

On 2 August 2022, the government of the Russian Federation issued Decree No. 1369 “On Measures to Implement Decree No.416 of the President of the Russian Federation dated on 30 June 2022.”¹ Decree 1369 sets out further details of the process for the transfer of operatorship of the Sakhalin II project from Sakhalin Energy Investment Company Ltd (SEIC) to a newly formed Russian LLC created by the Russian government: Sakhalin Energy LLC.

Decree No. 1369 comes hot on the heels of Russian Decree No. 416, the key features and possible consequences of which we discussed in our LNG alert last month.² In compliance with Decree 1369, Sakhalin Energy LLC, the new entity to operate Sakhalin II, was registered on 5 August 2022 with its managing director now duty bound to notify the shareholders of SEIC of the LLC’s registration. In terms of other specific company information for Sakhalin Energy LLC (i) the charter capital is 10,000 roubles, which is deemed to be fully paid; and (ii) Gazprom Sakhalin Holding is a member with a just over 50% participating interest. Information about other members of the LLC, however, is described as classified and not to be disclosed on the companies register. The charter of Sakhalin Energy LLC, the Audit Rules and the Rules for Evaluation and Sale of Shares are all publicly available attachments to Decree 1369.

The Audit Rules are a topic that warrant close examination. These set out a process for carrying out an audit of activities of foreign persons in connection with the implementation of the Sakhalin II Production Sharing Contract (PSA). “Audit” is defined broadly as an analysis of any activity, including financial audit, technological audit, environmental audit or any other type of audit proposed by the Federal Ministry of Energy. The audit is to be conducted over a 60-day period from the date when the list of foreign persons, subject to the audit, is approved by the government of the Russian Federation. Notably, while financial and environmental audits have a defined period in respect of which foreign persons are to be audited (January 2019-June 2022), technological audits can go back as far as the commencement of the PSA on 22 June 1994. From 5 August, Sakhalin Energy LLC will carry out its activities in accordance with the terms and conditions of the PSA, as amended by Decree 1369. In particular, Sakhalin Energy LLC has now obtained all intellectual property, including licensed liquefaction technology and all other property, including SEIC’s cash balances.

Additionally, the Rules for the Evaluation and Sale of Shares in the LLC appoint an “LLC B1 Consult” to carry out the evaluation of the shares of the LLC. These prescribe a process whereby the sale of shares in Sakhalin Energy LLC is to be effected on the basis of a tender and only Russian legal entities meeting government approved criteria can take part in the tender. This is an important point. In our previous piece, we explained how the impact of Decree No. 416 would primarily affect LNG buyers and investors in the Asian markets, notably in Japan and South Korea. That prediction has proved accurate. In recent weeks, with the transfer process having gathered a head of steam, (i) Japan’s government has asked Mitsui & Co and Mitsubishi Corp to “think positively” about joining Sakhalin Energy LLC;³ and (ii) affected buyers, who hold LNG import contracts with SEIC, have no doubt been deep in negotiations with their Russian counterpart, framing the terms of the new contractual arrangement with the new LLC.

The issuance of Decree No. 1369, and the incorporation of Sakhalin Energy LLC, may now introduce some further complexity and time pressures into those talks. For example, in circumstances where the newly created Sakhalin Energy LLC replaces and assumes the rights and obligations of the now previous project company – SEIC – the negotiation process should be carefully considered. This is particularly true given the (i) operation of long-term LNG contracts and the role of historic obligations; (ii) frequency of cargo loadings falling within the current period of negotiation; and (iii) importance of ensuring contractual continuity and certainty for the future relationship with Sakhalin Energy LLC.

Furthermore, Decree 1369 contains a number of orders to various federal executive bodies in relation to Sakhalin Energy LLC.

¹ The decree is effective from 3 August 2022.

² Squire Patton Boggs LNG Alert, July 2022: <https://www.squirepattonboggs.com/en/insights/publications/2022/07/asia-lng-market-update-russian-decree-no-416>

³ Reuters, “Japan asks Mitsui, Mitsubishi to ‘think positively’ in joining Sakhalin-2 entity” – <https://www.reuters.com/business/energy/japan-govt-asks-mitsui-mitsubishi-think-positively-joining-sakhalin-2-entity-2022-08-05/>.

For affected buyers, these recent legislative developments shine a spotlight on some noteworthy issues to be aware of in any negotiations. For example, while the new decree does specify, to an extent, a mechanism for the transfer of various assets from SEIC to Sakhalin Energy LLC, title to the LNG produced from the Sakhalin II project is not expressly dealt with in its text. Without the benefit of knowing the terms and conditions of the PSA, it remains unclear to LNG buyers whether the LLC will own the LNG produced or whether ownership will sit with the Russian Federation and be transferred to the LLC for use only for the term of the PSA.

Further, section 12 of Decree No. 1369 requires relevant federal executive bodies to reissue to Sakhalin Energy LLC all permits, licences and other documents previously issued to SEIC, within three days from Sakhalin Energy LLC applying for such documents. This effectively means that SEIC/Sakhalin Energy LLC will have a degree of control over the timing of the transfer of the export licence in due course. This, however, introduces a degree of urgency and represents another important consideration for buyers with upcoming deliveries to ensure contractual arrangements are in place with Sakhalin Energy LLC at the point of transfer of the export licence.

It bears repeating that a solid grasp of the terms of the contract will be crucial for deciding on how best to address this new announcement. As we noted previously, while the complexities and the timings may differ from buyer to buyer, based on its exposure to Sakhalin II LNG deliveries in its portfolio, the transition of the new working relationship with Sakhalin Energy LLC must be carefully considered to ensure that the transfer of rights and obligations to it are effective and binding.

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