CONTRACTUAL REGULATION OF HYDROCARBON FIELD DEVELOPMENT RELATIONS AT THE DOMESTIC AND INTERNATIONAL LEVELS WITH THE USE OF UNITIZATION AGREEMENTS

DOI 10.18572/2410-4396-2021-4-94-99

Lyubov I. Shevchenko
Doctor of Law, Professor
Honored Lawyer of the Russian Federation
Professor of the Department of Legal Regulation of the Fuel and Energy Complex (FEC) of the International Institute of Energy Policy and Diplomacy of the Moscow State Institute of International Relations (University) of the Ministry of Foreign Affairs of Russia
shevchenkoli@mail.ru

One of the tasks of the Energy Strategy of Russia is a comprehensive analysis of various spheres of the fuel and energy complex of the economy to identify the problems of functioning and use any required mechanisms for the regulation of different relations arising in this sphere including creation of an improved system of the applicable energy law, broader and more efficient use of the contractual regulatory potential. The issue of the use of contractual regulation methods in subsoil use attracts the most interest in this sphere; unitization agreements are of special significance. Such agreements enable mutually beneficial cooperation between various parties to the energy community in the hydrocarbon field development at the domestic and international levels facilitating the approximation of states in the legal and political framework. The author continues studies of unitization agreements that were briefly characterized from the legal standpoint by the author in the third issue of the Energy Law Forum journal for 2021.

Keywords: *energy law; hydrocarbon field development, transborder fields, unitization agreements.*

Domestic subsoil laws of many states include provisions on the regulation of transborder hydrocarbon fields requiring subsoil users to cooperate with each other in the field development as such cooperation has a positive impact on the rational use and protection of subsoil. The achievement of these objectives is facilitated by unitization agreements as a tool used in subsoil use that is gathering momentum in its application practice and is an efficient method to reach a consensus in the development of transborder fields.

It should be noted that unitization as a form of cooperation between two or more subsoil users entitled to develop and exploit a single field has been reflected in the Russian law in the Regulation on the Procedure for Licensing of Subsoil Use [1]. Unitization implies that all transborder field users enter into a single unitization agreement granting certain rights and imposing certain obligations

on each party to such agreement in terms of the joint field development. Not only individual subsoil users, but also states can be parties to a unitization agreement. The main goal of a unitization agreement is that if a field is developed jointly by several subsoil users, the latter, although acting on their own behalf, will do good and facilitate the activities of other parties to the agreement for the purposes of the most efficient exploitation of the field.

The following types of agreements can be singled out in this sphere: international unitization agreement referring to an interstate transborder field, where the subjects are states whose borders are crossed. In this case, the parties agree on a single fundamental action plan in relation to the use of the transborder field. Another type of a unitization agreement is characteristic of the cases when a field is located in a federated state on the administrative border of two constituent entities of the Russian Federation. In this case, the mentioned activity is primarily regulated by the laws of the constituent entities the field is located in and the field use agreement concluded between such constituent entities. Federal subsoil use laws may be applied to the solution of fundamental issues except for the cases when the field itself is owned by the state. One more type is a unitization transborder field use agreement concluded between the direct holders of rights to such a field, namely, between subsoil users. However, we cannot conclude that the state makes no impact on the activities of subsoil users: the state sets the key unitization parameters and exercises due control over the agreement conclusion and fulfillment process.

As a general rule, unitization agreements have a certain structure used as a basis, depending on their specific features. General requirements for the structure, content of unitization agreements are imposed by special typical (standard) agreements developed by government organizations. If the parties desire to introduce some amendments to a typical (standard) unitization agreement in accordance with the specifics of the established relations, the introduction thereof should be approved by the relevant authorized agencies; a standard unitization agreement may be amended only following a review and obtainment of a positive conclusion from the relevant agencies.

A unitization agreement should at all times determine the following:

- territory of the agreement consisting of several sites;
- obligations of the parties, namely the obligation to develop the field based on a single project and a common approved cost estimate;
- shares in the unitization agreement and the share revaluation procedure;
- procedure for the assessment and reevaluation of mineral reserves for the distribution of extracted products;
- procedure for the distribution and redistribution of extracted products and costs between subsoil users;
- establishment of a governing body to oversee transactions under the agreement;
- appointment of an operator, its rights and obligations;
- procedure for drawing up and approving of cost estimates and development programs;
- information exchange procedure;
- customs regime peculiarities;
- taxation and accounting.

The following concepts and terms play the fundamental role in the regulation of unitization relations:

- unit area: an area described in a unitization agreement, where exploration and development under the unitization agreement are carried out (unit); association of license holders based on a unitization agreement;
- participating area: a part of a unit area that contains an economically feasible amount of natural resources (serving as the unitization goal) according to the geological data or a part required for the performance of works at the unit area and benefiting from the extracted natural resources (unitized site);
- unitized substances: oil and gas are deposited in the ground under a unit area and extracted in an economically feasible amount under a unitization agreement;

- unit operator: a legal entity or its subdivision acting as a unit;
- unit holders: parties to a unitization agreement represented by license holders;
- working interest: rights to a share of unitized substances or interest in the site such substances lie in. The rights delegated to a unit area operator under a unitization agreement are not considered its working interest.

In practice, there may be such cases in the conclusion of a unitization agreement when one of the parties is unable to or refuses to enter into the agreement. In such cases, the party initiating the conclusion of a unitization agreement needs to submit evidence that it has made attempts to obtain consent of the refusing party. A unitization agreement may be considered valid only following the verification, approval of the agreement draft and issue of a validity certificate by the authorized agency.

Special requirements are set to the content of international unitization agreements, where a transborder field is developed as a whole, thus the legal regulation of the object and the activities of the parties should also be unified for everyone. The states are allowed to conduct negotiations with regards to the regulation of separate issues; common practice is an arrangement between states that the law of one of the states acting as parties to the transborder field development will be applied to the field they develop. Such task is even more simplified if the laws of the states have similar provisions concerning regulation of fundamental issues. If the laws of one of the states are better developed and more advanced, these are the laws that will be applied. If the level of the development of laws of the countries is substantially the same, the decisive factor will be the territory with the largest reserves of a jointly developed field.

International unitization agreements are aimed at the most efficient exploitation of fields crossing the border between states, which requires close cooperation between such states and the contractors or license holders operating in the corresponding field. The main principles of operations in this sphere are the need to establish adequate international standards for the rational subsoil use for two or more states being common owners of transborder resources; each state should act on the basis of prior consultations with other states that own the same natural resource object in order to achieve the optimal resource use scheme and inflict no damage on the legal interests of other states. These principles of joint operations are reflected in the United Nations General Assembly Resolutions 1973 and 1974 [2].

Ideas preceding unitization appeared in the early twentieth century in the USA but initially they reduced themselves to the "rules of capture", whereunder "the owner of a tract of land acquires title to the oil and gas which he produces from wells drilled thereon, though it may be proved that part of such oil or gas migrated from adjoining lands" [3]. One of the most well-known cases is Barnard v. Monongahela Natural Gas Company: the latter leased the rights to drill and produce oil and gas from two neighboring landowners under separate lease agreements. The company drilled a well in close vicinity to the property of one of the landowners, which by estimates was designed to extract gas from the area located by 75 % under the land held by another landowner. The landowner filed a motion to prohibit the company from depleting the basin but the court refused to issue an injunction [4]. Since such practice has resulted in inefficient management of crude hydrocarbons, the USA has developed a unitization concept that has been then adopted by IOC in a number of other countries. Today, standardized legal procedures of almost all states require approval of the claimed interest (both working interest and royalty shares) by government institutions.

Similar rules of capture have been in effect in Great Britain but their application has been controversial. There is no case law directly reviewing this issue concerning hydrocarbons. The Secretary of State for Energy and Climate Change of Great Britain has the authority to introduce unitization between licensees if it is in line with the national interests for the purposes of maximum oil extraction and avoidance of

unnecessary competitive drilling [5]. Section 4 of the Petroleum Act 1998 gives the Secretary of State the authority to issue rules containing standard provisions defining the procedure for carrying out of such activities, the rules may be amended or waived for a particular case at the discretion of the Secretary of State.

The laws of Australia stipulate the right of an extraction license holder to enter into a field development agreement as he thinks fit. Besides, the Joint Authority (a competent government authority) may upon its own initiative or upon the initiative of a license holder or a person legally entitled to perform oil extraction operations beyond the borders of the adjoining territory that includes a part of a specific oil pool entering the adjoining territory, to instruct any licensee whose licensed site included any part of the pool, to enter into a unitization agreement within a specific period of time. If the licensee fails to conclude a unitization agreement in accordance with the instructions within a specific period of time or a unitization agreement is concluded but no application for approval is filed under Section 81 of the Petroleum Act 1998, the joint authority may request submission of an agreement blueprint [6]. At any time following the blueprint submission, the Joint Authority may provide instructions which it believes to be necessary to ensure more efficient extraction of oil from the basin [7]. Instructions may be amended and supplemented from time to time at the discretion of the Joint Authority.

According to the Petroleum Law of Brazil (Article 27), "if any fields spread above adjoining blocks operated by other concessionaires, the parties concerned should agree on output division. In the event that there remain any disagreements within the maximum period of time established by Agencia Nacianal do Petroleo (ANP), the latter relies on an arbitrator's resolution to determine which rights to blocks and obligations should be fairly distributed based on the applicable general legal principles" [8]. Thus, Brazilian laws require the parties to form territory units for extraction, and if the parties cannot come to an agreement, the issue is resolved by an arbitrator.

Examples of using unitization agreements (in the experience of foreign states) are the Australia — Indonesia Timor Gap Treaty [9]; the UK-Norway Frigg Reservoir Agreement [10].

The Australia — Indonesia Timor Gap Treaty is related to the development of the Timor Gap. The Timor Gap is the name of the area of cooperation between two states with an area of about 16 129 square nautical miles. In 1972, Australia and Indonesia established the greater part of the continental shelf border but back then Timor was a colony of Portugal, and the latter refused from negotiations on delimitation of borders between Australia and the East Timor province. In 1975, East Timor became a part of Indonesia. After numerous attempts at arriving at a consensus and failed negotiations, Australia and Indonesia have come to a conclusion that the best decision would be the establishment of an area of joint operations. Thus, a unitization agreement on the Timor Gap was signed in 1989 and entered into force in 1991 after ratification by the Australian government. The Preamble to the Treaty notices that the Treaty is based on the principles of Article 83 of the United Nations Convention on the Law of the Sea 1982. It is also noted that the Timor Gap Treaty should not affect any delimitation of the continental shelf. However, it contains a brief confirmation of the desire of the parties to reach an agreement on the delimitation issue.

With regards to the unitization provisions in this agreement, it is important to note that the agreement contains an article on natural resources. If a hydrocarbon cluster crosses the border of the central zone and a part of the deposit located on one side of such border can be extracted in full or in part from the territory (water area) located on the other side of such border, the parties should seek to reach an agreement on the deposit development means and division of profits from exploitation of the relevant deposit. Similarly, in the event that the efficient development of a deposit in the central zone requires construction

of facilities outside the central zone, each state should facilitate the contractors of the Joint Authority in the construction and use of such facilities. That said, such construction and use of facilities will be regulated by the laws of the state, on the territory (water area) of which it is located.

An agreement between Great Britain and Norway is related to the development of the Frigg field located in the northern part of the North Sea (discovered in 1972). By estimates, the initial recoverable reserves amount to 185 billion cu. m. of natural gas, 39.18 % of which are located in the British sector under the agreement. The parties have the following obligations under the agreement:

- the Frigg field has to be developed as a single object by single operator in accordance with the development plan approved by parties to the Agreement;
- the parties have to approve the type and location of equipment to be used to develop the field;
- each party has to request its subsoil users to enter into unitization agreements with each other and subsoil users of the adjoining state to develop the field under the Agreement;
- each party has to approve the field structure, proven reserves and proportional distribution of reserves between the parties;
- each party has to file a claim to the commercial court in the event of Agreement violation;
- each party has to allow subsoil users to drill wells stipulated by the development plan and permit free movement of people and materials between industrial objects for safety reasons;
- each party guarantees that the product share received by subsoil users of each state following the termination of Frigg field development will be in line with the proportionate distribution approved by parties to the Agreement.

Each party to the Agreement guarantees that its subsoil users will not transfer their rights to the Frigg field to any third parties without its prior consent and each party has to consult the other party before giving consent to such a transfer.

A vivid example of experience of the Russian Federation in the direction under consideration is an agreement between Russia and the Kingdom of Norway on demarcation of maritime areas and cooperation in the Barents Sea and the Arctic Ocean that was signed in 2010 and entered into force in 2011 and became a result of more than 40 years of negotiations and discussions between the countries [12].

The border between Russia and Norway in the Barents Sea and the Arctic Ocean was demarcated thanks to this agreement, and the moratorium on the study and development of oil and gas fields on the continental shelf was lifted also thanks to this agreement. An important feature of this agreement is that it is not aimed at the development and study of a specific field, but rather at any further projects that will appear between Russia and Norway if new hydrocarbon fields are discovered in the designated territory.

Thus, the reviewed unitization agreements seem to be an efficient mechanism of the contractual regulation in the fuel and energy complex relevant in the present-day conditions. More and more unitization agreements are now concluded to reach the maximum efficiency of the development process; the study and use of the existing hydrocarbon fields is also aimed at making the field exploration and hydrocarbon extraction process more seamless if several states are involved in this process. Moreover, the example of the agreement concluded between Russia and Norway serves as evidence that unitization agreements are now a relevant means of the contractual regulation of relations arising in the hydrocarbon field development sphere as this agreement is focused not only on the available fields and their development, but also on future relations if such field is discovered and there appears the need to perform works together. This is the reason for the conclusion of the agreement between the Russian Federation and the Kingdom of Norway, where the parties have in advance

negotiated all and any rights and obligations of the parties in case of the appearance of a new hydrocarbon field on the adjacent territory of these states.

The Russian Federation has also entered into other subsoil use agreements: an agreement with the Azerbaijan Republic on the demarcation of bordering bottom sites in the Caspian Sea of September 23, 2002 [13]; an agreement with the Republic of Kazakhstan on the demarcation of the bottom of the northern part of the Caspian Sea for the purposes of exercising of sovereign subsoil use rights (ratified by the Federal Law of the Russian Federation of April 5, 2003) [14].

Challenging issues concerning the transborder field development procedure are usually regulated by international agreements between the states on the territory of which such field is located at. Such agreements are developed based on international provisions, in particular, based on the United Nations Convention on the Law of the Sea [15].

Apart from international provisions, domestic subsoil laws of many states contains provisions on the regulation of transborder fields, namely, oil and gas fields. Pursuant to domestic laws, subsoil users usually have to cooperate with each other in field development as such cooperation produces a positive impact on the use and protection of subsoil. Unitization is one of efficient methods of such cooperation. ■

References:

1. Resolution of the Supreme Court of the Russian Federation No. 3314-1 of July 15, 1992 (as amended on April 5, 2016) On the Procedure for the Enactment of the Regulation on the Procedure for Licensing of Subsoil Use // ConsultantPlus reference legal system.
2. Resolutions of the 28th session (1973) // United Nations General Assembly. URL: https://www.un.org/ru/ga/28/docs/28res.shtml ; Resolutions of the 29th session (1974) // United Nations General Assembly. URL: https://www.un.org/ru/ga/29/docs/29res.shtml.
3. Hunton A.K. Unitisation – the Oil and Gas Industry's Solution to One of Geology's Many Conundrums / A.K. Hunton // Lexology. 2014. 29 August.
4. Barnard v. Monongahela Nat. Gas Co. - 216 Pa. 362, 65 A. 801 (1907). URL: https://www.lexisnexis.com/community/casebrief/p/casebrief-barnard-v-monongahela-nat-gas-co.
5. Territorial Foundations of the Gulf States / ed. by R. Schofield. London : UCL Press, 1994. 284 p.
6. Petroleum Act 1998. URL: https://www.legislation.gov.uk/ukpga/1998/17/contents.
7. Unitization // FindLaw Attorney Writers. 2008. 26 March. URL: https://corporate.findlaw.com/business-operations/unitization.html.
8. Murchison Field Agreement (Cmnd 8270) (as amended by Cmnd 8577).
9. Australia — Indonesia Timor Gap Treaty. URL: https://treaties.un.org/doc/Publication/UNTS/Volume%201098/volume-1098-I-16878- English.pdf.
10. Kaye S. The Timor Gap Treaty / S. Kaye // Natural Resources & Environment. 1999. Vol. 14. Iss. 2. P. 92-94, 143-144.
11. Agreement between the Government of the Kingdom of Norway and the Government of the United Kingdom of Great Britain and Northern Ireland Relating to the Exploitation of the Frigg Field Reservoir and the Transmission of Gas therefrom to the United Kingdom. May 10, 1976.
12. Agreement between the Russian Federation and the Kingdom of Norway on the Demarcation of Maritime Areas and Cooperation in the Barents Sea and the Arctic Ocean // President of Russia. 2010. September 15.
13. Agreement between the Russian Federation and the Azerbaijan Republic on the Demarcation of Bordering Bottom Sites in the Caspian Sea (Moscow. September 23, 2002) // Garant reference legal system.
14. Agreement between the Russian Federation and the Republic of Kazakhstan on the Demarcation of the Bottom of the Northern Part of the Caspian Sea for the Purposes of Exercising of Sovereign Subsoil Use Rights. Ratified by Federal Law of the Russian Federation No. 40-FZ of April 5, 2003 // Collection of Laws of the Russian Federation. November 24, 2003. No. 47.
15. The United Nations Convention on the Law of the Sea (UNCLOS). Adopted in Montego Bay on December 10, 1982 (as amended on July 23, 1994).