



ALIGNING INTERESTS IN THE OIL DRILLING CONTRACT

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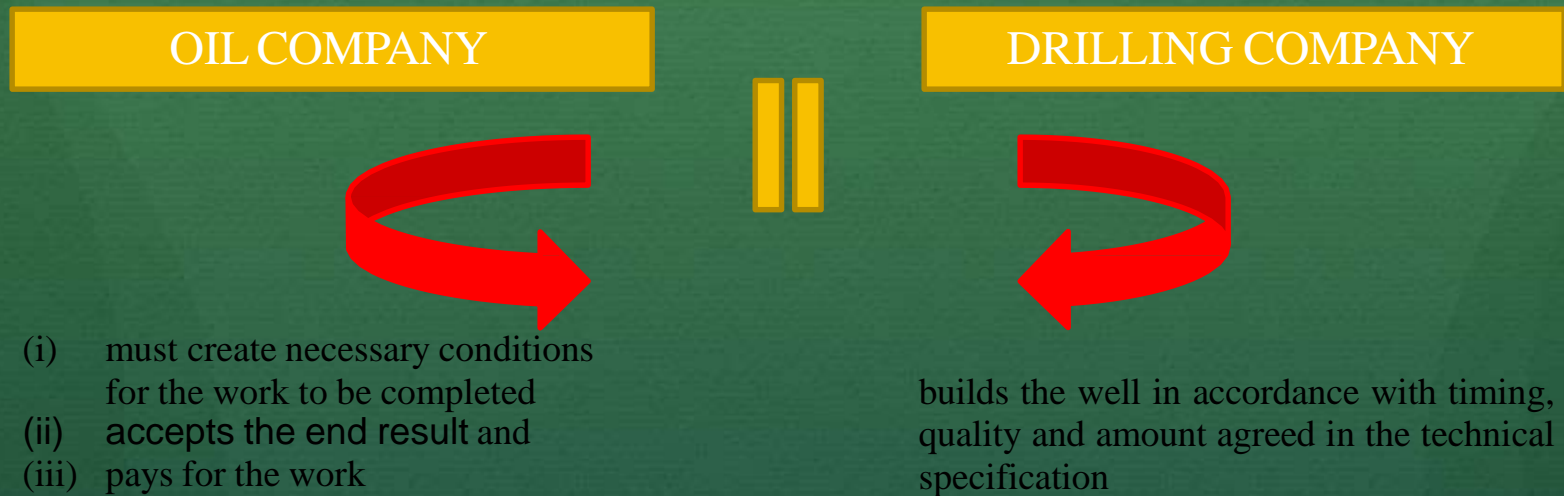
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&
PARTNERS

OIL DRILLING CONTRACT

- Oil drilling contract is a construction contracting under Article 651 of the Civil Code



REGULATION:

CIVIL CODE vs PROCUREMENT RULES (SAMRUK-KAZYNA, TCO, etc.)

ESSENCE OF THE CONTRACT

1. **SUBJECT** - Turn key or daily pay
2. **COST** – fixed amount or remeasurable contract
3. **TIME** – Preliminary, interim and final deadlines for performance and acceptance, submission of technical documentation by the client, supply of materials by the parties
4. **Quality of work and warranty** – compliance with contract terms
5. **Rights and obligations of parties** – performance of work by the contractor and acceptance of such work and payment therefore by the client.
6. **LIABILITY** – fines / canceling the contract

CONTRACTOR'S LIABILITY AND RISKS

- Untimely start or slow conduct due to the fault of the Contractor (Article 627.2) **the references hereinafter are to the Civil Code**
- Undue quality of work and materials as indicated in the acceptance act (Articles 664, 635 и 617.2)
- Undue performance due to flaws in the materials provided by the client (Article 625.2)
- Loss of client's materials (Article 626)
- Breaches of the client to subcontractors (Article 619.2)
- Timely notice on substantial increase in price for the additional amounts (with suspensions of work) (621.3 и 654.4)
- Requirements with regards to environment and safety of the conducted works (653 и 661);
- Overdue transferring the results of work (618.2)

CLIENT'S LIABILITY AND RISKS

- Risk of accidental loss or damage of materials provided by the client (665.2);
- Payment of advance amount specified in the contract (623.2)
- Increase of the work costs, damage and contractor's expenses due to (i) lack of cooperation from the Client and (ii) Client's omissions (629)
- Risk of accidental impossibility of performing the works (652.2)
- Risk of loosing or damaging the work due to no fault of the contractor (664.3)
- Payment to eliminate the defects for which the contractor carries no liability(666 ΓΚ)

CONTRACTORS RIGHTS

1. Receive payment including advance payment (616)
2. Independently determine the method to perform works, including issues of arranging works, provision of materials, mechanisms and other resources (616.2)
3. NOT to compensate the defects by monies but to eliminate such defects during reasonable period of time or to redo the work from scratch (635)
4. To demand increased payment for the work should there be a substantial increase of materials' cost or terminate the contract (621.5)
5. To keep amounts saved (622)
6. Hire subcontractors (619)
7. To keep the results of work until full payment is made (624.1 ΓΚ)
8. To suspend the works until receipt of instructions should there be incompatibility of materials with adverse consequences for the Client (628.1)
9. To own the well until transfer to the Client and payment of all amounts (651.4)
10. To demand new budget if the cost of works exceeds 10 per cent or more
11. To withdraw from transferring the wells and client's property until payment in full is made (292.1)

CLIENT'S OBLIGATIONS

1. Provide technical design and budget (TDB) prior to works' commencement (654);
2. Accept the work and pay as indicated in the agreement (616)
3. To respond to warnings on non-compliance of the TDB(654) and provide services to the contractor in conducting the design works (669)
4. To provide land plot, buildings and erections for the construction process, provide transportation of cargo for the contractor, temporary infrastructure of water, steam, etc. (658)
5. Timely provision of the agreed materials and replacement of low quality materials or change improper instructions (628.3)
6. Should defects be found the Client shall first demand either of (i) eliminating defects free of charge or (ii) reduce price or (iii) compensate expenses (only if such clause is envisaged in the agreement) (635)
7. Not to intrude into operational and economic activities of the Contractor (660.1)
8. To notify immediately on any adverse changes during supervision of performance (660)
9. To cooperate as envisaged in the agreement (629)
10. To pay the expenses and losses due to temporary shutdown (662)

TECHNICAL DESIGN AND BUDGET (TDB)

- Agreement must define content and structure of TDB and period of its submission by the client (654.3).
- Client may demand changes unless they cause increase in costs of the works (655.1)
- The Client must compensate to the Contractor additional expenses caused due to change of the original design specifications (669.5)

Expenses due to change of technical documents and amount of works*

- i. All changes must be agreed by the parties;
- ii. Party responsible for calculation of additional costs must be defined in the contract
- iii. Consequences of reducing the amount of works

* state expertise and marketing analyses by both parties are mandatory with regards to materials or equipment under Samruk-Kazyna procurement rules.

ACCEPTING THE WORK

- Client must accept the work within agreed period and shall commence the acceptance upon as soon as notified by the Contractor (630 и 663)
- Should there be avoidance to accept and after 2 reminders by the contractor the latter shall be entitled to sell or otherwise alienate the results of its work (630.7)
- Should there be refusal to sign the acceptance act a corresponding note shall be made and such note shall be recognized by the court (663.4)

Documents that must be prepared after the completion of work (too many?):

1. Land restoration act;
2. Act on return of the technical documentation;
3. Act on completed works; and
4. Acceptance act.

Price

Defining the price

- Basis – approximate or fixed budget.
- How to increase the price if the ceiling is set by the procurement plan of the oil company? (Clause 133 of Samruk-Kazyna Procurement Rules)

Factors impacting the change of the contract's price:

- i. change in the well's structure;
- ii. increase in the price of materials and equipment / type of tubes;
- iii. change of tariffs affecting the price formation
- iv. other factors.

Payment procedure

- payments shall be made according to stages;
- ratio compliance between payment and work progress.

Liability / Sanctions

- charging fines shall have compensation nature and first of all shall compensate actual losses
- imposing punitive penalties due to to non-performance and/or undue performance of Contractor's obligations;
- There must be parity and reciprocity / Balance

Imposition of punitive penalties from one side without presence of guilt is against the law !

Both parties must coordinate imposition of fines.

Reasons for remission of penalty

1. lack of Contractor's guilt for non-performance and/or undue performance of the obligation;
2. proof that debtor did take all possible measures to perform the obligation;
3. impossibility of due performance due to force majeure circumstances;
4. third parties' guilt;
5. failure by creditors to take timely action to protect breached rights and other basis for release from liability envisaged by the legislation or by the agreement.
6. reduction of the penalty amount by court when creditor increased the penalty amount by non-acting;
7. Article 293 envisages the right of the court to reduce the amount of penalty where there is obvious disproportion between the penalty and losses;
8. There is no definition of such "disproportion" however court practice includes cases when penalty that exceeded 100% of debt was considered as disproportionate;
9. Legal entities are prohibited to take any action aimed to harm other entity, to abuse any of their rights as well as use a legal right in a way that would contradict that right's purpose;
10. One must express disagreement if there is objection against calculation of the penalty

Eliminating defects and cancelation/termination of the contract

- unilateral termination of the contract due to non-performance and/or undue performance of the obligations by the Contractor.
- Pay attention to time frames for Client's notice on contract termination.
- Client has the right/obligation to give reasonable period to Contractor to eliminate the defects.
- Period for attaching signatures to the reconciliation report that is signed upon termination of the agreement.

WARRANTY OF PRODUCT QUALITY / TIME

- Defects identified during warranty period (665)
- Usual wear, improper maintenance, improper instructions of the Client, improper repair by the Client, or third parties are not covered by the warranty
- Quality warranty for the results of work covers all of its segments unless otherwise envisaged by the contract.
- It is important to have all terms and timing conditions of the warranty crystal clear.
- What is “turn key” for oil drilling? Putting all the risks on to the drilling company.

Systematic challenges in the oil drilling contracts

Insurance terms

Insurance cost shall be at the account of the Client and must be included into the price of works.

Correlation of the obligations of the oil drilling contract and subsoil use contract. Mismatches possible.

Dispute resolution

Conventional court or arbitration? What is more independent?

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