law Issues, Legal Assistance and Legal Relationships (signed in 1993 between CIS countries). Moreover, Ukraine has a number of bilateral legal assistance treaties that provide for the enforcement of foreign judgments, predominantly with formerly socialist countries.

Despite Ukraine's accession to the New York Convention, national courts are still relatively inexperienced in enforcing arbitral awards. As a result there are occasions when judges may be considered to exercise too liberally their discretion to refuse to enforce an award on grounds of public policy. Nevertheless, the overall rate of successful enforcement of foreign judgements and arbitral awards is over 90 per cent.

13.4 Have there been instances in the oil and natural gas sector when foreign corporations have successfully obtained judgments or awards against Government authorities or State organs pursuant to litigation before domestic courts?

In December 2012, the Stockholm Arbitration Court approved a final ruling in a gas supply dispute between Ukraine's Naftogaz and Italy's IUGAS. The case is that in 2003 Naftogaz and IUGAS entered into a gas supply agreement covering sales of up to 13 bcm of natural gas in 2003-2013 at USD 110 per 1,000 cm. After entering into the contract, material changes occurred in the gas markets which resulted in export restrictions being enacted throughout Ukraine. In January 2008, IUGAS requested arbitration under the contract. As a result (according to mass media) now

Naftogaz must perform its obligations under the contract and provide IUGAS with the natural gas at the price of USD 110 or pay damages. However, it is not yet known if IUGAS has tried to enforce the arbitral award in Ukraine.

On 28 December 2012 a settlement agreement between the Cabinet of Ministers of Ukraine and Vanco Prykerchenska was approved by the arbitration tribunal in Stockholm. The USD 100 million dispute arose out of the unilateral termination by the Cabinet of Ministers of Ukraine of a PSA executed on 19 October 2007 with Vanco, which was awarded as a result of the tender for the Prykerchenska subsoil block of the Black Sea continental shelf. In 2007 the licence for subsoil use issued to Vanco was revoked, and the PSA was later terminated by the Government. In 2008 Vanco Prykerchenska initiated arbitration, but the parties took the decision to sign the settlement agreement at the end. The arbitral award (and the respective settlement agreement) was approved by the Ukrainian courts in June 2013 and now it is valid and effective in Ukraine. On 11 February 2013 the Government renewed the Vanco PSA.

14 Updates

14.1 Please provide, in no more than 300 words, a summary of any new cases, trends and developments in Oil and Gas Regulation Law in Ukraine.

2012 was a year of revolutionary changes in the structure of imported gas supply. Using the reverse-flow scheme (i.e., the opposite of the normal flow of Russian natural gas through Ukraine to European customers), Naftogaz has managed to import natural gas purchased from Germany's RWE. Volumes of the reverse flows of natural gas have reached 56 mcm in November-December 2012 and 1.1 bcm in January-August 2013.

The point of using the reverse flow scheme is that Gazprom is charging Ukraine so much for gas (up to USD 530 per 1,000 cubic metres) that buying it from European suppliers appears to be cheaper (approximately USD 390 per 100 cubic metres) than getting it directly from Russia. In September 2013, Naftogaz also signed an agreement with RWE creating a legal framework for "virtual reverse" and further natural gas supply from RWE – a deal that does not contain binding purchase or supply commitments, such as required by Gazprom.

In 2012, the legal framework for PSAs was somewhat improved with the adoption of Law No. 5406-VI dated 2 October 2012 "On Amendments to Certain Legislative Acts of Ukraine with Respect to Performance of the Production Sharing Agreements". As a result, investors received additional benefits from the PSA regime and the PSA Law itself became more adapted to the international oil and gas practice. We expect that improvement of the PSA legislation continues in 2013-2014, in particular, with respect to further liberalisation of the PSA regime, use of complex multilateral agreements and adoption of legal acts regulating offshore E&P activities.

In December 2012 the Ministry of Energy and Coal Industry adopted the procedure for drafting and approval of the balances for supply and distribution of the natural gas in Ukraine. The procedure is aimed at the liberalisation of the Ukrainian gas market, as it is the first document ever, which provides for the mechanism of development and approval of the annual and monthly balances of all natural gas that is imported, produced and is then distributed among different types of consumers in Ukraine.

2012-2013 has been one of the most difficult periods for the oil refinery industry in Ukraine. In the first half of 2013 only 1.51

million tones of oil was processed at the domestic refineries. Kremenchug oil refinery became the only operating refinery in Ukraine, while the rest were shut as a result of low efficiency and considerably cheaper oil products being imported from neighbouring countries. In the meantime Eastern-European Fuel and Energy Company (VETEK, Ukraine) and Lukoil (Russia) completed the deal on the sale and purchase of the Odessa oil refinery. The refinery may be put back to operation by VETEK in October 2013.

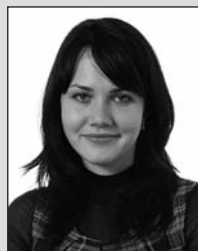


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