



Association
of Gas Producers
of Ukraine



**TOGETHER
TO ENERGY
INDEPENDENCE
OF UKRAINE!**

**ANNUAL
REPORT
2017**



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SUMMARY OF 2017

The past year has become the year of true establishment of the Association, confirming the efficiency of joining efforts of the market players with the purpose of solving the topical issues on the industry's agenda.

As a result of fruitful collaboration, the gas production industry has achieved several **important goals** in 2017.

START OF THE GOVERNMENT'S CONCEPT

The implementation of the Concept for Development of Ukraine's Gas Production Industry by 2020 as the strategic roadmap for the Government and the companies has begun.

STIMULATING TAXATION

The stimulating taxation and stabilization clause were introduced. This has increased the investment attractiveness of new gas production projects, and has strengthened Ukraine's upstream competitiveness in the race for international capital.

ROYALTY DECENTRALIZATION

Decentralization of royalty was started to direct them to develop the local communities. This should make the regions more interested in cooperation with the industry for mutual benefit. It is forecasted that the additional receipts of the communities only from gas royalty in the first year of the Law will exceed 1.5 billion UAH.

NEW RULES OF FIELD DEVELOPMENT

New Rules of Development of Oil and Gas Fields were implemented. They replaced the soviet-era 33-year old rudimentary act. The new permitting procedure for development of hydrocarbon deposits is more simple and clear.

CANCELATION OF RESERVES REASSESSMENT

The requirement to reassess reserves every 5 years was cancelled. This will allow to direct the released funds and efforts to modernize the assets, drill new wells, and increase gas production.

DIALOG REGARDING TARIFFS

A constructive dialog was started between the industry, the European institutions, and the energy regulator regarding the improvements of the gas transmission tariff policy.



Daniel Maydanik
Chairman of the Board

PLANS FOR 2018

The development of the domestic gas production has truly become the strategic priority of the Government policy. The country has begun to confidently step towards self-sufficiency in natural gas supply. Our ongoing optimism is based on the common achievements and jointly-developed further plans.

The base priorities of reforms in the gas production industry for 2018 should be in **the four areas**.

DRAFT LAW № 3096-d

The field development authorization procedure and allotment of land for wells' drilling should be drastically simplified. The passing of the deregulation bill № 3096-d will advance Ukraine to the best world models and will significantly increase the industry's mobility.

LIBERALIZATION OF THE GEOSCIENCE DATA TURNOVER

The turnover of the geoscience data should be liberalized, and the access to electronic databases should be open. This will allow the investors to optimize their investment decisions and nominate the selected blocks for open auctions.

NEW LICENSES

The state should propose a large-scale program of proposing new licenses for exploration and development of hydrocarbons. It is necessary to hold a few grand auctions, which will attract credible investors.

MODERNIZATION OF THE BASIC LEGISLATION

Updates to the Law On Oil and Gas and the Subsoil Code is long-awaited. The articles should be consolidated and unified with the modern European requirements and international progressive trends.



Roman Opimakh
Executive director

ASSOCIATION OF GAS PRODUCERS OF UKRAINE

– is a nonprofit organization founded in December 2015 to represent the upstream sector of the hydrocarbons industry in Ukraine. It is comprised of seven leading gas producing companies of Ukraine: Ukrgasvydobuvannya, DTEK Oil&Gas, Burisma Group, Geo Alliance Group, Smart Energy Group, KUB-GAS and JV Poltava Petroleum Company.

OUR GOAL

is to promote energy and economic security of Ukraine.

OUR MISSION

- implement advanced energy resources market regulation
- create a competitive energy market in Ukraine
- apply the best expertise and technologies in the exploration and production of hydrocarbons
- establish an effective dialogue between business and government
- improve investment attractiveness of the natural gas production industry
- build social partnership with the regions of natural gas production

OUR RESULTS

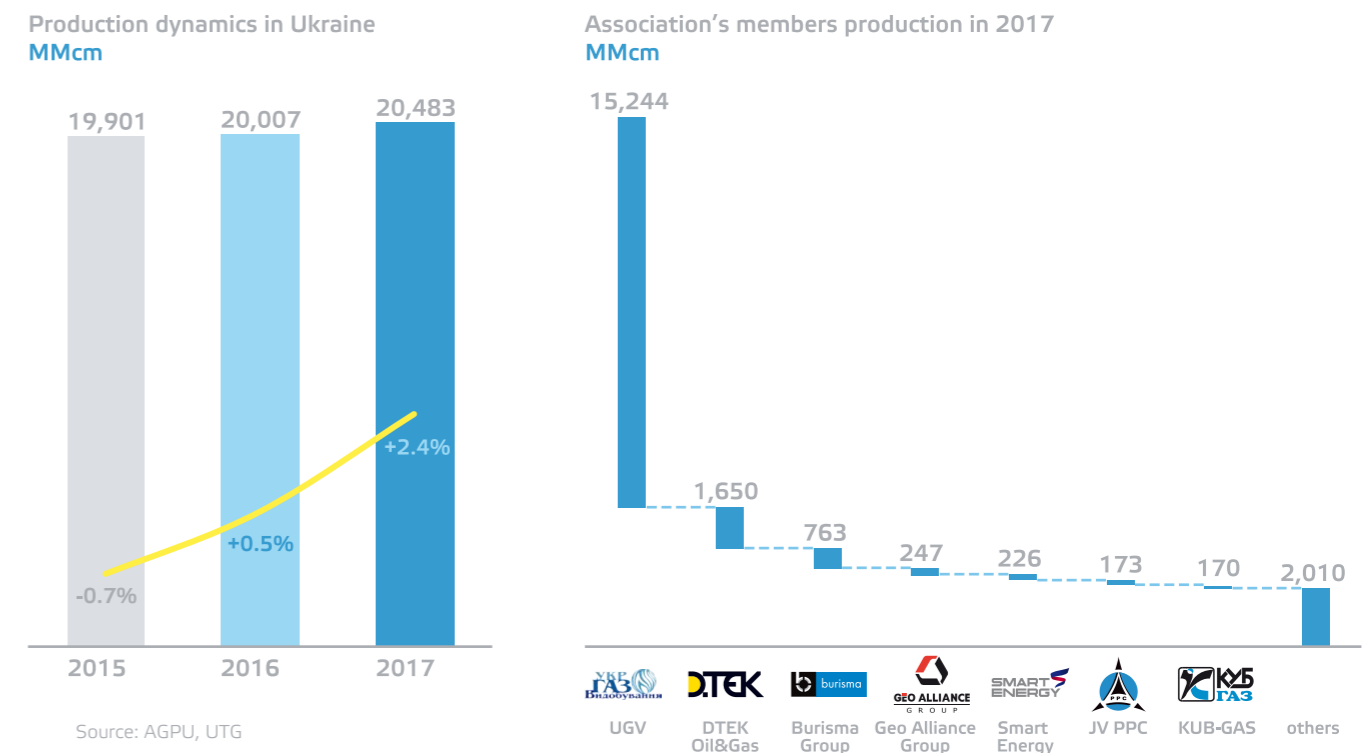
Gas production was 20.5 bcm in 2017, which is 2.4% more than production of the previous year. Compared to the past couple of years, the state-owned Ukrgasvydobuvannya has shown significant growth of 4.4%, which allowed it to achieve a record mark of 15.25 bcm of production. Unfortunately, the rest of the market was not able to improve their previous year results.

The petroleum industry has contributed 74.6 billion UAH of taxes to the national budget, which is 26% more than a year before. This makes it almost 10% of the total budget revenues. In addition, the producers have paid more than 151 million UAH as a part of social agreements for the development of the local communities.

All Association's members have made it to the top-100 largest taxpayers in Ukraine based on consolidated payments.

OUR MISSION AND RESULTS OF WORK

The Association's companies make up together around 90% of domestic gas production



YEAR IN NUMBERS



125
WORK EVENTS



Volodymyr Groysman
Prime Minister of Ukraine



Volodymyr Kistion
Vice Prime Minister of Ukraine



Olga Bielkova
Deputy Head of Verkhovna Rada Committee on Energy, Nuclear Policy and Safety

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HIGH-LEVEL MEETINGS



Ihor Nasalyk
Minister of Energy and Coal Industry of Ukraine



Oleksandr Danyliuk
Minister of Finance of Ukraine



Ostap Semerak
Minister of Ecology and Natural Resources of Ukraine



Maksym Nefyodov
First Deputy Minister of Economic Development and Trade of Ukraine



Oleksandr Dombrovsky
acting Head of Verkhovna Rada Committee on Energy, Nuclear Policy and Safety



Viktor Galasiuk
Head of Verkhovna Rada Committee on Industrial Policy and Entrepreneurship



Kseniia Liapina
Head of State Regulatory Administration of Ukraine



YEAR IN NUMBERS



92

PUBLICATIONS, PAPERS, AND OPEN MESSAGES



34

PUBLIC EVENTS



7

LEGAL ACTS AMENDMENTS

**NEW
FISCAL
REGIME**



WITH THE ASSOCIATION'S ACTIVE CONTRIBUTION

1 Stimulating taxation and stabilization clause were implemented

Starting 2018, there are two current standard hydrocarbons fiscal regimes in Ukraine.

The old regime provides for taxation for all oil wells and for gas wells drilled prior to 2018: the royalty rates of 29% and 14% depending on the depth of the reservoir. To develop the hydrocarbons offshore, a flat 11% royalty is in place.

The new regime is stimulating gas production by implementation of 12% and 6% rates depending on the depth of the new onshore gas wells drilled from 2018. For such investment projects the Government also guarantees fiscal stability for five years, until 2023, which envisions a ban on increasing the fiscal burden.

2 Royalty decentralization has begun

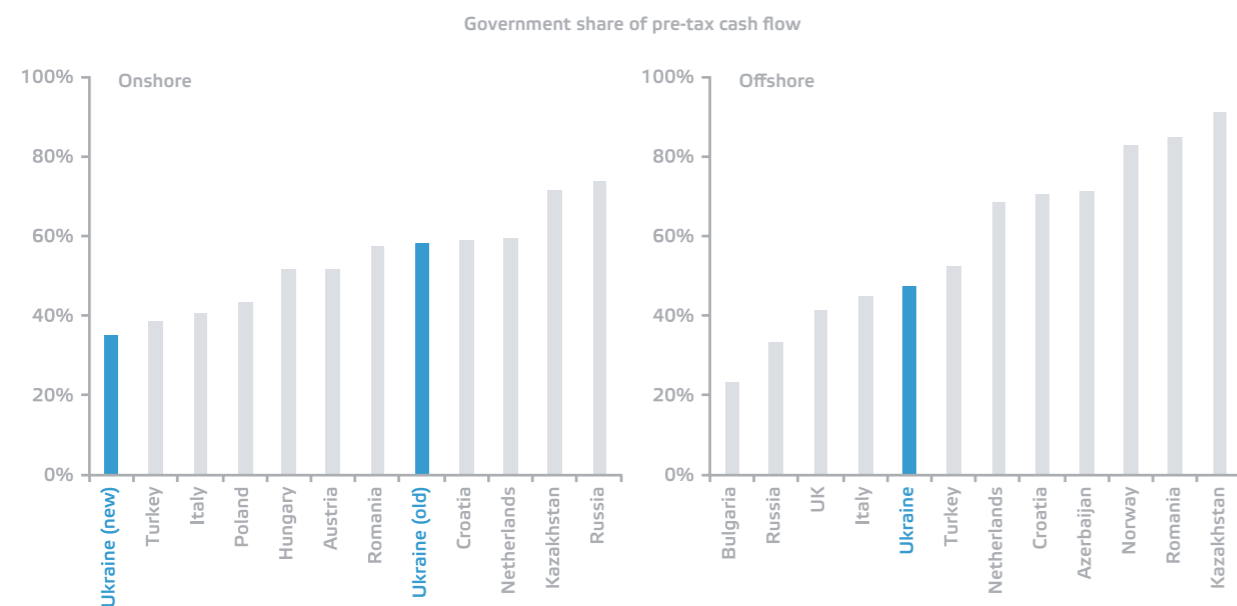
Starting 2018, 5% of the royalty paid will be deducted to local communities' development. The funds will be directed to the local budgets of the villages, regions, and oblasts, on the territories of which production is held. Such a policy should make the locals interested in a more constructive collaboration with the industry for mutual benefit.

3 Attractive royalty was implemented for PSAs

The investor may choose to cooperate with the Government under the production sharing agreement regime, for which the royalty rates are 2% and 1.25% for oil and gas respectively. In return, investor is obligated to transfer part of produced resources to the state. The agreements are signed for up to 50 years and include the stabilization clause for the whole period.

4 Gas condensate royalty was equated to oil (from 2019)

The new tax regime has significantly improved the investment attractiveness of Ukraine on the European arena



Source: Wood Mackenzie, 2018

Note: discounted rate 10%, nominal terms, 250 bcm onshore field, long-term gas price: \$6/mcf, cost: onshore - \$1.55/mcf, offshore - \$2.25/mcf

UPCOMING STEPS

1 DEVELOPMENT OF TIGHT GAS

Ukraine's unconventional deposits exceed 10 tcm, which makes its development a very promising direction. That stress the necessity to invent the tools to stimulate the development of that resources in economically feasible way.

2 ABOLITION OF EXCESSIVE PAYMENTS

The current task is to eliminate the different treatments in the legislation and harmonize it with the international commitments of Ukraine according to the Ukraine-European Union Association Agreement. In particular, it includes the existence of a single payment for the receipt of the license, which should be paid as a result of the transparent and competitive bidding. Any other payments that currently exist – payment for incremental reserves, payment for extension of the license – should be eliminated.

3 IMPROVEMENT OF TARIFFS POLICY

According to the Ukrainian legislation, payment for the entry to the gas transmission system is the obligation of the producers. The currently set tariff significantly exceeds the average European rate. There is an ongoing dialog of the industry, the TSO, and the national energy regulator on improvements to the tariff policy with the purpose of advancing it to the common European practice.

Ukraine is in top-3 countries in Europe in terms of natural gas reserves

Reserves and resources of gas in Ukraine tcm



Source: AGPU, Geoinform

SUBSOIL USE RULES AND PERMITTING SYSTEM



WITH THE ASSOCIATION'S ACTIVE CONTRIBUTION

- 1 The deregulation bill №3096-d on simplification of the permitting system of the industry was assessed
- 2 The new Rules of Development of Oil and Gas Fields were approved, which replaced the soviet 33-year old act
- 3 The requirement to reassess the reserves every 5 years was cancelled

The current permitting system in the gas production industry is too prescriptive and overly regulated. To launch the field development, 44 permits in 16 authorities should be collected, which takes over 3 years. Registration of each new well takes over a year, which is much longer than the drilling itself.

The excessive government control is in place on all stages of the project.

Field development plan. The Governmental agencies approve the development plan of oil and gas deposits and approve further every change to this plan, as well as makes the decision to enter the field in development.

Land allotment. In the environment of a ban for sale of agricultural land and changing its purpose, when receiving the block for development, the petroleum companies all the time come across the lack of access to land and impossibility to hold their operations.

Drilling wells and environmental protection. Apart from solving the land issues, the contracting company should obtain the approval of the well drilling project and arrangement of the complementary objects, as well as hold the environmental impact assessment according to the new European rules.

With the participation of the Association's experts and as a result of consulting with the international experts, the bill №3096-d was developed, which should advance Ukraine's permitting system to best international practice. The document should simplify the entering of the field in development stage and speed up the land allotment for well drilling.

Also it's necessary to amend the Law On Oil and Gas, and update the Subsoil Code through unifying their articles with the European requirements and the best international trends.

UPCOMING STEPS



1 PASSING THE BILL №3096-D

2 MODERNIZATION OF OIL AND GAS UPSTREAM LEGISLATION

Passing №3096-d will advance the Ukrainian permitting system to the world's best standards

EXISTING PROCEDURE		
1	Land allocation	
2	Approval of the field exploration plan	
3	Launching the field in exploration phase	
4	Approval of the well drilling plan and its arrangement <ul style="list-style-type: none"> ⦿ approval of the land allocation working plan ⦿ permit for temporary removal of the fertile layer of soil ⦿ state ecological expertise of the project documents ⦿ permit to perform the hazardous work ⦿ permit to operate the hazardous equipment ⦿ permit for special water use ⦿ permit for waste ⦿ registration of the well as the urban planning object ⦿ declaration of pilot well development ⦿ approval of the documents for well construction ⦿ waste declaration ⦿ permit to start construction works ⦿ declaration of readiness of the object for operation ⦿ approval of the well drilling plan and settlement of its arrangement ⦿ act of starting the drilling rig operations 	
	5	State expertise of the mineral resources (SMRE)
	6	Approval of the field development plan
	7	Mining allotment
	8	Change of the purpose of the land (if needed)
	9	Launching the field in development phase
	10	Connection to gas transmission system, gas metering



DEREGULATION	
1	Land allocation (easement legalizing)
2	Approval of the well drilling plan and its arrangement <ul style="list-style-type: none"> ⦿ approval of the land allocation working plan ⦿ environmental impact assessment ⦿ approval of the well drilling plan and settlement of its arrangement
	<ul style="list-style-type: none"> ⦿ permit to perform the hazardous work* ⦿ permit to operate the hazardous equipment* ⦿ permit for special water use* ⦿ permit for waste* ⦿ waste declaration* ⦿ declaration of pilot well development ⦿ act of starting the drilling rig operations*
3	State expertise of the mineral resources (SMRE and other)
4	Connection to gas transmission system, gas metering

Cancelled 14 approvals and 6 procedures
Sped up by >18 months

Currently 44 permits/approvals
Time consumed – over 3.5 years

*obtained for several years by the contracted organization

NEW LICENSING ROUNDS



WITH THE ASSOCIATION'S ACTIVE CONTRIBUTION

- The draft of amendments was developed to ensure equal access to subsoil and cancel the practice of issuing the license without the auction**
- The draft of the new Rules of the geoscience data turnover was developed**

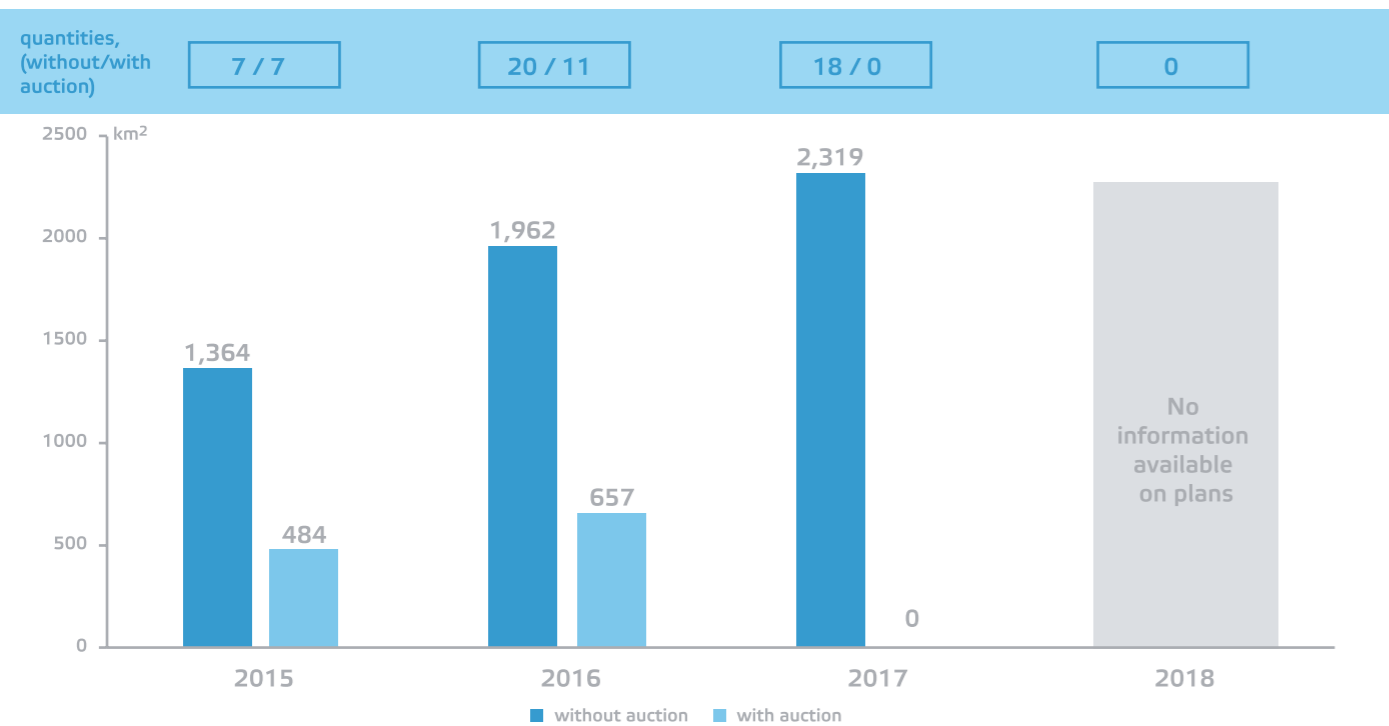
Traditionally, petroleum **auctions are held unacceptably irregularly**, and the proposed block are tiny and not interesting to the external investors. For over a year, no biddings were held in Ukraine.

At the same time, approximately 90% of all the **blocks were issued without auctions**, which indicates the dominance of double standards.

Another problem is the **lack of free access to state-owned geoscience data** (accumulated in the soviet times) and its limited turnover. The subsoil users almost lack the transparent opportunity to individually assess the vacant blocks and nominate them for auctions.

Very few blocks are put out for auctions – the investors lack the fields for development

Issue of licenses for hydrocarbons exploration and development in Ukraine*



Source: AGPU, State Geoinform

*not accounting for the licenses for production (prolonging and converting from exploration to production)

UPCOMING STEPS

1 ELIMINATION OF DOUBLE STANDARDS

The Government should eliminate the double standards and minimize the corruption risks during the issue of special permits. The changes to the legislation should make the process clear, open and transparent.

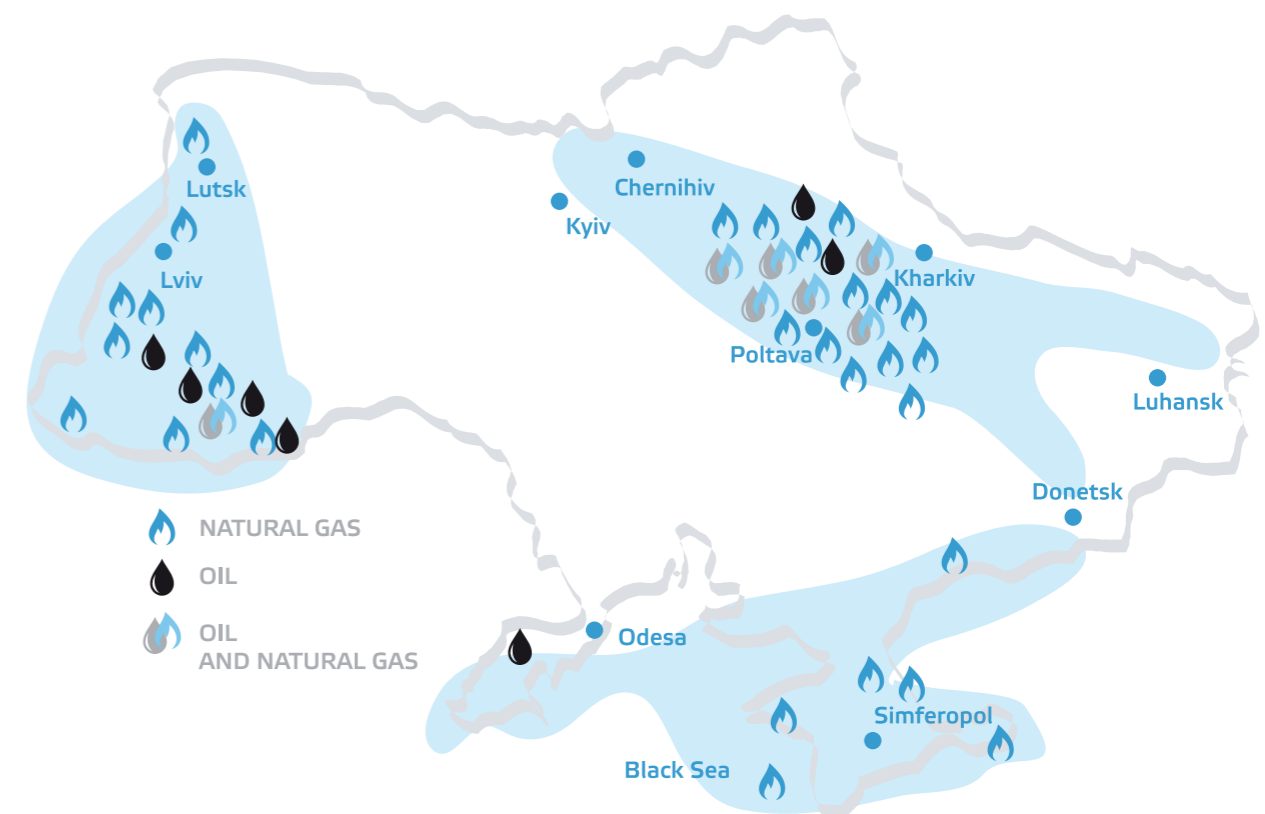
2 LICENSING ROUNDS

The Government should propose the "aggressive" program for issuance of new licenses for exploration and development of hydrocarbons. It is necessary to hold a couple of grand pilot auctions, which will create new investment objects, to which the credible companies will come.

3 LIBERALIZATION OF GEOSCIENCE DATA TURNOVER

The turnover of geoscience data should be liberalized, and the access to electronic databases of the potential blocks and information on the fields currently under development (without disclosure of the contents of the information) – should be open for access.

At least 50 new oil and gas onshore and offshore blocks can be proposed annually to investors at transparent rounds



ASSOCIATION COOPERATES WITH



ASSOCIATION UNITES





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