



**USAID**  
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**HYDRO POWER AND ENERGY  
PLANNING PROJECT (HPEP)**

# REPORT ON OIL INDUSTRY LEGAL FRAMEWORK

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# **REPORT ON OIL INDUSTRY LEGAL FRAMEWORK**

USAID HYDRO POWER AND ENERGY PLANNING PROJECT  
(HPEP)

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## **1.0 INTRODUCTION**

Two primary laws regulate the oil sector in Georgia. These laws are: Law of Georgia on “Oil and Gas” (Oil and Gas Law) and Law of Georgia on Construction, Operation, Maintenance, Repair and Operation of Oil Transportation Facilities and on Legal Principles of Oil Import, Transportation, Storage and Export Through Oil Transportation Facilities (Oil Transportation Law).

Oil and Gas Law gives a definition of oil products. Oil products are petrol, diesel oil, kerosene, black oil, liquid oil, lubricants and other products that comply with commodities defined by codes 271000270, 271000290, 271000320, 271000510, 271000550, 271000590, 271000690, 271000740, 271000980 according to foreign economic activity commodity nomenclature.<sup>1</sup>

## **2.0 REGULATION OF OIL AND GAS RESOURCES**

Oil and gas operations and oil refining, gas treatment or transportation are carried out in accordance with the Constitution of Georgia, international agreements of Georgia, Oil and Gas Law and other laws of Georgia.

Preparation, signing and termination of the contract are executed in compliance with Oil and Gas Law.<sup>2</sup>

## **3.0 THE PURPOSES OF THE OIL AND GAS LAW**

The purpose of Oil and Gas Law is:

- a) Creation of the uniform legal basis of development of oil and gas resources and oil refining, gas treatment or transport activity and implementation of the single state policy in the field of development of oil and gas resources and oil refining, gas treatment or transport activity;
- b) Promotion of investments in the Georgian oil and gas sector and protection of legal interests of entities participating in oil and gas operations;
- c) Creation of an effective legal base for state regulation, supervision and control of oil and gas operations, oil refining, gas treatment or/and transportation activity in Georgia, establishment of the relevant regulatory authority – a legal entity under public law;
- d) Determination of general principles of contracts on oil and gas prospecting and production between the state and investor;
- e) Determination of functions of the National Oil Company of Georgia;
- f) Unification of the authority of government regulation of oil and gas operations, oil refining, gas treatment or/and transportation activity in Georgia into one regulatory body and formulation of its main functions.<sup>3</sup>

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<sup>1</sup> Oil and Gas Law, Article 1, paragraph “f”;

<sup>2</sup> Oil and Gas Law, Article 2;

<sup>3</sup> Oil and Gas Law, Article 3.

#### **4.0 OWNERSHIP OF OIL AND GAS RESOURCES AND CONDUCTING OIL AND GAS OPERATIONS**

Oil and gas resources existing in the depths of the territory of Georgia are the state ownership. Georgia obtains the exclusive and sovereign right on prospecting and exploitation of oil and gas resources on its land and continental shelf. The ownership on produced oil and gas is determined in accordance with the contract.

In case of termination of the oil and gas contract, regardless the reasons of termination, any structure and other immovable property placed on the area allocated under the license and in its depths, is the ownership of state notwithstanding the fact if the cost of this property is paid or not.

Oil and gas operations may be conducted in whole or in part by the state and natural or legal person under the contract made in accordance with this law and the license on use of oil and gas resources. Natural and legal persons have the right of oil processing, gas treatment or transport activity in accordance with this Law.<sup>4</sup>

#### **5.0 STATE MANAGEMENT AND REGULATION OF OIL AND GAS OPERATIONS**

The main functions of the MoE in the sphere of oil and gas are determined by law, the Statute of the MoE and the laws of Georgia. The main directions of the national policy for oil and gas are identified by the MoE. The functions of the Ministry in the field of oil and gas do not include the owner's or operating-economic activities. The management of the field of oil and gas pursuant to the main directions of the national policy is carried out by the State Agency of oil and Gas (Agency), legal entity of public law existing within the system of MoE.

The state management and regulation of oil and gas operations, oil refining, gas treatment and/and transportation activity is carried out by Agency.

The legal basis for the activity of the Agency is formed with the Constitution of Georgia, international agreements and covenants of Georgia, this Law and other normative acts of Georgia.<sup>5</sup>

The main functions of the Agency are:

- a) after consultations with the respective governmental institutions to select the area to be offered to the investor for conducting oil and gas operations; to make decision on the form (tender or auction) in which to offer the area, and on the form of contract;
- b) to formulate tender conditions and auction rules to identify the winner for the area offered to investors for conducting oil and gas operations;
- c) to arrange and hold tenders and auctions, to identify the winner for the area offered to investors for conducting oil and gas operations;
- d) to prepare all contracts, to hold negotiations and sign contracts on behalf of the state; when preparing contracts and holding negotiations the Agency is

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<sup>4</sup> See Oil and Gas Law, Articles 4, 5, and 6;

<sup>5</sup> Oil and Gas Law, Articles 7 and 8,

- entitled to request and receive assistance from any governmental institution and state enterprise and organization;
- e) to issue licenses on conducting oil and gas operations to investors on behalf of the state; to approve and grant, or giving the guarantee of granting all required powers, leases and allotments, permits, certificates. Upon receipt of the Agency 's application, all the governmental institutions of Georgia shall prepare and furnish the requested documents to the Agency;
  - f) to supervise and control the compliance with the terms and conditions set forth in the contract made in accordance with this Law and in the General License to Use Oil and
  - g) Gas Resources; to provide all necessary conditions in order for the investor to fulfill the obligations arising out of the contract and license;
  - h) to create and manage (gathering, systematization, analysis and storage of information and data) the central database of all data and information related to the oil and gas resources and operations in Georgia;
  - i) to issue normative acts for creation of a nondiscriminatory legal environment and for promoting effective performance of oil and gas operations, in consideration of market principles and national interests;
  - j) to transfer all operational and commercial duties provided by contracts (other than the regulatory functions) to the National Oil Company as long as the state or state company holds more than 50% of its stocks, to exercise control over the fulfillment of all the operational and commercial duties which are provided by contracts and transferred to the National Oil Company;
  - k) Deleted (5.06.2007, N4859-IS);
  - l) to issue oil refining, gas treatment, oil transportation or gas transportation licenses
  - m) (License of Activity) on behalf of the state; to issue all the necessary permits and approve funds;
  - n) to supervise and control the fulfillment of the terms and conditions of the License of
  - o) Activity and oil refining, gas treatment and transportation activity; to provide the necessary conditions for the holder of the License of Activity to fulfill his obligations under the license;
  - p) to supervise oil refining and gas treatment in order to ensure environmental safety and assure the quality of oil and gas products;
  - q) in case of necessity, to set up and manage a laboratory in accordance with the laws of Georgia;
  - r) to create and manage (to collect, systematize, analyze and store data and information) the central databank of all the data and information related to oil refining, gas treatment and transport activity;
  - s) to issue normative acts aimed at promoting the effectiveness of oil refining, gas treatment and transportation activity, in consideration of on the national interests, policy and market principles;
  - t) to take part in development, modification and approval of standards of raw material and oil and gas product standards;

- u) to establish the transportation tariffs for raw material and oil and gas products.
- v) In discharging these functions the Commission shall abide by the principle of publicity; in the course of formulating the tender and auction conditions, the Commission shall hold their public discussions and approve these conditions after such discussions.<sup>6</sup>

## **6.0 OIL EXTRACTION**

The contract under which the investor is granted the rights to exploit oil and gas resources and to use oil and gas-bearing entrails on the area is made between the state and the investor only who has been identified as the winner in the tender or auction held by the Agency. The conditions for holding a tender and an auction shall be identically reflected in the contract and in the General License to Use Oil and Gas Resources issued in accordance with the Oil and Gas Law.

The Agency determines the rules and procedure for holding a tender or an auction holding and registers them with the Ministry of Justice of Georgia one month prior to the announcement of the tender or auction.

The investor who wishes to take part in the tender or auction announced by the Agency shall submit the following information to the Agency:

- a) Forms and parameters of oil and gas prospecting and/or exploitation;
- b) Applicant's address and his business contacts with industrial and financial partners;
- c) Information on the applicant's owners and the managerial staff;
- d) Applicant's financial standing and estimated sources of financing of oil and gas prospecting and/or exploiting operations;
- e) Applicant's technical and technological capabilities and, if possible, technical and technological capabilities of the applicant's possible partners;
- f) Applicant's experience (qualification) and the list of countries where the applicant has worked for the last 5 years;
- g) Applicant's proposal on the optimal performance of oil and gas prospecting or/and exploitation on the area;
- h) Applicant's guarantee that he will provide the Agency with complete information on the performance of oil and gas operations on the area;
- i) If necessary, the preliminary consent of the private landowner on the use of his land in the course of the oil and gas operations conducted by the investor and the lease terms. If the applicant fails to obtain the preliminary consent of the landowner, he shall provide information about location and parameters of this land and on the difficulties arising in the course of preliminary negotiations as well as the details of the contract proposed to the landowner.

In case if the tender is held:

- a) the winner shall be the bidder who meets the tender requirements and submits an economically and technically most acceptable bid. Within one month after the investor's winning the tender, in accordance with the

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<sup>6</sup> Oil and Gas Law, Article 8<sup>1</sup>;

conditions of participation in the tender, the negotiations between the Agency and the winning investor for contract award shall proceed.

- b) if only one bid is submitted, the Agency shall have the right to cancel the tender;
- c) if several bidders equally meet the tender requirements, the auction shall be held among them;
- d) if within 6 months following the commencement of negotiations the contract between the Agency and the winning investor is not made, the tender results shall be invalid;
- e) if no applicant meets the tender requirements, the Agency shall announce the tender to be invalid.<sup>7</sup>

Georgian territory is divided into 25 license blocks. General licenses on use of oil and gas at blocks are issued through the international open tender process. At present, Oil extraction and exploration works are conducted by seven companies in Georgia. Among them: Aksai BMC., CanArgo Energy Ltd., Frontera Eastern Georgia, Ninotsminda Oil Company, Marexin Resources Exploration International, Strait Oil and Gas, Jindal Petroleum Ltd. Georgia. The Production Sharing Agreements (PSA) were signed with these companies, according to which, oil and gas search and extraction works are financed by the companies itself and the production is shared with the state (by various percentage, which is determined by the agreement).<sup>8</sup>

In case if an auction is held:

- a) the winner is the bidder who meets the auction terms and proposes the highest bid to the state. Within one month after the investor's winning the auction, in accordance with the conditions of participation in the auction, the negotiations between the
- b) Agency and the winning investor for contract award shall proceed;
- c) if no price bids are made, the Agency shall announce the auction to be invalid.<sup>9</sup>

## **7.0 OIL AND GAS CONTRACTS**

Along with other oil and gas contracts the main types of contract are:

- a) product sharing contract;
- b) risk service contract;
- c) service contract.

The Agency may prepare and use the template contract mentioned above.<sup>10</sup>

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<sup>7</sup> Oil and Gas Law, Article 10.

<sup>8</sup> <http://www.energy.gov.ge/en/4390>

<sup>9</sup> Oil and Gas law, Article 10;

<sup>10</sup> Oil and Gas Law, Article 11;

Any contract made between the Agency and investor shall contain:

- division of the contractual term to periods of prospecting and production;
- the minimal amount of the works (seismic research, boring wells, etc.) agreed in advance and the amount of the money to be spent;
- the conditions for compensation of costs and product sharing;
- the rule for calculation of the market price of oil and gas and the cost of compensation oil;
- ownership of the oil and gas extracted;
- the legal status, functions and obligations of the operating company established for conducting oil and gas operations;
- determination of bonuses, conditions for payment of bonuses and other charges;
- the terms and rules for the development and financing of the oil and gas fields prospecting and assessment projects, general and annual working programs;
- the obligation to perform the minimal amount of oil and gas prospecting and assessment works and the rules of its revision;
- the obligation of area reduction;
- the terms and rules for the development and financing of the oil and gas fields setup and exploitation projects or/and process flow sheets, general and annual programs;
- the agreed amount of oil and gas extraction that will be specified later according to the approved process flow sheet or project as well as the obligations of the minimum amount of field setup works and the terms for commencement of extraction and well operation, and for execution of other works;
- the obligation to use casing-head gas;
- raw material transportation conditions;
- the field development specifics;
- proprietary rights to the property created and used for oil and gas extraction;
- proprietary rights to the geological information obtained in the course of minerals
- use;
- types and volumes of discharging industrial waste and underground and waste waters into depths and the conditions for execution of appropriate works;
- the obligation to protect environment and production safety of facilities;
- the rules and conditions for the use of common infrastructure facilities;
- the instrument of implementation of control over the fulfillment of the rights and obligations granted under the contract and license;
- conditions for execution of liquidation works;
- insurance terms;
- the obligations to be fulfilled in the case of Force-Majeure;
- procedure of dispute resolution;
- the rules for preparation of documents required for geological works;

- the rules for determination of the quantity of oil and gas store in the depths, the rules for estimation of the quantity and quality of oil and gas extracted, left in the field and lost.<sup>11</sup>

## **8.0 GENERAL LICENSE TO USE OIL AND GAS RESOURCES**

The General License to Use Oil and Gas Resources is issued by the Agency on the basis of the contract within 1 month from its signature. The license shall contain the terms and conditions identical to the contractual ones. The investor shall pay the license fee. To participate in the tender or auction, the bidder pays the costs of holding the tender or auction in manner provided by the Agency. The license fee shall not be paid by the compensatory oil and gas.<sup>12</sup> The activity license is issued by the Agency.

## **9.0 CONFIDENTIALITY OF INFORMATION**

Initial geological, geophysical, geochemical information, data about interpretation of this information, production data, samples of rock, including the coating and inter-rock liquid received by the investor within the operations provided under the contract is the property of state. The investor has the right to use freely and gratuitously this information, data and samples in Georgia and abroad only for the purpose of performance of oil and gas operations and under the conditions that the confidentiality of information will be observed.

The investor has the right to disclose the confidential information related to performance of the contract to its branch, any professional adviser, bank or financial body where the investor tries to attract the funds under the condition that the confidence of this information is observed. On expiration of a certain time the state has the right to provide the confidential information to the third person.<sup>13</sup>

## **10.0 OIL TRANSPORTATION LAW**

The Oil Transportation law gives legal principles especially for interstate agreements concluded between Georgia and other countries.

The Interstate Agreement of March 8, 1996 between the Government of Georgia and Government of the Republic of Azerbaijan concerning “the Renovation of Pipeline Facilities, Construction of New Pipelines and Transportation of Oil through These Pipelines. Agreement between GOIC and Oil Companies on Construction of Pipelines and Their Exploitation is in force since March 8, 1996.<sup>14</sup>

In case if provisions of state agreements or articles of pipeline construction and exploitation contradict or do not comply with the Constitution of Georgia, international treaties of Georgia, or internationally recognized principles and norms of law, than the Constitution of Georgia, international treaties of Georgia, or internationally recognized principles and norms of law shall prevail.

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<sup>11</sup> Oil and Gas Law, Article 12;

<sup>12</sup> Oil and Gas Law, Article 19;

<sup>13</sup> Oil and Gas Law, Article 25;

<sup>14</sup> Oil Transportation Law, Article 1;

Neither laws nor resolutions, order or decree of executive branch, other legislative act or international treaty of Georgia, which is adopted after the entry into force of the Oil Transportation Law, may not prevail the provisions of the Law. Agreements related to the project may be give a force of law.<sup>15</sup>

Each Ministry and all other official bodies of the executive branch, state owned enterprise and legal entity, regional and local state bodies are obliged to follow the conditions of projects and agreements in case if the supervision and control of pipeline construction and exploitation falls within the competence of these bodies.<sup>16</sup>

## **11.0 CONCLUSION**

Oil and Gas law gives detailed information concerning ownership of oil and gas resources, conducting oil and gas operations, state management and regulation of oil and gas operations, oil extraction, oil and gas contracts, general license to use oil and gas resources. While Oil Transportation Law gives legal principles for intergovernmental agreements concluded between Georgia and foreign countries.

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<sup>15</sup> Oil Transportation Law, Article 2;

<sup>16</sup> Oil Transportation Law, Article 3.

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