

10 February 2015

*To all our clients and friends*

## **INFORMATION MEMORANDUM**

### **Amendments to Kazakhstan's Subsoil Use Legislation**

On 29 December 2014, Kazakhstan adopted a Law "On Introduction of Amendments into Certain Legislative Acts of the Republic of Kazakhstan on Subsoil Use Issues" which, except for some provisions, was put into effect starting 11 January 2015 (hereinafter, the Law of 29 December 2014).

Adoption of the Law of 29 December 2014 brought about most serious amendments to the Law on Subsoil and Subsoil Use (hereinafter, the Subsoil Law or the Law) and to a number of other legislative acts: Land Code, Environmental Code, Administrative Code, Tax Code and Law on Trunk Pipelines.

Pursuant to the current local regulations, relevant subordinate regulatory legal acts are to be drafted, adopted and amended within one month of the Law enactment, i. e., by 11 February 2015.

This Information Memorandum contains a brief analysis of some key amendments to the Subsoil Law. A more detailed analysis will be further provided to those interested.

#### **1. General Evaluation of Amendments**

Amendments to the Subsoil Law and other legislative acts have long been the subject of attention and active discussion by business and legal community. It was supposed that their adoption will usher the country's more liberal subsoil use legal regime and bridge the gaps in legal regulation of a number of important issues.

One cannot say that all objectives have been fully attained; however, certain steps in this direction have been taken. The traceable trend towards liberalization of the subsoil use legislation can be assessed very positively, particularly, in view of the fact that the last 15 years clearly demonstrated an opposite tendency. Still, for example, as regards the use of technogenic mineral formations, the legislator is rather headed towards tightening the legal regime, than liberalizing it. The amendments have resulted in a more detailed and clearer regulation of certain important issues.

Practice will show how much the legislative innovations will improve the investment climate in reality.

#### **2. Most Important Changes**

The most important amendments to the Subsoil Law are as follows:

- limitation of the state's preemptive right sphere of application;
- moratorium on the transfer of subsoil use right;



- introduction of an auction as a special type of competitive bidding for subsoil use right, alongside with tender;
- possibility to obtain exploration rights in accordance with a simplified procedure in instances defined by the Law;
- changes in the list of conditions to be mandatorily included in the exploration and production contract;
- new regulation of issues relating to the use of technogenic mineral formations (TMF); and
- other important amendments mentioned in p. 4 below.

### **3. Other Changes**

#### *3.1 Changes in the Competence of Governmental Agencies*

A part of changes are the regulations associated with re-distribution of competence among the governmental agencies in charge of subsoil use regulation. For instance, a significant share of powers was transferred from the RK Government to the competent authority, which is now authorized to adopt different subordinate legislative acts, approve the list of subsoil sections put up for competitive bidding, develop and approve the model contract form and the template exploration contract, etc.

#### *3.2 Changes in the Law Terms and Definitions*

Using the previously unknown to the subsoil legislation procedures and institutes demanded expansion of the Subsoil Law terminological framework. For these purposes Article 1 was added with new concepts and their definitions (auction, underexplored subsoil sections, contract area transformation, template exploration contract), the Law's existing definitions also undergoing changes and clarifications.

#### *3.3 Editorial and Other Changes*

Certain changes are intended to bring all Subsoil Law articles in conformity with each other and are of editorial nature.

### **4. Summary Analysis of Most Important Amendments**

#### *4.1 Limiting the Sphere of Application of the State's Preemptive Right*

As a result of amendments, the state has a preemptive right to acquire subsoil use rights (a part thereof) being alienated on a chargeable or a free-of-charge basis and/or subsoil use right-related objects only with respect to contracts for subsoil sections or deposits of strategic importance.

#### *4.2 Subsoil Use Right Transfer Moratorium*

The previously effective limitations on the transfer of subsoil use right within two years of the contract effective date now apply only to hydrocarbons production, exploration and combined exploration and production contracts.

#### 4.3 Auction – a New Form of Subsoil Use Right Competitive Bidding

Prior to the introduction of amendments, competitive bidding for subsoil use rights was held only in the form of tenders; now it may be both in the form of a tender and an auction.

The auction is defined in Article 1 of the Subsoil Law as "*a simplified procedure for determining the winner from among the competitive bidding participants having submitted auction participation applications.*"

The auction winner becomes the participant offering the largest signature bonus amount, which, after being announced three times, has not been exceeded by other participants' bids.

Analysis of legislation shows that the auction (due to its procedure, documents to be prepared for participation, timeframes and scoring procedure) is indeed an easier way to obtain the subsoil use right.

#### 4.4 Simplified Subsoil Use Right Obtainment Procedure

One of the Law's key innovations was legislatively fixing a simplified procedure for obtaining the exploration rights based on a potential subsoil user's application. However, such right is granted only in respect of underexplored subsoil sections, the granted section not to exceed ten blocks each of which is equal to one minute in the geographical system of coordinates.

When obtaining exploration rights under the simplified procedure on the basis of direct negotiations, a template exploration contract (whose form is approved by the competent authority) is to be concluded. This contract already signed by the potential subsoil user is to be attached to the application.

The prospecting work project is to be developed and approved by the subsoil user independently after signing and registration of the template contract. This project is subject to mandatory environmental expert review.

The subsoil user obtaining the exploration right under the simplified procedure is exempted from local content obligations in respect of personnel, goods, work and services.

#### 4.5 Changes in the List of Conditions to be Mandatorily Included in the Exploration and Production Contract

Pursuant to the amended Law "*contracts, other than contracts (agreements) for state geological study of subsoil and template exploration contracts, shall be executed in the form and content according to model contracts by the types of subsoil use, as approved by the competent authority*" (Article 61(2) of the Subsoil Law).

The list of mandatory conditions, which previously comprised 27 items, is now reduced to 4, primarily due to removing almost all conditions duplicating the statutory provisions. On the contrary, the list of the so-called "special conditions" has been expanded.

#### 4.6 Grounds for Subsoil Use Contract Termination on Competent Authority's Initiative and Other Related Issues

The Law complements the list of grounds for unilateral contract termination by the competent authority, which now includes, inter alia, less than 30% performance of financial obligations for 2 consecutive years.

The Law contains reference to one more ground for unilateral contract termination: refusal to provide or provision of false information as indicated in subparagraph 13-1 of Article 76(1). However, there is no such subparagraph in the Subsoil Law. We believe, this is a technical

error and the reference should be to the information on work program fulfillment (Article 76(1), subparagraph 13).

The Law sets forth the deadlines within which a subsoil user can remedy the contract breaches specified in the competent authority's notification as the ground for unilateral contract termination.

If previously the timeframes for remedying the breaches were set by the competent authority in respect of each subsoil user, now they are legislatively established.

In certain cases, the deadlines may be extended following subsoil user's application.

#### *4.7 Changes Regarding Project Documents Regulation Issues*

A prospecting work project is now subject only to mandatory state environmental expert review.

This is another streamlining introduced by the Law. Previously, prospecting work projects were also subject to industrial safety expert review and sanitary-and-epidemiological expert review.

An assessment work project that includes a pilot production project or a pilot operation project is subject to a number of mandatory expert reviews. If the assessment work project does not include a pilot production project or a pilot operation project, it is subject only to mandatory environmental expert review.

The period for approval of assessment work projects has been increased from 5 to 8 months.

Production Work Project Documents. The list of production work project documents no longer contains Feasibility Study.

The period for the project documents development and approval has been increased from 18 to 21 months.

It should also be mentioned that approved projects for solid minerals do not require modification, if the production volumes set thereby deviate by less than 20% in physical terms from the approved project parameters. Accordingly, in this case, the work program does not require modification as well.

#### *4.8 New Regulation of Technogenic Mineral Formations Use*

The state's right of ownership to TMF now covers not only TMF put to storage before 30 May 1992 or included in the state register of mineral resources, but also minerals contained in the TMF put to storage after 30 May 1992 in volumes on which no minerals extraction tax and/or royalty has been paid.

The Subsoil Law has been added with a new Chapter 9-1 "Processing or Other Use of TMF" establishing the TMF usage legal regime. For example, it is expressly provided that processing of TMF owned by a subsoil user or another person is not qualified as subsoil use operations.

#### *4.9 Contract Area Transformation*

The Law entitles subsoil users conducting solid minerals exploration operations to apply to the competent authority for contract area transformation via severing subsoil section (sections) from the contract area.

This right is also granted to subsoil users conducting production under the same contract at several deposits some of which are on the list of high-viscosity, flooded, marginally profitable, marginal or depleted deposits, in order to sever such deposit (deposits) from the contract area.

The permit for contract area transformation is issued by the competent authority, provided that the Law-determined conditions are met.

Subsoil section (sections) are severed from the contract area upon agreement of the parties via entering into a separate contract in respect of the severed section (sections) and amending the contract whose area is so affected.

#### *4.10 Offshore Oil Spills*

The Subsoil Law is added with a special Article 95-1 designed to govern legal relations arising in cases of offshore oil spills (hereinafter, the Spills) and setting out requirements to subsoil users in the event of Spills.

Three levels of Spills have been identified, depending on the quantity of spilt oil and the scope of resources required to clean up the Spill.

Subsoil users conducting offshore petroleum operations must possess own materials and equipment necessary for cleaning up the Spills of the first and second level. In order to clean up third level Spills, subsoil users must contract a specialized attested professional emergency rescue organization possessing resources to clean up the Spill.

Subsoil users are to compensate in full for the harm caused to the environment and third parties by the Spill and for the state's Spill cleanup expenses.

#### *4.11 Oil Accounting Information System*

Entities active in the petroleum production and turnover sphere must equip their production facilities (the list of which to be approved by the RK Ministry of Energy) with control and recording meters and ensure their functioning in accordance with the procedure established by the same Ministry.

No activities are allowed in the sphere of oil production and turnover and operations involving oil extraction, production, treatment, processing, transportation, storage, sale, shipment, import and export to and from the RK territory without equipping the production facilities as per the above list.

This new legislative requirement is to be enacted starting 1 January 2017.

Should you have any questions regarding the Law application, we would be happy to render pertinent advice.

Best regards,

AEQUITAS Law Firm