

## **BACKGROUND BRIEFING: CANCELLATION OF PRIKERCHENSKA PRODUCTION SHARING AGREEMENT**

### Summary of Dispute

- In April 2006, U.S.-based Vanco International won an open tender to explore and develop the Prikerchenska block of the Black Sea Continental Shelf in Ukraine. Vanco is a leading independent oil and gas company based in Houston, Texas with over a half century of offshore drilling experience.
- The competitive selection process involved four different Ukrainian cabinets of ministries. Other bidders for the tender included ExxonMobil, Shell, Chernomornaftogaz, Hunt Oil, and UkrNafta, who all stated that the process was open, fair, and transparent.
- Following the tender, the parties negotiated for 18 months on the Production Sharing Agreement (PSA) which was signed on October 19, 2007 between the Government of Ukraine and Vanco International. Then-Deputy Prime Minister A.P. Kluyev signed for Ukraine, and the signing ceremony was attended by President Viktor Yushchenko and U.S. Ambassador to Ukraine William Taylor.
- In May 2008, Prime Minister Tymoshenko unilaterally cancelled the license for the Prikerchenska block and said it should be given to state-owned Naftogaz Ukrainy. The PM gave little reason for the cancellation except to accuse Vanco of having “backroom” talks with Gazprom. Vanco has unequivocally denied these allegations and has not been in contact with Gazprom.
- On May 21, U.S. Ambassador to Ukraine William Taylor issued the following statement condemning the revocation of the PSA: “I am very disappointed that the Cabinet of Ministers today took unilateral action to revoke the PSA the Government of Ukraine negotiated with the U.S. company Vanco. For the Government of Ukraine to attract investors, particularly in those sectors vital to its energy security, it needs to make clear that it respects the sanctity of contracts and the rule of law.....We urge the Government to reconsider its decision and return to a policy of dialogue, so this project, important to Ukraine’s energy security, can get back on track.”
- On May 23, Ukrainian Justice Minister Mykola Onischuk said it will be difficult for Ukraine to prevail in any legal proceedings against Vanco involving the cancellation of the PSA. If an arbitration appeal is submitted against Ukraine, “it would be difficult to protect our interest, as Ukraine is trying to cancel the agreement unilaterally,” Onischuk said. The Justice Minister added his desire to follow the procedure outlined in the PSA, which calls for talks between Vanco and the government in the event of any dispute. On May 30, the security council of Ukraine called on the cabinet of Prime Minister Tymoshenko to re-instate Vanco’s contract.
- Vanco hopes to resolve this issue through dialogue with the government, but has not ruled out taking the Ukrainian government to arbitration to defend its rights.

### Project History

- The Prikerchenska field provides a unique opportunity for Ukraine to develop its energy independence and improve its energy security. Vanco’s technical exploration experience and expertise provides Ukraine with the ability to tap these valuable resources.

- Vanco is a highly experienced oil and gas company with expertise in deep water exploration. The Prikerchenska project will require exploration at depths of over 2000 meters. Vanco's proven record of oil and gas exploration and production includes projects in five countries with challenging, deep-depth areas: Cote d'Ivoire (two blocks), Equatorial Guinea, Gabon, and Ghana.
- Vanco is the project leader and other investors include Ukraine's System Capital Management, through its energy holding Donbass Fuel-Energy Company (DTEK), Shadowlight, the investment vehicle of Evgeny Novitsky, a top executive at Sistema, and Integrum Technologies, a subsidiary of the Austrian investment firm IK Ag.

### Project Exploration and Technical Details

- The Prikerchenska site is geologically challenging. It consists of 3 perspective areas, including the Sudak fold belt, the Sudak deep water fold belt, and Tetyayev area. The total site area is 12,960 square kilometres, and the sea depth is up to 2,200 meters.
- The project consists of a survey phase and a development and extraction phase.
- Phase I: From 2008 through 2010, a three dimensional, seismic survey of 3,000 sq. km., including the drilling of two wells. Estimated cost is \$100 million USD. From 2011 through 2013, a three dimensional, seismic survey of an area of 1,000 sq. km., including the drilling of two wells. Estimated cost is \$130 million. From 2014-2015, two wells will be drilled at an approximate cost of \$100 million.
- Phase II: This involves organizing the actual extraction of hydrocarbon resources. The projected total investments throughout the life of the project exceed \$15 billion USD.

### Benefits for Ukraine

- The Prikerchenska project will increase Ukraine's energy independence by providing a domestic source of oil and gas. Production could also allow Ukraine to export hydrocarbons to other countries.
- The successful realization of the Prikerchenska project will be a positive development for foreign investment in the Ukrainian economy. It will further demonstrate that the government is committed to the rule of law and that the fate of foreign investment in Ukraine does not depend on which government is in power.
- When taxes and payments for subsoil use are calculated, Ukraine should receive 73% of the income from the Prikerchenska field, with the investors receiving 27%.
- Oil and gas extracted from the Prikerchenska Shelf will go to the Ukrainian domestic market first.
- Technical Expertise: Vanco is a leading western energy firm with experience dealing with challenging environments like Prikerchenska. Ukraine's DTEK is particularly keen to use this experience to gain the technical expertise necessary to develop its own domestic energy business. At present, there are no domestic Ukrainian firms with the technical capacity to drill on the Prikerchenska Shelf.