

# LEGAL REGULATION OF SUPERVISING IN EXPLORATION OF OIL AND GAS DEPOSITS

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Supervising (or — supervisory services/supervising) is a type of a fee-based service provided by an independent legal entity or an individual. The service implies the representation of the customer's<sup>1</sup> interests while monitoring geologic-geophysical exploration works and drilling works within the supervisory powers of the customer as defined in para. 1, Article 715 the Civil Code of the Russian Federation to verify the compliance of the executed operations to technological rules, fixed by state control bodies, industrial instructions and regulations of subsoil users. This monitoring can be continuous (seismic survey, drilling) or random (perforating-explosive operations, core sampling, lab studies etc.)

In the current situation, supervising is necessitated by the high cost of exploration work, which motivates the customers to employ supervisors — experts to monitor the compliance between the geological survey objectives and the progress of works directly on site.

Another reason for the wide application of the supervisory services is explained by the fact that supervisory reports (both interim and final) can be used as evidence in disputes between the contractor<sup>2</sup> and the customer related to the quality of field data or in the case of troubles during the drilling of wildcats. In other words, documents confirming or denying the correctness of the contractor's actions will be welcomed for the proper assessment of the situation by the counterparties or by other persons (e.g., a judge).

An important feature and the benefit of a supervisor as a customer representative is its independence both from the contractor and from the customer as the objectiveness of the employees of the latter can be biased by the incorrect technical solutions, approved by such employees or by their managers. The independent

<sup>1</sup> In the present article the "customer" is understood as the principal under the supervisory services contract, where a principal can be a subsoil user (as defined in RF Law 2305-1 "On subsoil" on 21.02.1992) or a person acting under a contract (e.g. operator etc.).

<sup>2</sup> "The contractor" in the present article is understood as the contractor under the contract for a geological survey (e.g. seismic crew, drilling contractor etc.).

position guarantees that the judgment of a supervisor is unbiased and objective, which compares him favorably with other controllers.

It is an open secret that supervising is done by specialized divisions of the customer. This type of “supervising” can hardly show an acceptable efficiency.

An “in-house” supervisor is not always “unbiased” and “independent” from his/her colleagues and particularly from superiors, which may lead to hiding violations, delaying defection of deviations from the rules and other negative facts that will immediately impact the safety and quality of exploration.

The above statement supports the viewpoint that hiring a supervisor is an inseparable element of professional culture in the modern exploration activity.

Supervising is a widely spread service, but still legal aspects of this service are not well defined. Such theoretical gaps frequently cause serious practical disputes, in the sphere of responsibilities and quality/completeness of services in particular.

To understand the specifics of a supervising, we should, first of all, define its features:

1. Non-state function of monitoring;
2. A supervisor is not entitled to make any legal acts on behalf of the customer, except the suspension of works;
3. A supervisor is independent from the contractor executing the works.

Supervising in itself is neither engineering monitoring, nor is it in-process or industrial control. It mainly applies to the drilling supervision, as the process of drilling for oil or water implies the construction of facilities.

Supervising of drilling differs from the engineering monitoring both by form and essence. Resolution of Gosstroy of Russia (the Russian Federation State Committee for Construction, Architectural and Housing Policy) No. 44 “On the approval and enactment of Rules for the Site Monitoring of construction of buildings and facilities” on June 10, 1999 states that the contract for engineering monitoring puts specific requirements for the monitoring company, i.e., the company should be the developer of the detailed design documents for the constructed object.

At the same time, the supervisory control can not be regarded as engineering monitoring for a number of rules laid down in the Provisions for a customer-developer (integrated customer, directorate of constructed facility) and engineering monitoring approved by USSR Gosstroy Resolution No. 16 on February 02, 1988 “On the approval of the Provisions for a customer-developer (integrated customer, directorate of constructed facility) and engineering monitoring” (hereinafter — the Provisions for a customer-developer). The supervisory control does not allow resolving *inter alia* such problems as the control of construction milestones, compliance of the construction costs to approved projects and cost-estimates.

Moreover, from the viewpoint of the notion of “engineering monitoring” as defined by para. 6.3 of SNiP (Rules and Norms for Construction) January 12, 2004 (“Organization of construction” approved by Resolution No. 70 of Gosstroy of Russia on April 19, 2004) the engineering monitoring by the developer (customer) has under the following mandate (inapplicable to drilling):

- verification of the availability of the quality guarantee documents (in some cases — certificates) for materials, items and equipment, documented results of incoming inspection and lab tests;
- monitoring over the compliance with the rules of storage and warehousing of materials, items and equipment;
- monitoring over the elimination of defects in design documents detected during the construction, recorded return of defective documents to the designer, verification and documented acceptance of corrected documents and their transfer to the contractor.

From the view point of essence, the supervising of drilling has some features in common with the industrial control as the process supervisor has to check:

- the compliance of the sequence and the content of process steps to the process rules and regulatory documents applicable to such technologies;
- conformity of process modes to the approved flow-charts and regulations;
- conformity of the quality parameters of performed operations and their results to the requirements of design and technological documents.

At the same time, industrial control is executed by the contractor while a “drilling supervisor” is, first of all, a customer’s representative.

The specific features of supervisory services described above allow to conclude that there is a legal difference between them and the services for the construction supervision in general and the supervision over the construction of wells in particular. This statement entails important legal implications because we can state that the legislators do not regard the drilling supervision as a variant of supervision over the construction, reconstruction, overhaul of capital development objects that may impact the safety of such objects (subpara. 32.2. section III in the List of works for engineering survey, construction, reconstruction, overhaul of capital development objects that may impact the safety of the capital development objects, approved by the Order of the RF Ministry of Regional Development on December 30, 2009, No. 624 “On the approval of the List of works for engineering survey, construction, reconstruction, overhaul of capital development objects that may impact the safety of the capital development objects”). So we can state that the legislation does not require the companies providing supervisory services to enter into the self-regulating bodies to get certificates permitting to execute the relevant work. This is a very important provision for small and medium enterprises.

Coming back to the legal nature of the supervisory contract, it should be noted that supervising is a type of agency contract.

The possibility to apply the provisions of Article 52 of the Civil Code of the Russian Federation “Agent services” to the relevant legal relations stems from the fact that the subject of the agreement under question is the execution of real and legal actions by a person, in its own name, and at the cost of the customer during the supervision over the execution of exploration works and services by contractors, as well as the representation of the customer’s interests at the suspension of works, i.e., execution of legal actions on behalf of the customer.

It is worth noting that, in a classical supervisory contract, the subject is the supervisory control as such. But, in real life, there are mixed contracts that combine the supervising services with the services for design and survey, R&D, fee-based services, and freight forwarding.

For example, the contracts for the supervising of field seismic data acquisition, in addition to the supervising as such, often imply the supervising over the initial processing of field findings, coordination of the project and generation of the final report on the field studies done by the contractor, delivery of field data from the place of origin to the place of storage. At the same time, the provision of unconditional safety of executed works can not be the subject of a supervising contract.

A supervisor, acting on its own behalf, performs such actions as recording the significant process events (e.g., records into the drilling log about the violations of Selective Processing Plot (SPP), verifying the field data quality at field seismic data acquisition, generating reports, statements, etc.

There are objects requiring very close attention of a supervisor that defines the results of the works, namely:

- 1) readiness of the facility and the personnel of the customer (a field team, a drilling team etc.) to start the works;
- 2) compliance of equipment, tools and materials, used by the contractor, with the quality criteria sufficient to meet the prospecting tasks set by the customer;
- 3) compliance of the executed works to the approved design and technical documents, norms of RF legislations and local regulatory acts of the customers (provisions for the execution of works, environmental standards etc.)

Acting on its own behalf, the supervisor may execute legal actions, e.g., to participate in the acceptance procedure of field data or investigation of an accident.

At the same time, a supervisor, acting as a representative of the customer and exercising the supervision over works/services, may act on behalf of the customer, namely: suspend the work if the violation of process rules creates a danger to life or property. This mandate is usually included into the contract, but the right to use it requires an additional permission from the customer to suspend the work.



One of the main responsibilities of a supervisor is well fitting the above statements: timely and continuously informing the customer about the occurrence of an event from the agreed list, i.e., regularly providing the agent's reports, which can be made in the form of daily notes, violation statements, etc., that fully comply with the provisions of Article 1008 of the Civil Code of the Russian Federation "The agent's reports". A supervisor also provides final statements (reports) at the end of a certain stage of geological work.

The responsibilities of a supervisor are frequently defined by the situation: it is customary to see the interaction of a supervisor with third persons without any power of attorney. This practice may be explained by the fact that the range of actions that can be executed on behalf of the customer is very limited. The supervisor's mandate is detailed both in the contract between the customer and the supervisor (e.g., as rules of supervising) and in the contract between the customer and the contractor (e.g., in the technical specifications).

The above mentioned statements allow deeming a supervising contract as a type of an agency contract.

It is worth stating that, despite some commonalities, a contract for the supervising over drilling is not a contract with the customer-developer as defined by the Provision for the customer-developer due to a number of legal aspects. The drilling supervisor, contrary to the customer-developer, does not and can not bear the responsibility for:

- timely commissioning of production facilities and object construction in accordance with the approved design documents and cost estimates;
- timely preparation for the operation of the above mentioned objects and facilities;
- timely supply of equipment and payment for the executed construction and installation works and delivered equipment as mentioned in para. 1.4 of the Provision.

It might be interesting to look at the limits of responsibilities for an exploration supervisor from the legal point of view.

Very often a customer tries to shift to a supervisor the responsibility for unfavorable implications resulting from the deviation of rules or from accidents. This understanding of the exploration supervisor's role is not correct.

A supervisor is responsible for the proper execution of obligations assigned to him by the principal (subsoil user) such as — timely arrival to the site with materials and equipment necessary for the execution of relevant tasks, provision of information and, if provided in the contract — for the suspension of works, and for the match between the qualification of the supervisor and requirements laid down in the contract.



At the same time, holding the supervisor responsible for the implications of violations or accidents does not match the function of a supervisor, particularly if the customer was timely informed about such deviations but did not take any actions against the contractor.

An inadequate execution of supervisory duties can not be regarded as a direct cause of violations of the rules or accidents.

An accident may be caused by the conditions uncontrollable by the contractor or the supervisor, such as: weather, incorrect geological data about the structure of a layer, hidden defects in equipment and instruments or the poor execution of obligations by the contractor. In the first and in the second case, the supervisor is not responsible for such situations as stipulated in Article 401 of the Civil Code of the Russian Federation “Responsibility for the violation of obligations”.

And while in the first case a supervisor is unconditionally not responsible, in the second case he is not responsible, unless failed to send a prompt notification. As stated above, the subject matter of a supervising contract does not imply the insurance of work safety, as the supervisor is not entitled to choose materials and equipment, to select the contractor, and to manage its actions or accept the results of its work.

Summing up the above, it should be mentioned that the demonstration of the proper execution of services by a supervisor under the relevant agreement means the timely provision of the full information to the customer about the occurrence of events, as listed in the approved document. It is also the demonstration of proper diligence and due care as required by the nature of the supervisor’s obligations. In such circumstances, a supervisor may be regarded as a person that undertook all necessary precautions to ensure the proper execution of his obligations.