

## Kazakhstan

# The framework for oil & gas legislation in Kazakhstan

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Kazakhstan has enacted an elaborate body of commercial, financial and fiscal legislation to govern investment in the natural resources sector. Many benefits previously accorded foreign investors have been eliminated, and the trend has been to favour domestic interests. However, the country will continue to depend upon foreign investment and expertise to develop its enormous natural resource reserves.

The principal laws governing petroleum operations are the Law on Petroleum, dated June 28, 1995 and the Law on the Subsoil and Subsoil Use, dated January 27, 1996.

### The Subsoil Law and Petroleum Law

The Subsoil Law defines the procedures connected with the granting of subsoil rights, while the Petroleum Law applies narrowly to petroleum operations. The subsoil, including resources in their underground state, are state property, while resources brought to the surface belong to the subsoil user, unless otherwise provided by contract.

#### Subsoil use rights

The government defines the procedures by which subsoil rights are granted and exercised. The 'competent body', currently the Ministry of Energy and Mineral Resources, is responsible for tenders and negotiations over subsoil rights and the registration of contracts.

The national oil company KazMunaiGaz plays a significant role in the process, both in an administrative and commercial capacity. Local bodies are responsible

for the granting of surface rights and ensuring environmental compliance.

#### The contracting process

Subsoil rights become effective upon conclusion of a contract with the competent body.

The government establishes annually a list of blocks for tender and those reserved for KazMunaiGaz. Parties may participate in a tender by application to the competent body, which is assessed according to several criteria: the period for commencement of exploration and intensity of exploration, anticipated production and payments to the budget, amount of investment and nature of the financing and capital investment programmes. Recent amendments emphasise mandatory use of Kazakhstan employees, manufacturers and service providers, environmental compliance, the application of high technologies and infrastructure development.

Contracts may be awarded for exploration and/or production, production sharing, and construction of underground facilities. Exploration contracts are granted for up to six years, with the possibility of two extensions of two years each. Following a commercial discovery, the holder of exploration rights has an exclusive right to negotiate a production contract.

A production contract may be granted for up to 25 years (40 years for large deposits). The term may be extended with agreement of the competent body.

Petroleum operations are subject to Kazakhstan law. In principle, a contract may provide for resolution of disputes by international arbitration, pursuant to the Law on Investments.

#### The approval process

After negotiation with the competent body the contract is subject to approval by various bodies,



including tax authorities. Certain additional documents are required, including a project report, a field development plan and state studies on appraisal of reserves and ecology.

### **Stabilisation**

The subsoil legislation contains guarantees, providing that changes to legislation (except legislation involving national defence or security, ecological safety and public health) which worsen the position of the subsoil user are not applicable. The government has gradually weakened this stabilisation guarantee, particularly in relation to new projects.

### **Rights and obligations of subsoil users**

The subsoil user is accorded, inter alia, the exclusive right to conduct petroleum operations; erect production and social facilities; freely dispose of its share of production, and conduct negotiations for extension of the contract.

The subsoil user is required to use the most effective methods and technology; to use the contract territory solely for the purposes specified; to conduct operations in accordance with law; to observe requirements for environmental protection and worker safety; to give preference to Kazakhstan personnel, equipment and subcontractors; to observe tax obligations; to participate in the development of local infrastructure; to preserve the environment and objects of historical significance; and to restore the contract territory.

The obligation to give preference to local personnel, suppliers and subcontractors has been progressively strengthened, with the enactment of rules for the mandatory holding of tenders, with government participation, for the procurement of goods and services in a subsoil project. Rigid selection criteria and quotas apply.

The Petroleum Law requires the application of general currency, tax and customs legislation, virtually eliminating the negotiation of exemptions.

### **Revocation, suspension or termination of rights**

The government may revoke subsoil rights for the giving of false information, collusion with officials and violation of the contract or environmental/subsoil legislation. The contract may be amended or terminated if the conditions of the contract are not met, or if the contractor becomes bankrupt.

### **Transfer of subsoil use rights**

A subsoil right may be transferred or pledged only with the permission of the competent body, including in

cases of transfers to affiliates. Such permission may be refused under very broad 'national security' principles.

Recent amendments accord the government a preemptive right, superior to that of contracting companies in a project, to acquire a subsoil right, or shares in a company holding a subsoil right, in the process of being transferred (and in some cases, shares in the parent company, including offshore). Such preemptive right would apply even in the context of enforcement of a pledge over subsoil interests. Any financing secured by a pledge over subsoil rights must be used exclusively for the project.

### **Offshore PSAs**

A recent law on PSAs for offshore petroleum operations establishes special conditions for offshore projects under PSAs, pursuant to a model contract. These include the mandatory participation of KazMunaiGaz, with a minimum share of 50%, certain bonuses and taxes and local content requirements.

## **Tax legislation**

The tax regime that applies to subsoil users is defined in the Tax Code, dated June 12, 2001 (as amended), effective as of January 1, 2002. Significant amendments related to subsoil use taxation took effect in 2005.

The primary model is the assessment of all taxes of general application, together with the payment of excess profits tax and special payments by subsoil user, namely bonuses (signature and/or commercial discovery), royalties, and a rent tax on the export of crude.

A second model is provided for PSAs. This model envisages the transfer to the state of a defined share of production, the payment of bonuses, royalties and taxes of general application, other than excise tax, excess profits tax, land tax, property tax and rent tax on the export of crude.

The tax regime for subsoil users is defined in the contract. However, it must comply with the general tax regime in effect on the date of conclusion.

### **Environmental issues**

A state environmental study is a prerequisite to obtaining subsoil rights. However, it will not necessarily protect a subsoil user from subsequent environmental liability.

Environmental use payments apply to ongoing emissions within defined limits. A strict liability standard applies to environmental damage from offshore petroleum operations.

## Concession Law

In July 2006 Kazakhstan adopted a new law on concessions, which provides that concession projects may be approved in all sectors of the Kazakhstan economy, with the exception of the subsoil (natural resource) sector and certain sectors to be included in a list prepared by the President of the RK. Proposals for concessions may originate as private initiatives from individual investors.

A concession may be granted, on the basis of open tenders, for a period of up to 30 years. Prior to the expiration of the concession and the transfer of the concession object to the state, the concessionaire is entitled to recovery of its costs and the production and income arising from the commercial activity undertaken by concession

Concession projects are eligible for various forms of state support, including sovereign guarantees, infrastructure commitments, in-kind grants and state purchase commitments, subject to existing RK legislation. In addition, special tax and customs benefits granted to qualified investors in listed priority sectors pursuant to the 2003 RK Law on Investments may apply in conjunction with the additional benefits provided in a concession.

Concession objects may be pledged with the prior approval of the concessor, though any form of alienation of the concession object prior to the expiration of the

concession is prohibited. Finally, the resolution of disputes under concession agreements may be referred to local courts or international arbitral bodies, by agreement of the parties.

Although exploration and production projects for hydrocarbons and minerals are not eligible for concessions, energy transmission and transportation projects might well be approved on this basis.

## Conclusion

Notwithstanding recent changes affecting foreign investors, the direction of legislative activity in Kazakhstan has been largely positive, and the basic legal elements necessary for exploration and production projects are in place. However, the viability of projects should be carefully assessed on the basis of technical and commercial feasibility, as current legislation could change during a project.

### Note:

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