

Legal Regulation of M&A Transactions in the Kazakhstan Oil and Gas Industry

Natalya V. Braynina

*Partner of Aequitas
Law Firm*

Violetta M. Kim

*Senior Advisor of
Aequitas Law Firm*

Natural Resources Potential

Kazakhstan possesses significant oil and gas reserves concentrated in the western region, which allow to rank it among the world's largest oil-producing states.

According to the results of geological and economic evaluation of Kazakhstan's mineral reserves in place, the most significant economy-wise are coal, oil, copper, iron, lead, zinc, chromite ores, gold and manganese.

The country is among the 15 world's leading by oil reserves.

Kazakhstan holds 3.3% of the global hydrocarbon reserves.

The total volume of Kazakhstan's predicted recoverable hydrocarbon reserves is estimated at 17 billion tons, of which 8 billion tons are in the Kazakh sector of the Caspian Sea.

The approved recoverable reserves amount to 4 billion tons of oil and 3 trillion cubic meters of gas.

90% of the reserves are concentrated at the 15 largest fields, such as Tengiz, Kashagan, Karachaganak, Kumkol, Uzen, Karazhanbas, etc.

Panorama newspaper of 9 September 2011

2011 Data

Oil	Gas
The Republic of Kazakhstan globally ranks 9th by its proven oil reserves, which constitute 5.5 billion tons.	The proven gas reserves of the Republic of Kazakhstan are the 18th largest worldwide, making 1.8 trillion cubic meters.
The oil companies produced 79.7 million tons of oil and gas condensate, exceeding the 2009 production by 4.2%.	Gas production in Kazakhstan amounted to 37.4 billion cubic meters, with an increase against 2009 volume of production by 3.9%.
<p>The oil export was 71.2 million tons, which exceeds the 2009 numbers by 4.5%. Oil is mostly exported via CPC (40.2%), Atyrau-Samara (21.5%) and Atasu-Alashankou (14.2%) pipelines.</p> <p>The three oil refineries have processed 13.7 million tons of crude oil, the 2009 volume being exceeded by 12.8%.</p> <p>BP Statistical Review of World Energy 2011 website Kazenergy Association website</p>	<p>Commercial gas production volume was 21.1 billion cubic meters, which exceeded the 2009 numbers by 7.1%.</p> <p>BP Statistical Review of World Energy 2011 website Novosti-Kazakhstan news agency website</p>

Kazakhstan Oil and Gas M&A Transactions Market in 2009-2011

There is no official coverage of the M&A market in the Republic of Kazakhstan, the information being fragmentary.

2009

Most M&A transactions were held within the framework of a number of oil and

gas companies nationalization program. Principal financing came from Chinese and Korean investor loans.

The largest 2009 transaction was the US\$2.6 billion acquisition of 100% shares in Mangistaumunaigas JSC, the Kazakhstan's third company by oil production volume, by Mangistau Investments B.V. (50% - CNPC and 50% KazMunaiGas NC JSC).

China Investment Corporation acquired 11% of the charter capital of KazMunaiGas Exploration Production JSC for the total amount of US\$900 million.

Tau-Ken Samruk National Mining Company JSC was organized to promote the state's strategic interests in managing the state assets in the mining and metallurgical industry and to develop the natural resources and primary sector.

2010

South Korean Korea National Oil Corp (KNOC) acquired for US\$335 million Sumbe JSC developing several oilfields in Mangistau Oblast.

The conflict between the Russian LUKOIL Overseas Kumkol B.V. and Chinese CNPC with respect to interest in the Kazakhstan company Turgai Petroleum came to its resolution. The dispute was due to LUKOIL's unwillingness to waive its pre-emptive right to the interest in Turgai Petroleum. The Stockholm Court of Arbitration resolved in favor of the Russian company, however, the latter waived its right to purchase CNPC's interest, receiving in return US\$438 million in compensation and a number of other rebates from the Chinese party.

2011-2012 News

11 March 2011 - KazMunaiGas Exploration Production JSC came to agreement with Exploration Venture Limited on acquisition of 50% of shares in Ural Group Limited. Ural Group is a 100% owner of Ural Oil & Gas LLP, holding the subsoil use right to exploration at the Fedorovsky block.

22 March 2011 - Korea National Oil Corporation (KNOC) acquired 95% in Altius, a Kazakhstan oil company; the transaction value being US\$515 million.

18 April 2011 - Oil and Natural Gas Corporation Videsh Ltd (OVL), India's national oil company, acquired 25% interest in the project for the development of promising oil block in the Kazakh Caspian sector. OVL is to pay to KazMunaiGas

National Company (KMG) US\$80 million in consideration and finance the exploration program at the block. The joint investment plan for the Satpayev block development is worth US\$400 million.

14 June 2011 - KMG PKI UA (KMG 100% subsidiary) finalized the US\$334 million acquisition of 100% of Aktaunefteservice LLP.

26 August 2011 - Kazakhmys PLC resolved to sell Kazakhmys Petroleum, which was developing Akzhar oilfield.

15 December 2011 - Participants in the Karachaganak Petroleum Operating consortium are to reduce their interests to transfer 10% to KazMunaiGas, Kazakhstan's national company. BG Group is to reduce its interest from the current 32.5% to 29.25%, Eni - from 32.5% to 29.25%, Chevron - to 18% (currently 20%), and LUKOIL - to 13.5% (currently 15%). The signed agreement between KPO and the Kazakhstan Government on the 10% acquisition by KMG is to enter into force starting 30 June 2012.

29 December 2011 - KazMunaiGas Exploration Production JSC announced the closing of the US\$59 million transaction on acquisition from GasMunaiOnim LLP of 100% shares in Karpovsky Severny JSC holding a subsoil use right under the Contract for Exploration for Oil, Gas and Condensate at Karpovsky Severny Block in the West Kazakhstan Oblast of the Republic of Kazakhstan.

6 January 2012 - China Investment Corporation, a Chinese state fund, has acquired 11% of shares in one of Kazakhstan's largest energy companies, KazMunaiGas Exploration listed on the London Stock Exchange, the transaction value being US\$939 million.

24 January 2012 - KazCopper LLP (a Frontier Mining subsidiary) obtained a consent from the RK Ministry of Industry and New Technologies and appropriate governmental agencies to close the US\$2.5 million transaction involving the acquisition and transfer of contract for subsoil use at South Benkala field between PromSnab 2030 and KazCopper LLP.

7 February 2012 - Gasprom Neft JSC made a decision to approve the acquisition of 100% interest in the charter capital of a Kazakh company Sonol Invest LLP.

6 March 2012 - Gasprom Neft JSC, Russia's fifth largest oil company, is considering the possibility to acquire a bitumen production in Kazakhstan.

Legal Regulation of M&A Transactions in Kazakhstan

The Kazakhstan legislation contains no legislative definition of M&A transactions.

The M&A transactions include:

Acquisition of shares / participation interests, either directly in a Kazakh subsoil user, or in a controlling company;

Merger - a form of reorganization resulting in the arising of a new legal entity to which all property, rights and obligations of the merging legal entities are transferred. Merger is performed on the basis of a merger agreement and in accordance with the acts of transfer of the merging legal entities, whose activities are terminated.

Accession - a form of reorganization as a result of which all property, rights and obligations of the acceding legal entity are transferred to another legal entity. As a result of accession, the acceding legal entity is terminated.

Consents and Approvals

Governmental Consents and Approvals:

- compliance with the state priority right requirements when alienating subsoil use right and objects related thereto;
- competent authority's consent to the transfer of subsoil use right and objects related thereto;
- notification to the competent authority of the consummated transaction within five business days of its consummation;
- consent to economic concentration;
- consent to alienation of strategic facilities;
- registration of currency transactions with the RK National Bank.

Corporate procedures and approvals

State Priority Right

In order to preserve and strengthen the resource and energy base of the country's economy, in the newly concluded and previously concluded subsoil use contracts, except for the contracts for underground waters and common minerals, the state has a priority right over the other party to the contract, or participants in the legal entity holding the subsoil use right and other persons, to acquire the subsoil use right (a part thereof) being alienated on a for-a-charge or free-of-charge basis and/or objects related to the subsoil use right.

Objects related to subsoil use right - participation interests (shareholdings) in a legal entity holding the subsoil use right, as well as in a legal entity, which has a possibility to directly and/or indirectly define the decisions and/or influence the decisions made by such subsoil user, if the primary activity of such legal entity is connected with the subsoil use in the Republic of Kazakhstan.

No state's waiver of its priority right is required in the following cases:

- transactions involving alienation of shares or other securities supporting the right of ownership to the shares, or securities convertible into shares, which are circulating on the organized securities market;
- transfer of a subsoil use right or a part thereof or objects related thereto:
- to a subsidiary in which at least 99% of participation interest (shareholding) is directly or indirectly held by the subsoil user, provided that such subsidiary is not registered in a state with preferential tax treatment;
- between legal entities in each of which at least 99% of participation interest (shareholding) is directly or indirectly held by one and the same person, provided that the acquirer of all or a part of the subsoil use right or the objects related thereto is not registered in a state with preferential tax treatment;
- transfer of shares (participation interests) in a legal entity, which is a subsoil user, if as a result of such transfer the person acquires, directly or indirectly (via third parties), the right to dispose of less than 0.1% of the participation interest (shareholding) in the charter capital of the subsoil user legal entity and/or a legal entity, which has the possibility to directly or indirectly define the decisions of, and/or influence the decisions made by, such subsoil user, if the principal activities of such legal entity in the Republic of Kazakhstan are associated with subsoil use.

Procedure for Obtaining the State's Waiver of Its Priority Right

Interdepartmental Commission for the Issues of Exercising the State Priority

Right considers the application and other materials, subject to the national security requirements of the legislation of the Republic of Kazakhstan, and develops recommendations regarding the state's acquisition (waiver of acquisition) of the subsoil use right (a part thereof) being alienated and/or an object related to the subsoil use right.

The resolution, on behalf of the RK Government, regarding acquisition by the national managing holding or a national company of the subsoil use right (a part thereof) being alienated and/or an object related to the subsoil use right is to be adopted by the competent authority.

Consent to the Transfer of Subsoil Use Right to Exploration, Production or Combined Exploration and Production of Minerals, Except for Common Minerals, and/or Objects Related to the Subsoil Use Right

The transfer of the subsoil use right to exploration, production or combined exploration and production of minerals, except for common minerals, and/or objects related to the subsoil use right is to be performed **on consent of the competent authority.**

The competent authority issues its consent to the transfer of subsoil use right (a part thereof) or objects related to the subsoil use right only on the following conditions:

- if the acquirer of the subsoil use right (a part thereof) fully meets the Subsoil Law requirements to subsoil users and persons seeking to obtain the subsoil use right;
- if such transfer does not entail incompliance with the RK legislation requirements, including national security requirements or requirements regarding concentration of rights in the framework of a contract and/or concentration of rights to perform operations in the subsoil use sphere, or incompliance with international treaties concluded by the RK;
- if the application for consent to the transfer of subsoil use right or objects related thereto meets the legislative requirements.

If the RK legislation requirements, including national security requirements or requirements regarding concentration of rights in the framework of a contract and/or concentration of rights to perform operations in the subsoil use sphere, or the requirements of international treaties concluded by the RK are not met, the rejection of consent to the transfer of the subsoil use right is issued without explanation of reasons.

M&A Approval by Antimonopoly Agency

Transactions (actions) falling within the definition of economic concentration are to be performed upon antimonopoly agency consent.

Concept of economic concentration in the current legislation

- reorganization of a market entity by way of merger or accession;
- acquisition by a person (group of persons) of voting shares (participation interests, unit shares) in the charter capital of a market entity, due to which such person (group of persons) obtains the right to dispose of more than twenty five percent of the said shares (participation interests, unit shares), if prior to the acquisition such person (group of persons) did not dispose of the shares (participation interests, unit shares) of such market entity or disposed of twenty five or less percent of the voting shares (participation interests, unit shares) in the charter capital of the said market entity;
- obtaining by a market entity (a group of persons) into ownership, possession and use, including on account of payment in (transfer to) the charter capital, of fixed production assets and/or intangible assets of another market entity, if the book value of the property constituting the subject of transaction (interrelated transactions) exceeds ten percent of the book value of the fixed production assets and intangible assets of the market entity alienating or transferring the property;
- acquisition by a market entity of the rights (including on the basis of a trust management agreement, joint operating agreement, agency agreement) enabling to issue binding instructions to another market entity in its carrying out entrepreneurial activities, or to perform the functions of its executive body;

participation of one and the same individuals in the executive bodies, boards of directors, supervisory boards, supervisory councils or other management bodies of two or more market entities, provided that the said individuals define in such entities the conditions of carrying out entrepreneurial activities.

The following is not recognized as economic concentration:

- acquisition of shares (participation interests, unit shares) of a market entity by financial organizations, if such acquisition is made for the purpose of their subsequent resale, provided that the said organization does not participate in voting on the market entity's management bodies;

- appointment of rehabilitation manager, receiver or court-appointed administration (court-appointed administrator);
- consummation of transactions falling within the definition of economic concentration, if such transaction occurs within the same group of persons.

Antimonopoly agency consent to transactions entailing economic concentration is required, if:

- the aggregate book value of assets of the market entities (group of persons) being reorganized or the acquirer (group of persons) and the market entity whose voting shares (participation interests, unit shares) in the charter capital are being acquired, or their aggregate volume of the sales of goods for the last financial year exceeds 2,000,000 MCI (which currently approximately makes US\$20,500,000); or
- one of the persons participating in the transaction is a market entity occupying a dominant or monopolistic position on the relevant commodity market.

Obtaining Consent to Strategic Facilities Alienation

Objects related to subsoil use right may be referred to strategic facilities.

The list of strategic facilities is approved by the RK Government.

It is possible to alienate strategic facilities or encumber them by third party rights based on a resolution of the Government of the Republic of Kazakhstan to issue consent and in accordance with the procedure established by the RK Law on State Property.

No consent is required for transactions with shares that are referred to strategic facilities, if:

- the transaction is performed on an unorganized securities market;
- if alienated or encumbered are no more than five percent of the total number of the issuer's voting shares.

The consent may be denied, if:

- the encumbrance or alienation would entail incompliance with the RK legislation requirements, including national security requirements, or

incompliance with international treaties concluded by the RK.

RK Priority Right to Acquire Strategic Facilities Held by Individuals and Non-State Legal Entities

In the event a non-state legal entities or an individual intends to alienate a strategic facility, as well as in case a strategic facility is enforced or alienated by a rehabilitation manager or receiver, or a pledged property (strategic facility) is sold by a pledgee in an extrajudicial procedure, or if a strategic facility is enforced on the basis of a judicial act, the Republic of Kazakhstan possesses a priority right to acquire the strategic facility.

The priority right to acquire the strategic facility is exercised on behalf of the RK by the Government of the Republic of Kazakhstan, or, if so instructed by the Government, by the national managing holding.

Transactions with strategic facilities consummated without consent and in violation of the state priority right are invalidated.

Registration of Currency Operations

In case one of the parties to the transaction is the resident of RK, such transaction may be recognized as currency operation and may require registration with the RK National Bank.

The transaction involving the acquisition of shares (participation interests) in a legal entity is recognized as a currency operation, if 10% or more of shares (participation interests) in such legal entity are being acquired.

The operation is subject to registration with the RK National Bank, if:

- the amount of the currency operation, contemplating the incoming of property (funds) into the RK and/or the origination of resident's obligations to return the property (funds) to nonresident, exceeds the equivalent of US\$500,000; or
- if the amount of the currency operation, contemplating the transfer of funds (property) from the RK and/or the arising of resident's claims against the nonresident to return the property (funds), exceeds the equivalent of US\$100,000.

Corporate M&A Procedures

Acquisition of interests in limited liability partnerships (LLPs)

Preemptive right of LLP participants

Conditions of interest sale to a third party, as established by the LLP foundation documents

The LLP foundation documents may stipulate that an interest may be sold to a third party only subject to certain conditions fulfillment.

Acquisition of Shares in Joint Stock Companies (JSCs)

Preemptive right to purchase JSC securities

Disclosure of information on the acquirer, if thirty or more percent of the JSC voting shares are being acquired

Proposal to the rest of shareholders to sell shares, in cases where thirty or more percent of the JSC voting shares are being acquired

Procedures for the Adoption of Resolutions on JSC and LLP Participation in Other Legal Entities

JSC participation in the establishment or activities of other legal entities

The resolution on JSC participation in the establishment or activities of other legal entities by way of transfer of a part or several parts of assets, which in sum constitute twenty five or more percent of all JSC-owned assets, is referred to the exclusive competence of the JSC general meeting of shareholders.

The resolution on LLP participation in other business partnerships or not-for-profit organizations is referred to the exclusive competence of the LLP general meeting of participants.

Major Transactions or Interested-Party Transactions by JSC

The resolution to enter into a major transaction is to be adopted by the JSC board of directors.

Recognized as a major transaction is:

- a transaction or a number of interrelated transactions resulting (or which may result) in the JSC's acquisition or alienation of property the value of which constitutes twenty five or more percent of the total value of the JSC's assets;
- a transaction or a number of interrelated transactions as a result of which the JSC may redeem its placed securities or sell its redeemed securities that constitute twenty five or more percent of the total number of the placed

securities of the same type; or

- other transaction recognized as a major transaction in accordance with the JSC charter.

The resolution to enter into an interested-party transaction is to be adopted by the JSC board of directors.

The JSC affiliates are recognized as persons interested in a JSC transaction,¹ if they:

- are a party to the transaction or participate therein as a representative or an intermediary (agent);
- are the affiliates of the legal entity being a party to the transaction or participating therein as a representative or an intermediary (agent).

Things to Remember

Kazakhstan abolished contract stabilization, including with respect to the previously concluded contracts.

Exception is made only for the following contracts.

"The tax regime defined by a production sharing agreement (contract) that was concluded between the Government of the Republic of Kazakhstan or the competent authority and the subsoil user before 1 January 2009 and passed a mandatory tax expert evaluation, as well as by a subsoil use contract approved by the President of the Republic of Kazakhstan, shall be preserved with respect to taxes and other mandatory payments to the state budget for which such agreement (contract) expressly provides for tax regime stabilization, shall be effective only with respect to the parties to such agreement (contract) and with respect to the operators for the entire term of such agreement (contract), shall not cover persons which are not the parties to such agreement (contract) or operators, and may be amended by mutual agreement of the parties" (Article 308 -1 of the RK Tax Code dated 10 December 2008).

The general article regarding subsoil user guarantees is in effect in its new shorter version.

"The subsoil user shall be guaranteed the protection of its rights in accordance with the legislation of the Republic of Kazakhstan. Amendments to legislation deteriorating the results of subsoil user's entrepreneurial activities under

contracts shall not apply to contracts concluded before the introduction of these amendments. The guarantees established by this Article shall not cover changes in the legislation of the Republic of Kazakhstan in the sphere of national security and defense capacity and in the spheres of environmental safety, healthcare, taxation and customs regulation."

A contract may be terminated on the competent authority initiative:

- if the subsoil user fails to eliminate, within the period specified in the competent authority's notice, more than two breaches of obligations established by the subsoil use contract or by project documents;
- if the subsoil user transfers the subsoil use right and/or objects related thereto without competent authority's consent, except for the cases where no such consent is required;
- if the subsoil user's actions in the course of subsoil use operations with respect to subsoil blocks or fields of strategic importance lead to a change in the RK economic interests that jeopardizes the national security, the competent authority may demand amendment and/or modification of the contract, including that previously concluded, in order to restore the RK economic interests.

In the above-described situation, the competent authority may terminate the contract early, if:

- the subsoil user does not confirm in writing, within two months of receiving the competent authority's notice of contract amendment and/or modification, its consent to hold negotiations on the contract amendment and/or modification, or if the subsoil user refuses to hold such negotiations;
- the parties to the contract do not reach agreement on the contract amendment and/or modification within four months of the date the subsoil user has consented to hold negotiations on the contract amendment and/or modification;
- the parties do not sign amendment and/or modifications to the contract within six months of the date the agreed resolution on the restoration of the RK economic interest.
- upon resolution of the RK Government, the competent authority may unilaterally terminate the contract, including that previously concluded, in the

event the subsoil user's actions in the course of subsoil use operations with respect to subsoil blocks or fields of strategic importance lead to a change in the RK economic interests that jeopardizes the national security.
