

# NATURAL GAS EXPORT: CHALLENGES OF STATE REGULATION AND CONTROL

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*Export of natural gas is becoming ever more important for the economy of the Russian Federation. The circumstances mentioned above, as well as the strategic value of natural gas as an energy resource make adequate legal support in the field of state regulation and control necessary. Peculiarities of natural gas customs declaration are due to specific features of natural gas as an energy resource. These include the need for continuous natural gas supply via pipelines. The quantity of natural gas supplied is determined by dedicated metering devices and specified in the corresponding monthly reports.*

*The most pressing issues of natural gas exports include the procedures for customs declaration and customs valuation by customs authorities. The key aspect of customs declaration when exporting natural gas is that the customs applicant must submit a temporary declaration and a full declaration. With temporary periodic declaration, it is not two separate procedures that take place, but rather one, continuous procedure of customs clearance of the exported natural gas starting with submission of a temporary customs declaration by the applicant and ending with submission of a full customs declaration. The applicant specifies final information on the delivery based on the documents drawn up upon completion of the natural gas delivery in the full customs declaration. This approach means that the customs applicant should not be held administratively liable for failing to declare goods based on the information provided in the temporary customs declaration, as long as they include full details on the quantity and other supply terms in the full customs declaration.*

*Challenges also arise during customs valuation of the exported natural gas and imposition of administrative sanctions for failure to deliver currency returns due to circumstances beyond the exporter's control. The author offers a case law analysis of dispute settlement and suggestions on how to improve the existing legal regulation model.*

**Keywords:** energy law, legal regulation of natural gas export, state regulation, state control.

Export of natural gas is becoming ever more important for the economy of the Russian Federation. From just 138.6 billion m<sup>3</sup> in 2010, the volume of natural gas exported in its gaseous form increased to 200.8 billion m<sup>3</sup> in 2018. [1]

The Power of Siberia pipeline supplies gas to China since December 2019. [2] Under the contract for delivery of Russian gas along the “Eastern” route, 38 billion m<sup>3</sup> of gas will be supplied to China annually [3].

As per statistical reports of the Russian Federal Customs Service, 219.9 billion m<sup>3</sup> of natural gas for the amount of USD 41,633.1 billion was exported in 2019. [4]

The circumstances mentioned above, as well as the strategic value of natural gas as an energy resource make it necessary to ensure state control over public relations arising during natural gas exports.

State regulation of the natural gas export relations means that the government represented by authorized bodies takes action seeking to establish a procedure for exporting natural gas. The government implements regulation of natural gas export activities by adopting relevant international and national laws and regulations. The entirety of these laws and regulations creates a system of requirements and limitations that are to be met in order to export natural gas.

Principal laws and regulations governing natural gas export from the Russian Federation are the Customs Code of the Eurasian Economic Union (hereinafter referred to as the EAEU Customs Code), Federal Law No. 289 On Customs Regulation in the Russian Federation and Introduction of Amendments to Certain Laws of the Russian Federation (hereinafter referred to as the Federal Law on Customs Regulation), Federal Law No. 164 On Fundamentals of State Regulation of International Trade, Federal Law No. 117 On Gas Export, Decree of the Government of the Russian Federation No. 1694 On Approval of the Rules for Customs Valuation of Goods Exported from the Russian Federation, etc.

To ensure compliance with the natural gas export procedure, the government establishes state control measures, i.e., a set of actions aimed at checking the exporters' compliance with the natural gas export regulations.

State control over natural gas export is implemented via authorized government bodies vested with the corresponding powers.

Successfully completing the customs formalities is necessary to export natural gas.

Natural gas export customs regulation has a number of peculiarities that are to be considered when engaging in such activities.

An analysis of provisions of the EAEU Customs Code shows that it is the member states of the Eurasian Economic Union that

are largely responsible for regulation of natural gas export relations. First of all, it can be seen in the peculiarities of natural gas customs declaration, determination of export customs duties for natural gas, as well as in the procedure of declaring customs valuation methods for the exported goods by the customs applicant. In accordance with Article 3 Part 3 of Russian Law No. 5003-1 on the Customs Duty Rate dated May 21, 1993, export customs duty rates and the list of goods they apply to are established by the Government of the Russian Federation, unless otherwise stipulated thereby.

As per Decree of the Government of the Russian Federation No. 754 on Approval of Export Customs Duty Rates for Goods Exported from the Russian Federation to Countries Other than the Customs Union Treaty Parties, and Repeal of Certain Enactments of the Government of the Russian Federation dated August 30, 2013, the export customs duty for natural gas (code 2711 21 000 0 under the Foreign Economic Activity Commodity Nomenclature) is 30%.

The most problematic aspects of natural gas exports include the procedures for customs declaration and customs valuation by customs authorities.

Customs clearance of exported natural gas is performed by temporary periodic declaration. Specific aspects of such customs declaration are established in Articles 102 and 204 of the Federal Law on Customs Regulation. Consideration should be given to Article 204 of the Federal Law on Customs Regulation establishing the points of temporary periodic declaration for goods delivered via pipelines that include natural gas.

The key aspect of customs declaration when exporting natural gas is that the customs applicant must submit a temporary and full declarations. [5] Before making the delivery, the applicant has to submit a temporary customs declaration (TCD) stating the provisional information on the planned delivery of natural gas, and pay at least 50% of the customs duty calculated based on the information in the temporary customs declaration.

No later than on the 20th day of the month following the month of delivery, the applicant must submit a full customs declaration (FCD). The applicant has to specify definitive information

on the actual quantity of natural gas delivered in the FCD and pay the rest of the customs duty.

In practice, this peculiarity of the temporary periodic declaration procedure requiring a two-step process of exported natural gas customs clearance resulted in disputes between the customs authorities and the applicant. The customs authority held companies administratively liable under Article 16.2 Part 1 of the Code of Administrative Offenses of the Russian Federation (hereinafter referred to as the CAO of Russia) for failing to declare goods, when the quantity of natural gas declared in the FCD upon completion of the export procedure exceeded the quantity stated in the TCD before the delivery.

If submission of the temporary and full customs declarations were considered two separate procedures, the applicant would be obliged to state the entire volume of exported natural gas in the TCD. In this case, declaration of larger quantities of natural gas in the FCD would not be allowed.

However, according to the author, this approach would contradict the purpose of establishing the temporary periodic declaration procedure in the Customs Laws. Peculiarities of natural gas customs declaration are due to specific features of natural gas as an energy resource. Peculiarities of legal regulation of foreign economic transactions in the gas sphere were investigated in the works of V.V. Romanova. [6] These include the need for continuous natural gas supply via pipelines. The quantity of natural gas supplied is determined by dedicated metering devices and specified in the corresponding monthly reports. As per Article 204, Part 26, of the Federal Law on Customs Regulation, reports on actual deliveries drawn up based on the readings of metering devices the location of which is specified by the foreign trade contracts for natural gas delivery are used to confirm its quantity and quality during customs declaration of the natural gas transported via pipelines.

When submitting a TCD, the applicant cannot know the exact quantity and quality of the natural gas to be delivered in the next month of delivery.

As the Constitutional Court of the Russian Federation justly noted, both temporary and full customs declarations are submitted to the customs within one set of relations, namely the periodic customs declarations procedure. [7]

Therefore, with temporary periodic declaration, it is not two separate procedures that take place, but rather one, continuous procedure of customs clearance of the exported natural gas starting with submission of a TCD by the applicant and ending with submission of an FCD. The applicant specifies final information on the delivery based on the documents drawn up upon completion of the natural gas delivery in the FCD.

This approach means that the customs applicant should not be held administratively liable for failing to declare goods based on the information provided in the TCD, as long as they include full details on the quantity and other supply terms in the FCD. It should be mentioned that this viewpoint was reasonably supported by case law. Therefore, courts refused to impose administrative sanctions on customs applicants under Article 16.2, Part 1, of the CAO of Russia, when customs authorities relied solely on the information provided in the temporary customs declaration. [8]

The author believes that using the temporary periodic declaration procedure for natural gas exports makes it possible to accommodate both public and private interests. Public interests are accommodated by exact and timely transfer of customs duties for the exported natural gas to the treasury as at least 50% of the customs duty is paid by the applicant prior to the delivery while the balance payment is made no later than on the 20<sup>th</sup> day of the month following the month of delivery. Meanwhile, private entities are given the opportunity to comply with the conditions of customs declaration for exported natural gas by providing the exact details on the quantity of natural gas sold after the delivery.

Customs valuation is one of the most important customs controls for natural gas exports since the customs duty and, therefore, the amount to be transferred to the treasury are directly related to the customs value.

As per Article 38, Clause 4, of the EAEU Customs Code, the customs valuation procedure for exported goods is established by the laws of the EAEU member states. In the Russian Federation, this procedure is established by Decree of the Government of the Russian Federation No. 1694 dated December 16, 2019, enacting the Rules for Customs Valuation of Goods Exported from

the Russian Federation according to Article 23, Part 2, of the Federal Law on Customs Regulation.

Thus, when exporting natural gas, the applicant declares the customs value in the TCD and FCD. The customs duty is 30% of the customs value of the declared natural gas.

In accordance with the Rules, the customs value is based on the cost of the export transaction, i.e., the price paid or payable under the foreign trade contract.

Thus, the customs value of exported natural gas is generally calculated on the basis of the natural gas cost (price) determined according to the foreign trade contract terms.

Customs control is executed in accordance with Article 313 Clause 1 of the EAEU Customs Code and includes checking correctness of the customs value calculation method, structure, and amount specified by the applicant, availability of documents confirming the statements.

In practice, customs authorities use databases containing information on the cost of exported goods to check whether the customs value specified by the applicant is correct. Discrepancies between the information provided by the applicant during customs declaration of exported natural gas and the information in the customs authorities' databases often led to disputes. Changing the method from the transaction value method (Method 1) to the identical goods method (Method 2) usually resulted in additional customs charges.

Important clarifications regarding customs valuation are provided in Ruling of the Plenum of the Supreme Court of the Russian Federation No. 49 on Certain Issues Arising in Litigation in Relation to Enactment of the Customs Code of the Eurasian Economic Union dated November 26, 2019.

In particular, the Supreme Court of the Russian Federation states that the transaction value cannot be rejected by the customs authority just because it is lower than the prices of identical goods present in the data available to the customs authority. At the same time, if the customs value is significantly different from comparable prices of identical goods, it would be reasonable to require the applicant to provide documents confirming that the much lower price declared by the applicant is justified. Furthermore, the customs

authorities must take business practice into account when determining whether the declared customs value is adequately justified.

The court practice analysis shows that, in case of natural gas exports, customs authorities often rely on the inconsistency between the customs value declared by the applicant and the information regarding other natural gas export deliveries available to the authorities as the sole argument to justify correction of the customs valuation method and additional customs charges. This behavior of the customs authorities seems unreasonable since multiple factors have to be considered to determine the actual cost of exported natural gas.

Such parameters as the contract term (long-term or short-term), natural gas volume, its intended use (for business or technical purposes), etc. are of crucial significance for comparing natural gas supply transactions. Without considering these criteria, it cannot be determined whether goods are identical since each of these criteria has a direct impact on the natural gas price. Therefore, the approach adopted by commercial courts where the customs authority has to consider all of the above parameters when determining identical goods in natural gas export transactions seems reasonable. [9]

Export sales of natural gas leads to currency receipts in consideration for the exported natural gas.

Legal regulation of relations associated with currency assets is executed in accordance with Federal Law 173 On Foreign Exchange Regulation and Control, Instruction of the Bank of Russia № 181-И dated August 16, 2017, etc.

To comply with the foreign exchange control requirements, the exporting company must register the foreign trade contract for natural gas export with an authorized bank.

The key foreign exchange control requirement is that the exporter (resident) must have its currency earnings received for the goods delivered to a non-resident company credited to their bank accounts with authorized banks (Article 19 Clause 1 Part 1 of the Federal Law on Foreign Exchange Regulation and Control).

Failure to do so entails sanctions under Article 15.25 Part 4 of the CAO of Russia, including a fine from three fourths to the entire amount not credited to the accounts with authorized banks.



Thus, the exporting company must ensure receipt of currency from the foreign buyer. Obviously, it is impossible to ensure advance payments for all international delivery transactions in business practice. There are many disputes related to situations when currency earnings were not received due to circumstances beyond the exporter's control.

The approach adopted by the courts is that there are no grounds to impose administrative sanctions on a resident for failing to ensure currency receipts within the time stipulated by the foreign trade contract, if there was no misconduct on the part of the resident and if the resident used its best efforts to receive currency earnings within the time stipulated by the foreign trade contract. [10]

It should be acknowledged that this approach helped decrease the number of cases when residents were held administratively liable for failure to repatriate currency earnings. However, it is not always evident whether a resident exercised its best efforts to receive currency

earnings, or which efforts are sufficient to avoid the risk of administrative sanctions imposition.

A decision on whether there are grounds for imposing administrative sanctions on a resident is made according to the actual circumstances of a specific case and the court's discretion, which adds to the uncertainty in foreign trade.

Such strict requirements for natural gas deliveries are not always reasonable. Most natural gas deliveries are export transactions consummated under long-term natural gas supply contracts. Contracts with major importers have been in effect for decades, e.g., natural gas has been exported to Austria since 1968, to Germany since 1973, to Italy since 1974, to France since 1975. [11] With this in mind, importers are reliable payers under foreign trade contracts.

In view of the aforesaid, it seems reasonable to extend the existing procedure for foreign exchange regulation and control in natural gas exports to include provisions on exemption from sanctions for failure to receive currency earnings. ■

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