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Energy & Natural Resources - Croatia



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New hydrocarbon exploration and exploitation regime

Miran Maćešić

September 09 2013



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Ivana Manovelo



Introduction

On July 30 2013 the Hydrocarbons Exploration and Exploitation Act, which had already been approved by Parliament, became effective. With the passing of the act the required legal framework for hydrocarbon exploration and exploitation, which also includes the Mining Act (passed in April 2013) and the Concession Act (passed in December 2012), is now complete.

Based on the constitutional principle that all mineral resources in the natural environment belong to the state, through the Hydrocarbons Exploration and Exploitation Act the state is seeking investors and potential partners to invest in hydrocarbon exploration both onshore and offshore in the Adriatic. Successful investors which discover commercially exploitable reserves of hydrocarbons will be entitled to exploit such reserves.

Unique procedure

The Hydrocarbons Exploration and Exploitation Act follows existing principles of the Mining Act and the Concession Act for the award of licences for exploration and concessions for exploitation – two separate rights. However, it provides a unique tender procedure both to ensure that the successful bidder will obtain an exploration licence, and to award an automatic right to a concession in the case of commercial discovery.

In order to operate the tender process, supervise the licence and concession performance and assist and cooperate with investors, the government will establish an agency within 12 months of the date of enactment of the Hydrocarbons Exploration and Exploitation Act.

Before a formal public tendering procedure, the government may organise a presentation to potential investors regarding the hydrocarbon potential of certain regions, and must pass resolutions on the public tender content and terms (including the draft agreement) and the public tender announcement. The public tender must be announced in Croatia at least three months, and in the *EU Official Journal* at least six months, before the elapse of the bidding term.

Within a further term of two months, the government must pass a decision on the bids made by potential investors and issue the licence to the winning investor.

Licence

A licence gives the investor:

- the right to explore;
- the right to the concession if a commercial discovery is made; and
- the right to conclude an agreement.

A concession is the right to exploitation under the terms of the agreement. The concession is an integral part of the licence. The agreement must be concluded between the investor and the government within six months of issuance of the licence.

The duration of the licence is up to 30 years, which includes up to five years for exploration and up to 25 years for exploitation.

The exploration term may be extended for good reason for two six-month periods on request by the investor, but the exploitation time will be shortened by the extension period.

The exploitation time may be extended by the government if the investor so requests no later than 12

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months before the licence expires.

The licence is transferable between associated companies without prior government consent. However, the original licence holder is not released from the licence rights and obligations, and it remains jointly and severally liable with the new licence holder.

The licence is also transferable, on application by the investor, to third parties. In such case the government cannot refuse consent without good reason, but the government, through a national special purpose vehicle, has a pre-emption right of not less than 10% of the shares from the agreement.

The licence will be lost if the agreement is violated for standard reasons.

Agreement

The Hydrocarbons Exploration and Exploitation Act stipulates three types of agreement:

- exploration and division of the exploitation of the hydrocarbons (a production sharing agreement);
- exploration and exploitation with fees and taxes payment (a royalty payment agreement); and
- a combination of the two.

Drafts of the agreement will be included in the tender documentation.

Rules and regulations with regard to "fees and taxes" (ie, royalties) should be passed within four months from the date of enactment of the Hydrocarbons Exploration and Exploitation Act.

The agreement must be signed within three months of announcement of the tender winner, but not more than six months after the issue of the licence.

The parties are bound by the principle of stability of the agreement. However, the Hydrocarbons Exploration and Exploitation Act provides that the agreement will be amended by negotiation between the government and the investor in the case of amendments of laws, rules and regulations which significantly affect economic, commercial or other interests of the parties. Negotiations will be guided by the maintenance of interests and planned economic results of the parties at the time of issuance of a licence and conclusion of the agreement. Amendments of the labour, environment, health, safety at work and safety of property, protection of natural resources and mining works performance laws and regulations will not affect the licence and agreement.

The agreement also stipulates the methodology and manner as to how the investor will recover its exploration and mining costs from the exploitation of discovered commercial reserves.

If no commercial reserves are discovered within the terms of the licence, the licence and agreement cease and the investor is not entitled to recover its exploration costs. However, the investor may be allowed to continue works at its own cost and risks if there are no obstacles to such continuation.

According to the act, the mandatory provisions of the agreement include:

- the duration of exploration and exploitation;
- the minimal extent of exploration works, minimal exploration costs, revision terms and due performance penalty;
- the requirements for final exploration report and/or reserves report;
- the method of costs recovery;
- the method of hydrocarbons price calculation and costs recovery;
- the place of hydrocarbons ownership transfer;
- details of the royalty;
- details of the bonus;
- tax obligations;
- the operating company status, functioning and obligations;
- the proposition of exploitation financing, exploitation course and total and annual exploitation programme;
- the abandonment of duties;
- mining project requirements;
- transportation requirements;
- ownership transfer terms over mining equipment;
- ownership over geological data;
- waste disposal issues;
- environmental protection;
- public infrastructure use;
- supervision of due performance;
- insurance requirements;
- abandoning costs security;
- *force majeure*;
- dispute resolution;
- requirements regarding exploration documentation;
- the methods of reserves assessment, exploited quantities assessment and non-exploited quantities assessment;

- accounting standards; and
- confidentiality.

Comment

The Hydrocarbons Exploration and Exploitation Act introduces and imposes new principles in natural resources exploration and exploitation, and in mining generally. Therefore, there are some uncertainties and doubts in interpretation of the act's provisions. However, it is expected that the new rules and regulations that should be passed in coming months (particularly in regard to the unique public procurement process, methods of calculating exploration costs recovery, royalties and product sharing, hydrocarbon reserves, and the agency and national special purpose vehicles), should clarify the majority of the existing uncertainties.

Existing exploration licence holders and exploitation concession holders are due to harmonise their licences and concession agreements with the Hydrocarbons Exploration and Exploitation Act within two years of it coming into effect.

For further information on this topic please contact [Miran Maćešić](#) or [Ivana Manovelo](#) at [Maćešić & Partners](#) by telephone (+385 51 215 010), fax (+385 51 215 030) or email (mmacesic@macesic.hr or ormanovelo@macesic.hr).

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