

ClientAlert

Oil & Gas

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Potential Amendments to the Kazakhstan Legal Regime for Exploration and Production of Oil and Gas

New amendments to the legal regime for exploration and production of oil and gas in Kazakhstan have been developed by a government working group.

Affecting the Subsoil Use Law, the Code on Administrative Violations and the Environmental Code, the amendments primarily aim, on the one hand, to attract more investments in the industry by liberalizing and simplifying the rules, and, on the other hand, to strengthen responsibility for failures to comply with safety, environmental and industrial requirements for petroleum operations (the "**Amendments**").

The working group submitted a set of Amendments to the government on 13 December 2013 for submission as a draft law to the Mazhilis (the lower chamber of the Parliament) for the law-making process.

It is envisaged that the Amendments will be enacted into law in 2014.

Overview of Key Amendments

The key Amendments to the Subsoil Use Law (the "**Law**") include:

- **Re-injection of drill cutting waste.** A definition of "construction and/or operation of underground facilities associated with exploration and/or production" has been introduced, clarifying that no separate subsoil use contract for underground facilities is required for the disposal and storage of drill cutting waste in underground facilities during exploration and/or the production of hydrocarbons.
- **Limited pre-emption right.** Currently being considered by an interdepartmental commission ("IDC") is the state's pre-emption right, which applies to nearly any disposal of rights to exploration and/or production of hydrocarbons and hard minerals, as well as the disposal of associated equity interests. Under the Amendments, the power of the IDC would be limited to contracts concerning so-called strategic deposits. However, the general consent of the Ministry of Oil and Gas ("MOG") will be preserved. In addition, it is proposed that applications for obtaining a waiver of the state's pre-emption right may not be withdrawn or reconsidered within three months following the issuance of a waiver.
- **Qualification of strategic deposits.** At present, the government has discretionary power to designate a deposit as strategic. Under the Amendments, the government would be required to specify certain criteria for classifying deposits or subsoil plots as strategic. Please note that the designation of a deposit as strategic holds far-reaching consequences regarding the conclusion, amendment and termination of subsoil use contracts for strategic deposits.



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- **Termination of contracts.** The Law currently provides that the MOG may unilaterally terminate a subsoil use contract if a subsoil user fails to cure more than two previously committed breaches of the obligations established by a subsoil use contract or project documents, unless a subsoil user fully cures the breaches within the time period specified in the MOG's breach notification. It is proposed that breaching the project documents will no longer be a sufficient ground for the MOG to terminate a subsoil use contract. Meanwhile, the Amendments introduce an additional ground for the MOG to unilaterally terminate a subsoil use contract if a subsoil user refuses to provide or provides incorrect information about its ultimate beneficial owner.

As regards the time periods for curing breaches, currently such periods are discretionally determined by the MOG on an individual case-by-case basis. However, the Amendments would introduce general time limits for curing breaches of physical, financial or other contractual obligations, so that a specific period for curing a breach established in the MOG's breach notifications should be within those time limits. In particular, the cure period for a breach of physical obligations will be limited to 6 months, whereas the cure period for financial breaches should be set within three months and for other contractual obligations within one month.

- **Project document preparation terms.** The Law currently obliges subsoil users to ensure the development and approval of project documents within strictly prescribed periods which cannot be extended even with the consent of the MOG (except for state-owned subsoil users). In this regard, the Amendments are aimed at enabling the MOG to allow an extension of terms for the development and approval of project documents by any subsoil user.
- **Economic expert assessments for contracts.** At present, the Law requires draft subsoil contracts to undergo, among other things, economic and environmental expert assessments. The Amendments propose that economic expert assessments be carried out in respect of production contracts only, while the environmental expert assessments will be abolished entirely (Amendments to the Law and the Environmental Code).
- **Feasibility studies.** Currently, a feasibility study, being a so-called project document, is a mandatory prerequisite for subsoil use contracts related to production. Under the Amendments, feasibility studies would no longer be considered as project documents and, hence, as a prerequisite for production contracts.
- **Auction as a new method.** By default, a subsoil use right is granted to a person as a result of a bidding process. It is proposed that, as an alternative option for determining a potential subsoil user, the MOG could conduct tenders in the form of English auctions based on competition in an amount of a signing bonus.

- **Contract by application.** Inspired by the Australian mining boom, the government proposes granting exploration rights to unexplored areas (by application) modelled on the Australian mining regime. The Amendments provide that, among other things, (i) exploration rights will be granted on the basis of a simplified model contract, (ii) a subsoil user will be entitled to explore for any hard minerals (except uranium) and hydrocarbons, (iii) the contract area will be limited to 10 blocks, and (iv) geological information in respect of blocks will be provided free of charge upon request.
- **HVA production.** Guided by the industrial development message, the government introduced an additional obligation for subsoil users to implement the production of high value added ("HVA") products. The requirement will apply to existing combined exploration and production contracts subject to the discovery of deposits with significant or unique reserves, as well as to newly concluded production contracts in respect of such deposits.

Key Amendments to the Code on Administrative Violations

Pursuant to the Amendments, the Code on Administrative Violations will include additional articles on liability for failure to comply with specific requirements for the exploration and production of hydrocarbons that currently fall within the scope of Article 275 "Violation of rules on conducting subsoil use operations." In particular, such articles would specify liability for, among others: (i) failure to comply with so-called "project documents" related to petroleum operations; (ii) conducting petroleum operations in the absence of approved project documents; (iii) flaring of associated and/or natural gas in the absence of or in violation of a gas flaring permit; (iv) conducting petroleum operations in the absence of the utilization and/or processing of natural and/or associated gas; (v) failure to comply with well operation requirements; (vi) conducting petroleum operations at sea and on inland bodies of water in the absence of or in violation of a permit from the MOG; and (vii) conducting petroleum operations and other activity at sea related to oil spill risk in the absence of an approved program for the prevention and elimination of oil spills.

The penalties for violation range from approximately US\$1,200 to 1,800 for officers of a legal entity and from US\$12,000 to 24,000 for large businesses. The maximum penalty is a ban or the suspension of all or certain types of business activities.

Comment

Although a great number of forward-looking amendments have been excluded from the initial set, the proposed Amendments are a generally positive development for the Kazakhstan legal regime for the exploration and production of hydrocarbons. At the same time, the transfer of liability for breaching the obligations set out in project documents from the Law to the Code on Administrative Violations imposed in the form of ban or suspension of all or certain types of business activities, rather than termination of a subsoil use contract, would have, in our view, an adverse effect. Natural resource practitioners will be closely watching to see whether the Mazhilis adopts or modifies the proposed set of Amendments.

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