Review of the legislative base for investments in oil and gas sector of the Republic of Kazakhstan

This report is prepared with the technical assistance of the British Embassy to Kazakhstan and Kyrgyzstan. It does not necessarily reflect the official views of the Embassy.
The given work is devoted to description of various contractual alternatives that exist in the legislation of Kazakhstan from the point of view of historical, modern state and prospects of development of the legislation in this area.

The problem issues are identified in the given work from the legislative point of view, the analysis of the concession (concession-based) and contractual (SRP Agreements-based) systems of subsoil use in Kazakhstan.

The analysis of the legislative status of various kinds of oil and gas contracts is also carried out by the Kazakhstan Constitution.

The given work considers administrative and legislative procedures on acceptance of oil and gas contracts in Kazakhstan; their strong and weak sides, prospects for the future and the problem issues challenged in this sphere are also considered.

The analysis of alternatives for resolving conflicts arising in oil and gas projects is considered from the point of view of the development of arbitration procedures in Kazakhstan, including the analysis of problem issues in this area.

The work provides the analysis of the Kazakhstan’s approach in the present and the future for application of various stabilization measures in oil and gas contracts, it covers problem issues relating to the change of the legislation in this sector.

The analysis is carried out of development of legislative guidelines on management of oil and gas contracts, in particular, of draft of the new Law of Kazakhstan about subsoils.
Formation of the legislative base for investments in the oil and gas sector of Kazakhstan.

The mineral resources complex of Kazakhstan is one of the priority branches of the economy which provides for development of the Republic of Kazakhstan. This can be explained by the fact that Kazakhstan is the country with huge potential of mineral and raw resources. Almost all elements of Mendeleyev’s periodic system were discovered in the Republic with maybe just a few exceptions. In terms of the explored reserves of uranium, chrome, lead and zinc Kazakhstan ranks number two in the world. By manganese it is the third country in the world while by copper it is the fifth country in the world. By reserves of coal, iron and gold Kazakhstan is included in the world’s top ten countries. By gas, oil and aluminium it occupies the twelfth, the thirteenth and seventeenth places in the world, accordingly1. Analysis of the world tendencies of development of problems in the mineral and raw sector shows that in the long term prospect the growth of demand for natural mineral raw materials is inevitable and that the developed countries will continue to display economic and political activity in the regions of the world rich in mineral resources, such as Kazakhstan. In addition to its rich natural resources, the agrarian and industrial potential, qualified specialists and professionals and the competent labor forces, Kazakhstan occupies a favorable geopolitical position between the West and the East. The value of this position will apparently increase in the future given the expected boom of the Asian part of the world development.

Rich reserves of mineral and raw resources make Kazakhstan attractive both to the domestic and foreign investors. At the same time it needs to be mentioned that one of the major branches of the country economy that creates conditions for development of production, for life sustenance of the population and in many respects ensures the economic independence of the country is the oil and gas complex of the Republic of Kazakhstan.

We need to acknowledge that Kazakhstan has become known all over the world not only thanks to its natural wealth but thanks to attraction of foreign investments that promoted the economic development of the Republic of Kazakhstan including oil and gas complex development.

Attraction of foreign investments to the economy of the Republic of Kazakhstan including to its oil and gas sector became possible thanks to creation of the attractive image of Kazakhstan for investments. But it was possible only through development of the necessary legislative base. The fact that billions of dollars of the foreign capital are invested in Kazakhstan and that the main part of the money is invested in the mineral and raw complex of the RK confirms existence of the legislative base in Kazakhstan capable to create all the necessary conditions for attraction of foreign investments and effective use of mineral resources. Availability of the adequate legislative base has served as one of the major tools to make Kazakhstan attractive for foreign investments.

In the mid-nineties a number of the legislative acts were adopted. They allowed creating a sustainable legal base for operation of investors in the sphere of mineral resources use. The main ones are the Decree of the President of the Republic of Kazakhstan which has the force of Law of January 27, 1996 “About Subsoils and Subsoil Use” (further, the Decree “About Subsoils”), the Decree of the President of the Republic of Kazakhstan that has the force of Law of June 28, 1995 “About Oil” (further, the Decree “About Oil”) and the Law of the Republic of Kazakhstan “About Foreign Investments”2. Creation of favorable conditions for attraction of investments to develop mineral resources is proclaimed as one of main principles of the RK legislation about Subsoils and Subsoil Use (Item 7 of Article 3 of the Decree “About Subsoils”).

---
The tax and customs legislation is of big importance for investment activities in the oil and gas sector of the RK and for the activity of subsoil users engaged in oil operations.

The main work on changing the Laws about Subsoil Use is linked mainly with the changes in the tax and customs’ regimes/modes and also with investments in the oil and gas sector related to these conditions.

Foreign investments in the oil and gas production branch are guided by the norms of the general legislation about investments.

The Law of the Republic of Kazakhstan of June 10, 1991 “About Investment Activities in Kazakhstan” regulates activity of all investors including foreign. However Article 4 of the Law stipulated that investment activity of foreign entities in Kazakhstan is regulated by the Law on Foreign Investments while the activity of the Soviet and foreign entities in free economic zones is guided by the Law on Free Economic Zones.

Three interlinked Laws made the basis to formation of the external economic legislation of Kazakhstan adopted in the end of 1990: About the main principles on foreign economic activities of Kazakhstan (December 15, 1990); About Foreign Investments in Kazakhstan (December 7, 1990); About free economic zones in Kazakhstan (November 30, 1990). In 1991, the Law on currency regulation was adopted in Kazakhstan (June 13, 1991) and the Law on concessions in the Republic of Kazakhstan (December 23, 1991).

Decrees of the President of the Republic of Kazakhstan played an important role and had an important place in the system of the external economic legislation. The following two decrees must be named hereby: “About ensuring of foreign economic activities of Kazakhstan” (August 31, 1991) and “About organization of foreign economic activities of the Republic of Kazakhstan for stabilization of economy and carrying out of market reforms” (January 25, 1992). The last Law, in particular, ensured to all legal bodies acting in the territory of Kazakhstan irrespective of patterns of ownership the right to carry out their foreign economic activities without special registration including the intermediary activities except for transactions in the area of export of some kinds of products of the state value (oil, gas, coal, ore, rolled metal, grain, cotton, wool, etc.).

Of other normative acts we need to mention the Decision of the Cabinet of Ministers of the Republic of Kazakhstan of October 31, 1991 №661 “About the order on creation and activity of enterprises and organizations with foreign investments in the territory of the Kazakh Soviet Socialist Republic”. The Decree of the Supreme Council of the Republic of Kazakhstan of July 3, 1992 “About approval of the Rules about the procedure for allocation of land plots for use by joint ventures, international associations and organizations, foreign legal bodies and citizens to carry out their activity in the territory of the Republic of Kazakhstan”.

However it was obviously insufficient to have the general legislation about foreign investments. Oil is a strategic good, its exploration and extraction is rather difficult and an expensive business. Each oil deposit is absolutely different from other oil fields. Therefore special norms were needed that would take into account specificity of oil production.

Besides, foreign contractors who risk large capitals wanted a stable and clear legislation. They could not understand numerous and in many respects inconsistent Laws of the Republic. Therefore, there was a need in the special legislation on oil. In all oil-producing countries such legislation exists. These Laws are rather comprehensive, detailed and branch-wise.

The main legislative act in the sphere of exploration and production of mineral resources was the Code about subsoils and processing of mineral resources (adopted by the RK Supreme Council in May 30, 1992). According to the Republic of Kazakhstan’s Constitution the Code fixed that subsoils are the sole property of the RK. The property right on subsoils was executed
by the Supreme Council. At the same time the functions on management of natural resources on the basis of the Law were delegated to the Republican Government.

The Code foresees granting of subsoils for the following purposes:

- To conduct geological studies;
- For production of mineral resources;
- To build and operate underground constructions not related to production of mineral resources.

Subsoils for geological studies (for exploration) were provided by the RK Government on bid-based conditions. The Supreme Council delegated the right to grant subsoils for production of mineral resources in the deposits of the Republican value to the Government and the deposits of local value to the local Governments.

However given the strategic value of oil all oil deposits were expected to be transferred to deposits of the Republican value.

The main provisions fixed in the Code about oil were further developed in the special oil legislation on the basis of the Law about Oil. The Draft of this Law is developed by the Ministry of Energy and Mineral Resources with active involvement of lawyers of the Institute of the State and Law of the National Academy of Sciences. Lawyers of the World Bank and the American Law firm “Chadbourn and Park” also participated in development of the Draft of the Law. The Draft was included in the list of the Drafts to be considered in the March (1993) Session of the Supreme Council of the Republic of Kazakhstan.

Hereby we shall touch upon only some most important and disputable aspects of the Draft of the Law about Oil.

The Law is developed on the basis of the model of the oil contract. It defines the competences of the state bodies, definitions, concepts and kinds of oil contracts, the rights and liabilities of the parties, conditions for carrying out of oil operations, commercial and legal conditions of the concluded contracts.

The concept on oil includes not only crude oil but also natural gas, and also hydrocarbons produced from crude oil, natural gas, combustible schist or resinous sand. The Law on Oil regulates the relations connected with carrying out of oil operations under which we understand all works relating to geological prospecting, to field development, extraction, treatment and processing of product (including sweetening and dehydration of natural gas, and also extraction of associated compounds from oil), storage, transportation and sale of hydrocarbons in the domestic and external markets.

One of the most acute issues that arise while discussion of the Draft was the issue about the Competent Body: in other words what body will conclude contracts on behalf of Kazakhstan?

Attempts to define in the Law what ministry or body must act in the role of the Competent Body gave no good results. First and foremost this is explained by the struggle for superiority to conclude contracts on carrying out oil operations between the most powerful ministries (Ministry of Geology, Ministry of Energy and Mineral Resources and the Ministry of Economy). And, secondly, it was inexpedient under conditions of constantly changing structure of the state-run public authorities to define one body which for a stable and long term will be engaged in conclusion of oil contracts. With changes in the economic and political situation in the Republic

---

3 See: Suleimenov M.K. Legal regulation of foreign investments and subsoil use in Kazakhstan (Selectas. Almaty, 2006. Pages 194-204
there could be a need in changing the functions of the existing bodies or to create new state bodies. But this could cause a need in introduction of changes in the Law on Oil.

Proceeding from this the Law defined the Government of the Republic of Kazakhstan or any other state body which will be delegated by the Government the rights directly connected with conclusion and execution of contracts to carry out oil operations as the Competent Body. The Government can define such a body by its Decree or appoint such a body for each oil contract.

The role of the Competent Body is assigned at present to the Ministry of Oil and Gas.

Under the contract the Law understands an agreement to carry out oil operations between the Contractor and the Competent Body.

Depending on conditions of concrete oil operations combined and other forms of contracts are permitted.

Conditions of concession contracts were defined in the Law on Concessions in the Republic of Kazakhstan (Adopted by the Supreme Council in December 23, 1991). Concession is submission of subsoils and land plots for lease for a certain term. The classical form of concessions is not encountered in the world practice nowadays. The so-called modernized concession is applied nowadays but not frequently. It is the concession with elements of PSA when the concessionaire is imposed a number of additional liabilities unspecific for lease contracts.

Given the developed petroleum industry it was considered as inexpedient to use concession contracts for certain stages of development of the Republic. PSAs and Service Contracts are Works Contracts. The Republic employs the contractor to carry out oil operations for certain payment.

According to service contracts (risk services) the contractor renders services to carry out oil operations and will be remunerated in currency. So far such contracts have never been concluded in our country.

Until recently, the most widespread and appropriate contracts to conditions of Kazakhstan used to be the PSA (production sharing agreements). The sense of this agreement is in that the contractor carries out oil operations (oil E&P) at its own expense and at its own risks. In case of oil discovery part of the extracted product goes for compensation of expenses of the contractor (Cost Oil) and the rest part is shared between the parties in certain proportion (Profit Oil). Besides, the contractor pays to the Republic all the mandatory taxes and payments (a bonus, a royalty, rental payments).

A contract was concluded with the French company "Elf- Aquitaine" for 30 years on "Production sharing conditions" to develop an oil field in the Aktyubinsk region. A similar contract was concluded with firms “BG” and “AGIP” to develop the largest Karachaganak gas condensate deposit in the Uralskaya region for 40 years.

The practice of creation of joint ventures got well developed for development of oil fields. Yet, the world practice shows insufficient efficiency of this form of relations in the oil and gas industry. Special place is occupied by the transaction with the American company “Chevron” to produce oil in the Tengiz oil field of Atyrau region. On the basis of the contract between “Tengizneftegas” and “Chevron” it was expected to establish the JV “TCO”. However creation of the JV was preceded by conclusion of the agreement between the Government of the Republic of Kazakhstan and Corporation “Chevron” which defined the main economic conditions of the project. “Chevron” makes investments worth of billions in the oil extraction in the Tengiz oil field. Extracted oil is shared between the parties in the proportion to ensure profit for the parties in the ratio of 80% to Kazakhstan and 20% to “Chevron”.
Certainly, the Law on Oil covers first of all and mainly relations with foreign contractors because it is in this very area that most of problems and issues arise that need to be settled. However it is necessary to underline that the Law on Oil is also applied to the Kazakh contractors. That is, carrying out of all oil operations is transferred on the contractual basis, all oil prospecting and oil-extracting organizations are obliged to conclude contracts with the Competent Body 4.

Who can represent itself as the contractor in the oil contract? The contractor is any legal either physical person, or association of such persons, the state and/or the international organizations which carry out oil operations in the Republic according to the Law on Oil. Hence, not only enterprises but citizens also can act as the contractor (both the Kazakhstan and foreign). Certainly, we can so far only theoretically imagine that a citizen of the Republic of Kazakhstan will undertake to develop an oil field but this is quite real when we speak about foreign citizens.

As for enterprises (legal entities) here we need to differentiate between the Kazakhstan legal entities and foreign legal entities.

Kazakhstan developed the necessary normative-legal base to ensure activity of investors in the oil and gas sector of the RK economy. At the same time, the legislation that regulates the subsoil rights and the subsoil user rights including the tax and customs regulations due to a number of objective and subjective reasons constantly changes thus evolving changes in the rules on carrying out of operations on subsoil use and changes in the conditions for investment activity on subsoil use including the oil and gas sector.

But changes in the legislation with a view of its improvement do not necessarily give positive effects. Quite frequently such changes in the legislation are caused by some specific reasons or by objectives to overcome some problems, to fulfill some tactical tasks to increase the level of income of the budget and etc. But at the end of the day all this brings to collapse of the developed legal framework and aggravation of the legal regulation of operations on subsoil use.

In this respect we need to note that the legislation on investment activity in the oil and gas sector has passed through difficult stages of reforms and at present it passes through the period of changes.

The main issues of significant value to determine the state investment policy in the oil and gas sector are the issues about the ways to transfer subsoils to subsoil users: the license-contractual system of regulation on carrying out of oil operations, and also regulation of the ownership issues on the extracted oil at carrying out of oil operations and the procedure for obtaining of the economic rent by the state: application of the concession conditions or conditions about production sharing in the contract on carrying out of oil operations.

Historically it has developed so that one of the first contracts on carrying out of oil operations concluded after gaining by Kazakhstan of its sovereignty was the PSA 5.

According to the Decree of the Cabinet of Ministers of the Republic of Kazakhstan as of March 10, 1992 № 205 «About approval of the Agreement about cooperation in prospecting and

---

4 About provision of the right on subsoil use and on changing of the licensing procedure on provision of the right of subsoil on the contractual basis. See: The right and foreign economic activities in the Republic of Kazakhstan / Executive editor M.K.Suleimenov. Almaty, KazStateLawUniverstity, 2001, pages 159-190.

exploration and development of hydrocarbon fields in Aktyubinsky region of the Republic of Kazakhstan on the terms of product sharing concluded with the company “Elf Aquitaine” (France), the given contract is one of the first contracts on carrying out of oil operations and one of the first agreements on product sharing concluded by the Republic of Kazakhstan after adoption of the Declaration on the state sovereignty of the Republic of Kazakhstan (Decree of the Supreme Council of the Kazakh Soviet Socialist Republic as of October 25, 1990) and announcement about the state independence of the Republic of Kazakhstan (the Constitutional Law of the Republic of Kazakhstan as of December 16, 1991).

The fact that one of the first contracts on conducting of oil operations included the terms on product sharing was to some extent justified by the public right of Kazakhstan and also by the international practice in implementation of oil operations.

Article 9 of the Declaration about the state sovereignty of the Republic of Kazakhstan (further, the Declaration on the sovereignty) provided that the exclusive domain of the Republic of Kazakhstan includes as the basis of its sovereignty the earth, subsoils, water, air space, flora and fauna, other natural resources, cultural and other historical values of the nation, all economic, scientific and technical potential – the whole national wealth available in the territory of the country. Article 11 of the Declaration about the sovereignty established the right of the Kazakh Soviet Socialist Republic to independently establish the order for use of natural resources. Article 11 of the Constitutional Law of the Republic of Kazakhstan of December 16, 1991 «About the State Independence of the Republic of Kazakhstan» (further, the Law on the State Independence) also provided that the exclusive domain of the Republic of Kazakhstan making the basis of its state independence includes the earth and its subsoils, water, air space, flora and fauna, other natural resources, economic and scientific and technical potential.

The specified contract was concluded actually in absence of the Kazakhstani legislation on use of natural resources, use of subsoils or lack of the procedure on conclusion of oil contracts including PSAs. The contract with the company “Elf Neftegaz” was concluded before acceptance not only of such legislative acts that are still in force as the Law of the Republic of Kazakhstan of January 27, 1996 «About Subsoils and Subsoil Use» (further, the Law on Subsoils) or the Law of the Republic of Kazakhstan of June 28, 1995 «About Oil» (further, the Law on Oil), but even before acceptance of the Code of the Republic of Kazakhstan of May 30, 1992 «About Subsoils and Processing of Mineral Raw» (further, the Code about Subsoils). During conclusion of the specified contract the following laws were in force in territory of the Republic of Kazakhstan, in particular: the Law of the Kazakh Soviet Socialist Republic of December 7, 1990 «About Foreign Investments», the Law of the Kazakh Soviet Socialist Republic of June 10, 1991 «About investment activity in the Kazakh Soviet Socialist Republic», the Law of the Republic of Kazakhstan of December 24, 1991 «About the Custom’s Tariffs and Duties», the Law of the Republic of Kazakhstan of December 25, 1991 «About the Tax System in the Republic of Kazakhstan».

Article 2 of the Decree of the Supreme Council of the Republic of Kazakhstan of December 16, 1991 «About Enforcement of the Constitutional Law of the Republic of Kazakhstan “About the State Independence of the Republic of Kazakhstan”» provided that before acceptance of the corresponding legislative and other normative acts of the Republic of Kazakhstan the norms of the legislation of the USSR and the recognized by the USSR norms of the international law can be applied in its territory because they do not contradict the Law on Independence, other legislative and statutory acts of the Republic of Kazakhstan. It did not infringe the right of the Republic of Kazakhstan to conclude PSAs with consideration of international experience in carrying out of oil operations. More over the exclusive domain of the Republic of Kazakhstan on subsoils and natural resources proclaimed by the Declaration on the state sovereignty of the Republic of Kazakhstan that made the basis for its sovereignty and the state independence were used as the basis for conclusion of PSAs. Lack of the legislative regulation for PSAs preconditioned application of the international experience and of the international rules generally applied to PSAs.
It is well-known (and can be approved by any reference sources, scientific-economic and legal editions and publications about issues of the tax regime on carrying out of oil operations or operations on subsoil use, by the international experience of conducting operations on subsoil use and oil operations and etc.) that PSAs which are commonly referred to as “contractual system on subsoils use” involve the legal systems that exclude the private property on subsoils and/or mineral resources that are in subsoils, and make an alternative to concessions (the so-called «concession system» and to concession agreements) assuming the property right of the subsoil user on subsoils and/or on mineral resources which are in subsoils within a certain site or block of subsoils.

The main distinction between the concession (that is on the basis of the concession agreement) and the contractual system (that is on the basis of the PSA) is relation to the issue of the property rights on mineral resources. The legal traditions of the Anglo-Saxon countries and France became the initial sources for this distinction. Concessions as it follows from the name itself assume the private property ownership on mineral resources. Nevertheless, in the majority of the countries subsoils belong to the state but under the framework of concession contracts the rights on oil fields are transferred to extracting companies – to subsoil users.

At that, by the general rule the concession system provides the economic rent of the state from use of subsoils in the form of getting of a royalty and taxes of subsoil users while the contractual system assumes getting of a royalty and a share in the result of production sharing.

In some countries royalty payment is not required during conclusion of PSA, for example, at the present stage in Indonesia (but at that there is a high share of the state when the production is shared). Even in some countries “negative” royalty is foreseen - a royalty in favor of the contractor. For example, in the Philippines (with a high level of the state participation in subsoil operations). In other countries the royalty payment is foreseen in the form of percentage from the accounted profit (for example, some PSAs in New Zealand) and other alternatives do exist but in the majority of the countries royalty on PSA is established in the form of certain percentage from the gross output paid to the state-proprietor of subsoils till reimbursement of the costs and share of production.

Essential distinction between the concession and contractual systems is determination of the property rights for mineral resources. With the concession system the concessionaire has the property rights for mineral resources including oil in the wellhead of the production well and to sell mineral resources as the proprietor while paying all taxes, including profit taxes from sales. While with the contractual system (in case of conclusion of PSAs) the contractor becomes the proprietor of mineral resources only after production sharing in a certain point of sharing. Such a point is as a rule closer to the place of export of mineral resources or to a place of transfer of mineral resources by the transport organization (the main pipeline, the bulk-oil terminal, a place of loading of solid mineral resources by the freight forwarder and etc.).

Besides, the contractor under the PSA receives a share in production as payment for development of an oil field and extraction of mineral resources which belong to the state on the basis of the exclusive domain and for acceptance of the risks connected with E&P operations. As soon as the contractor is not the proprietor of the extracted mineral resources and receives a share as payment for its work, the PSA does not foresee according to the rule of thumb for payment by the contractor of any established profit taxes or other taxes (paid by subsoil user under the concession system) and other mandatory payments to the budget except for royalty.

---

7 See: Klukin B.D. Mining relations in the countries of Western Europe and America. - M: The Publishing House “Gorodets”, 2000, pages 11-12
(payments for use of subsoils not connected with receiving of profit) and a share of product when it is shared.

At that, from the economic point of view, the economic rent with consideration of the total subsoils use term be it the under the concession and contractual systems is comparable for both of them. The difference is generally related with the legal registration and to some extent with distribution of risks including settlement of various issues of subsoils and/or mineral resources ownership.

There is one more distinction between the concession and contractual systems. It lies in determination of the property right on the equipment used to carry out subsoil operations or oil operations. At the concession system this property is the concessionaire’s property which gets the rights for depreciation charges based on the generally established procedure. At contractual system the contractor has the right to get compensations of the expenses to carry out subsoil operations (including the equipment cost) at the expense of extracted production prior to product sharing. After reception of this compensation this property is subject to be transferred to the state - to the proprietor of subsoils and extracted mineral resources.

The Republic of Kazakhstan Code of May 30, 1992 «About subsoils and processing of mineral raw» (further, Code about Subsoils of 1992) became the first legislative act of the Republic of Kazakhstan in the area of subsoil use. According to the Code about Subsoils of 1992 the subsoils were considered the state’s exclusive domain. At that, a paid special use of subsoils was permitted – to use subsoils to meet the economic and other needs of the country through extraction (separation) of its components or for placing of underground constructions, burial of hazardous substances and production wastes, for dumping of sewage. According to the Code about Subsoils of 1992, exploration, production and processing of radioactive raw materials was carried out by legal entities on the basis of licenses and contracts according to the order established by the acting legislation. As for granting of subsoils for use to the enterprises with foreign participation, to foreign legal and physical persons, the Code about Subsoils of 1992 provided a rule about granting a possibility on the terms of the contract (under which the agreement on production sharing was expected) and on concession terms. At that, prior to conclusion of the contract or concession the user of subsoils was expected to get a license for special use of subsoils. In case of concession no separate contract on granting of subsoils for use was foreseen and all terms about granting of subsoils were stipulated in the appendices to the license.

Acceptance of the Decree of the President of the Republic of Kazakhstan, valid as the Law, as of June 28, 1995 “About Oil” (further, the Law on Oil) and the Decree of the President of the Republic of Kazakhstan, valid as the Law, as of January 27, 1996 “About Subsoils and Subsoil Users” (further, the Decree about Subsoils) has become the next stage in reforming of relations in the oil and gas sector. With adoption of the Law about Oil the procedure was legislatively fixed for granting permissions to the Contractor to conduct E&P operations for a fixed term within the Contract territory, and also the procedure was fixed for granting to the Contractor of the right to carry out oil operations on the basis of the Contract which defines the issues of property rights on the extracted oil including the terms about production share or concession, issues of taxation and other necessary conditions. Actually, with adoption of the Law about Oil both PSAs and concession agreements were allowed.

Since August 1999 in the course of further improvement of Laws on Subsoils and Laws about Oil the legislative regulation of operations on subsoil use has refused to license activities on subsoil use and has passed to the contractual system of granting of the subsoil user rights. At that, the respective changes and amendments were introduced in the Law on Oil and according to it PSAs, work contracts, service contracts for fee (service contracts) and concession agreements started to be understood as contracts to carry out oil operations. Laws about

---

Subsoils and about Oil establish the general rules to carry out operations on subsoil use, objectives and principles of the legislation, the competence of the executive powers, the order for granting of the rights for subsoil use, conclusion of contracts on exploration and production, rules of the account of the state fund and protection of subsoils, conditions for safety of the population and the personnel, the rights and duties of the subsoil users.

At that, the need in the Law and importance of the Law on Oil are necessitated by essential specific features of oil operations which include not only chemical but also physical properties of oil, gas and other hydrocarbons referring to the concept of oil used by the Law on Oil. Unlike the majority of other minerals that can be found mainly in a solid form, oil is found in the liquid or gaseous condition and occurs as a rule deep under the earth under big pressure that causing specificity of oil extraction from subsoils and for its transportation, for field development and other infrastructure development in support of oil operations.

Mining development all over the world and the international practice of implementation of oil and gas operations shows that all over the world either the concession or contractual systems are applied that foresee production sharing\(^1\) in mining and development of subsoils and mineral resources.

There is one more system for development of oil and gas deposits: the so-called service contracts with risks and without risks stipulating payment to the contractor for performance of works on oil extraction and development of an oil field with preservation for the proprietor of subsoils - that is for the state - of the exclusive domain rights on minerals. Actually by their essence such service contracts can be referred to single-time contracts with PSAs and they differ from PSAs only in terms of source of compensation to cover expenses of contractors and by profit generation for carrying out of subsoil operations. If in PSAs the profit part of the contractor is formed at the expense of a part of extracted production then in service contracts the profit part is formed at the expense of payment by the customer - the proprietor of subsoils which is also compensated by the proprietor at the expense of extracted production. In any case there can not be any new system to carry out oil operations but the concession or contractual (based on agreements on share of production or the service contract). Certainly there can be distinctions in terms of some conditions, in particular, taxation, order for compensation of expenses and etc., but in fact the relations between the state - the proprietor of subsoils - and subsoil users will be presented either by concession relations or contractual relations on production sharing or rendering of services for fee\(^2\).

On the background of reforming of the legislative regulation of relations on subsoil use in Kazakhstan which is characterized by development of the new Law on Subsoils and Subsoil Users in replacement of the Law in force about Subsoils and the Law on Oil and development of the new Tax Code that provides for new order of taxation of operations on subsoil use and so on, quite interesting statements are made about Kazakhstan: that it gives up concession contracts and PSAs in the sphere of subsoil use and a new kind of contracts will be introduced and that instead of royalty as payment for use of subsoils the tax on production of mineral resources is introduced. To prove it an argument is given that the new Law on Subsoils and Subsoil Use does not foresee any division of Contracts on carrying out of subsoil operations in concession contracts, PSAs and service contracts. We need to admit that reforming of operations on subsoil use is conducted now due to changes in the order of taxation but not due to introduction of any new kind of the subsoil contract.

Despite the statement of developers of the Draft of the new Law on subsoils and subsoil users the Contract on carrying out of subsoil operations is fixed in the Draft mainly as the concession

\(^1\) Suleimenov M.K. Selected works on civil Law /Scientific editor. V.S. Em – M.: Ctatus, 2006, page 259

if is not otherwise provided. It follows from definition of the property rights on mineral raw – that it is the part of subsoils extracted to the surface that contains minerals. According to Item 2 of Article 10 of the Draft it is provided that if it is not otherwise specified in the Contract the mineral raw belongs to the subsoil users on the basis of the property rights. This is peculiar to concession relations. As for what we need to understand under «if it is not otherwise specified by the contract» here one conclusion arises - the contract can foresee that the property rights can be maintained by the contract and preserved after the proprietor of subsoils that is after the state of the country. But this is peculiar to relations under PSAs. Therefore, irrespective of conditions of taxation of the contract, the contract on subsoil use by the Draft of the Law about Subsoils and Subsoil Use is supposed to be a concession if it is not provided otherwise by the contract. Such order is included in the legislation of Kazakhstan since adoption of the Code about Subsoils of 1992. At that, the Laws about Subsoils and about Oil always allowed conclusion both of concession contracts and PSAs or service contracts.

As for the tax on production of mineral resources provided by the new Tax Code of Kazakhstan, we need to state that practically it does not differ from royalty. Tax on production of mineral resources as any royalty or bonuses is not linked in any way to profitablness of the project on subsoil use and is charged prior to any deductions or without their account, it is a regressive payment because the lower are profits or profitability of the project on subsoil use the higher is the level of these payments. Similarly to royalty the tax on production of mineral resources while being the tax on the gross revenues of the subsoil user it provides for the state-proprietor of subsoils to get profits at early stages of extraction without deductions or profits (losses) of the subsoil user.

From the practical point of view change in the status of special payment of the subsoil user on the tax, increase of the rate of this type of tax in comparison with the earlier acting royalties does not change anything dramatically. As it has already been marked earlier, even with the existing essential difference between the concession and contractual systems the economic rent for both cases is practically comparable. This is achieved by the market approach: if the oil and gas project does not give the average branch level of profitability taking into account the stock level of minerals, of the prospective expenses and incomes of the subsoil user, of availability of the necessary infrastructure, transport routes, of the comparable economic and political risks, nobody will undertake to develop the given deposit or deposits in this country. Inflow of investments in the oil and gas sector will be a signal about an attractive investment climate in the country, about the normal level of taxation, high degree of trust of investors to the economic and political situation in the country and etc. Lack of the sufficient level of investments in the oil and gas sector will require from the state revisiting of the legal regulation of oil operations, revision of the level of tax burden on the oil and gas sector, creation of any additional incentives for investments, including foreign investments as it was in the first half of the last decade when the Special Law on Foreign Investments was passed. The only thing which must be mentioned is that unreasonable and frequent changes in the legislation in the field of regulation of subsoil use, unreasonable declarations about giving up of this or that system of subsoil use system (even of the contractual or concession systems) and introductions of any new subsoil use systems, all of a sudden and frequent changes of the Tax Laws, excessive increases in tax burdens certainly can negatively impact the investment climate of Kazakhstan in the oil and gas sector and on the economy as a whole.

**Administrative and legislative procedures on conclusion of oil and gas contracts.** The Kazakhstan legislation regulates the administrative procedures in detail on conclusion of oil and gas contracts that refer to kinds of contracts on subsoil use.

While recognizing the positive sides of the detailed regulation of the administrative procedures on conclusion and execution of oil and gas contracts because this promotes on the one hand to increasing of transparency in this sphere, yet in practice there are still negative sides of these processes. Last years there were changes in the state policy during the state-legal regulation of the economy which especially displayed itself during the economic growth of Kazakhstan especially on the background of price surges for oil and other raw materials of Kazakhstan.
Strengthening of intervention of the state in the economic activities, balancing of the rights of foreign and national investors at the cost of erosion of privileges for the first, refusal of stability of the legislation and strengthening of the dominating influence of the national companies still exists and takes place in Kazakhstan. These changes are reflected in the Laws repeatedly adopted for the last five-eight years: About Investments, About the State Regulation of production and Turnover of Oil Derivatives, About PSAs and cancellation of the same Law, about introduction of changes and additions in Laws on Oil and on Subsoils and Subsoil Use, the new Tax Code, a number of Laws on ecology being developed, new Laws on competition, on the State Property and so on12.

Certainly, this is the right of the state to define the state policy in the sphere of economy with consideration of the state interests, the state ownership on subsoils, the needs of the society in the sphere of environmental protection and the state objectives on ecological safety and etc. The State has the right and is obliged to improve regulation of relations in the oil sphere and in other strategic branches of the RK economy. However, at that it is important not to go too far and it is necessary to distinguish between the state control and intervention in the economic activities of entities in this sector.

The market economy which is related to building of the lawful state and the civil society which Kazakhstan has always aspired to build assumes a clear separation of the public-legal and private-legal spheres; differentiation between the public law and private law is in the focus of the concept of the legal policy of the Republic of Kazakhstan which confirms the need to observe the fundamental basics of the civil legislation the most important principle of which is equality of entities13.

Meanwhile the last several years we are concerned about the increasing size of retreating from the market economy principles. – The message is slightly unclear. Worth re-wording. Unreasonable intervention of officials in economic activities of enterprises is increasing more and more, the number of the laws that foresee increase of licensing, certification, approvals and other permission procedures is growing. All these measures are introduced under the pretext of strengthening of the supervising role of the state, protection of the state interests and interests of the people. But quite frequently not the state interests are behind of all this but the ministerial or corporate interests of some officials who try to receive for themselves reasonable and unreasonable privileges and advantages, possibility to issue permits and licenses.

But this tendency aimed to limit application of the private-legal relations, to strengthen the state intervention, to ensure to the state in the private-legal relations the unilateral privileges, advantages and priorities is getting wider and stronger.

One of examples when the state unreasonably got the unilateral advantage in the private-legal relations and mixed methods of the public and private law is the amendment to Article 71 of the Law about Subsoils and Subsoil Use. The given amendment states: «For preservation and strengthening of the resource-energy base of the national economy in the newly concluded and earlier concluded contracts on subsoil use except for the contracts on underground waters and commonly occurring mineral resources, the state on behalf of the Government of the Republic of Kazakhstan or by the Decree of the RK Government the National Operating Holding or the National Company on subsoil use are granted the priority rights versus the other parties to the contract or participants of the legal person that has the subsoil rights and before other persons for acquisition of the alienated subsoil rights (or parts of it) and (or) a share of participation12.


(block of shares) in the legal entity that has the subsoil rights and also in the legal entity which has a possibility to directly and (or) indirectly define the decisions and (or) to make influence on the decisions taken by the subsoil user if the given legal person's core activity is connected with subsoil use in the Republic of Kazakhstan on the terms not worse than the terms offered by other buyers».

In the case under consideration there was a fact of compulsory exception/withdrawal of property (shares, for example). “Compulsory” means contrary to the will of the owner of shares and without the court decision. In history of Kazakhstan there were cases of compulsory purchase of shares of banks and insurance companies when they had come to the point of negative capital. The process of taking into consideration of this reason in 1996 was accompanied by a big scandal because not only the rights of simple shareholders of these banks were infringed who were not guilty at all in any way that their banks had come to the point of the negative capital.

The purchase of shares of the owners as well as realization of the priority right of the state to buy the subsoil rights including through acquisition of the alienated by the subsoil user shares is actually a transfer of property from the private ownership to the state ownership. Compulsory transfer to the state ownership of the property which was in the private ownership is called nationalization which can be carried out only through adoption of the Special Law on Property Nationalization.

The state which feels unfairly infringed by foreign or national investors has quite a legitimate right – the so-called nationalization. This right is immanently inherent to each country of the world. It is evidence of sovereignty of the state. But then it is necessary to conduct nationalization, to openly and honestly declare about it, to use the norms of the public law without trying to change and adapt in the state’s own interests the earlier concluded contracts. In this respect I’d like to note that the developed bill of the RK «About the State Property» foresees the norms about the order, cases and procedures of nationalization that foresee taking into account the international practice the rights of the state for nationalization, in exceptional cases with full indemnification to proprietors and to the third parties of the cost of the nationalized property and compensation of all losses incurred due to nationalization of the private property.

Certainly, implementation of expropriation is the sovereign right of each state. Both the international practice and the international arbitration demonstrate such cases when the right on expropriation was admitted prevailing over stabilization provisions of contracts. In this connection a question arises about the limits for application of the given concepts: national security, economic safety, ecological safety. It is inadmissible to unlimitedly expand these concepts, to justify with their help the right of the state for unilateral change and cancellation of contracts.

Speaking specifically about the procedures on conclusion and execution of oil and gas contracts regulated by the RK legislation we need to say the following:

As it was already stated originally the Law on Subsoils foresaw the license-contractual system. That is without a license the contract on subsoil use could not be concluded. Later the legislator deviated from this system and has established the contractual system. Thus, according to the current legislation - Article 13 of the RK Law as of January 27, 1996 «About Subsoils and Subsoil Use» - the rights on subsoil use are ensured in two ways:

- Through conducting of bids among investment programs for subsoil rights and conclusion of a contract, and
- Through direct negotiations and conclusion of the contract.

Article 8-1 of the RK Law as of June 28, 1995 «About Oil» contains the reference norm to the Law on Subsoils concerning the procedure of granting of rights to carry out oil operations on
exploration, production, combined E&P, building and (or) operation of underground storehouses and oil tanks.

Subsoil rights are considered given and arising only from the moment of contract conclusion. Subsoil rights are ensured through direct negotiations and conclusion of contracts if the applicant has the exclusive right for production due to conducted exploration on the basis of the concluded Contract on exploration; in case of the Contract conclusion on building and/or operation of the underground constructions not in support to exploration and/or to production; in case the applicant is the National company; in case established by Article 73 of the Decree of the RK President as the Law in force as of January 27, 1996 № 2828 “About Subsoils and Subsoil Use”; in other cases provided by the legislative acts of the Republic of Kazakhstan. In other cases the granting of subsoil rights on exploration, production of mineral resources, including from the man-made mineral formations which are in the state ownership is conducted through announcement of tenders for investment programs.

The concrete order for granting of subsoil rights in the Republic of Kazakhstan including the rights for exploration, production, combined E&P of mineral resources including from the man-made mineral formations which are in the state ownership and also on building and operation of the underground constructions not linked with E&P is foreseen by the Rules on granting of subsoil rights approved by the Governmental Decree of the Republic of Kazakhstan of January 21, 2000 № 108.

Speaking about the ways to conduct tenders/competitions: they can be open (conducted among an unlimited number of participants, with notification about it and its conditions published in mass media) or closed (conducted among limited number of people by way of notification of its potential participants). Following the results of evaluation of the received Competitive bids the Tender Commission makes a decision about the winner of the Tender and the corresponding Minutes is issued with the Commission's decision about selection of the winner of the Tender with attachment of the Competitive bid of the winner.

The term for publication or notification published or sent according to Item 8 of the present Rules is defined by the Competent Body depending on the specificity of the target (site of subsoils) about which the Tender is announced.

The notification about conducting of the Tender must include: information about the time and venue of the Tender; the deadline for submission of bids; the main conditions of the Tender; place and a short description of the site of subsoils (block) put for the Tender; cost of the package of the geological information; minimum sizes of the subscription bonus; the size of payment for the right of participation in the Tender established by the Competent Body with requisites for payment. The notification can include other information about the conditions for carrying out of the Tender.

The order of definition of a subscription bonus is defined by Rules about the order for definition of the size of a subscription bonus in contracts on subsoil use (carrying out of exploration, combined E&P and also production of mineral resources except for the commonly occurring minerals) in the Republic of Kazakhstan approved by joint orders of the Minister of Finance of the Republic of Kazakhstan as of June 22, 1999 № 315 and the Chairman of the RK Agency on Investments as of June 22, 1999 № 1.

Order for organization of the work of the Commission to conduct tenders of investment programs to obtain the rights on subsoil use in the Republic of Kazakhstan and regulations of its activity is foreseen in the Rules about the Commission on conducting tenders of investment programs to obtain the rights on subsoil use in the Republic of Kazakhstan approved by the Governmental Decree of the Republic of Kazakhstan as of February 13, 2003 № 158. The Commission is a constantly operating body created to conduct tenders of investment programs and define winners of tenders to grant to the winner the subsoil rights according to the
legislation of the Republic of Kazakhstan in the sphere of subsoil use and carrying out of oil operations. At that, the personal structure of this Commission is approved at present by the Governmental Decree of the Republic of Kazakhstan of March 2, 2006 «About formation of the Commission on conducting of tenders to obtain the rights on subsoil use».

The primary goal of the Commission is to determine the winner from amongst participants of the tender of investment programs to obtain the subsoil rights in the Republic of Kazakhstan. Accordingly, the Commission functions in the sphere of its activity are: to ensure timely and qualitative consideration of competitive bids; evaluation of competitive bids submitted by the respective persons; development of proposals on improvement of the procedure for granting of the subsoil rights in the Republic of Kazakhstan.

The applicant elaborates a bid based on the terms established by the conditions of the Tender.

Application for participation in the Tender includes: 1) the name of the applicant; the legal address of the applicant and the address of the main place of activity; the state affiliation (for legal entities), citizenship (for physical persons); information about the heads or owners of legal entities and persons who will represent the applicant; information about the technical, administrative, organizational and financial opportunities of the applicant confirmed by documents.

Acceptance and registration of competitive bids for the tender is carried out by the Competent Body. The submitted competitive bids are accepted for consideration after payment by the applicant of a payment for participation in the tender. The applicant is officially notified about acceptance of the bid for participation in the tender/competition in a monthly period from the date of submission of the bid.

After acceptance of the application form for participation in the Tender/Competition the Competent Body provides to the applicant a package of the geological information about the site of subsoils (block) in respect of which it intends to grant the subsoil rights. The package of the geological information is formed by the state body on use and protection of subsoils and must include the geological information necessary for the applicant to develop a competitive bid. The package of geological information given to various applicants must be identical.

The Competent Body has the right to refuse to accept the application form for participation in the tender/competition due to the following reasons: if the applications were issued with infringement of requirements of the present Rules; if the applicant submitted false or incorrect data; if there are no documentary confirmations that the applicant possesses or will possess technical, organizational, administrative and financial opportunities necessary for E&P operations specified in the bid for participation in the competition.

The competitive bids delivered to the Competent Body and admitted for the Tender are not returned to the Tender participants. In the course of conducting of the Tender/competition based on the decision of the Commission the applicant can improve its competitive bid. Changes and additions in the competitive bid are made in addition with indication of the term for their submission. The bid is considered improved since the moment of submission of changes and additions to the Competent Body and their registration by the Competent Body.

The main criteria of definition of the winner of the Tender/competition are: the term of the beginning and intensity of carrying out of E&P, achievement of profitability of production and profitableness of the project on production; the prospective sizes of the initial and of subsequent payments to the budget; the size of the investment, terms and conditions for financing of the project and capital investments in development of industrial and social infrastructure in the contract territories; observance of requirements of the legislation and statutory acts on protection of subsoils and environment, safe conducting of works. On condition of relative equality of all submitted competitive bids the Tender Commission has the right to
define the intermediate list of winners of the Tender/Competition to define the final winner of the Tender/Competition. To define the final winner of the Tender/Competition the Tender Commission has the right to request additional information concerning the bids from the participants included in the intermediate list. The final winner of the competition is registered in the Minutes\textsuperscript{14}.

The winner of the closed competition is informed by the Competent Body about its victory in the Tender/Competition according to the official procedure. Results of the open Tender/Competition are published in the official publications. The moment of registration of the minutes about the winner of the Tender/Competition is considered to be the moment of approaching of obligations of the given winner of the Tender/Competition for conclusion of the Contract on the conditions not less favorable in relation to the Republic of Kazakhstan in comparison with the conditions provided by the competitive bid, and performance of other conditions defined by the legislation.

Decision of the Competent Body to carry out direct negotiations or the Minutes of the Tender Commission about the winner of the Tender/Competition served as the basis for starting negotiations about conclusion of the Contract. The Competent Body and Subsoil User act as the parties to the Contract. The RK Ministry of Energy and Mineral Resources acts as the Competent Body to conclude contracts on E&P, combined E&P of mineral resources and also minerals extracted from the man-made mineral formations. The RK Committee of Geology and Protection of Subsoils of the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan acts as the Competent Body to conclude contracts on building and/or operation of the underground constructions not supporting E&P and for the state geological studying of subsoils.

Both physical and legal entities can be subsoil users by the Contract. If the subsoil right is given to several physical and/or to legal entities who will subsequently become the joint owners of the subsoil rights then the Contract will be concluded between the Competent Body and such physical and/or legal entities. At that, the mutual subsoil rights and liabilities about performance of the Contract conditions are defined by the contract (agreement) between subsoil users and make the integral appendix to the Contract.

Negotiations are conducted by the Working Group of the Competent Body with mandatory participation of representatives of the interested ministries and bodies. The structure of the Working Group is approved by the Competent Body on the basis of the nominees put forward by the ministries and bodies.

The Draft contract is prepared by subsoil users with consideration of provisions of the Model Contract and is submitted not later than in 90 days from the moment of registration of the minutes by the Tender Commission about the winner of the Tender/Competition or decision made by the Competent Body to conduct direct negotiations.

The Model Contract is approved by the Governmental Decree of the Republic of Kazakhstan as of July 31, 2001 № 1015. The Competent Body on conclusion and execution of contracts with subsoil users is obliged to be guided by provisions of the Model Contract during preparation and conclusion of contracts. At conclusion of contracts on the basis of the earlier issued licenses the Competent Body must consider conditions of these licenses. The Model Contract contains necessary conditions of the contracts on subsoil use including the issues of contract termination, suspension of its force and all other conditionalities regulated by the legislation and the imperative norms. The Model Contract, in particular, provides that the Competent Body is obliged to suspend the contract if there is a direct threat to life and health of people who work or live in a zone of influence of the conducted works related to the contract terms.

The Model Contract regulates in detail through the imperative procedure many conditions including the issues of suspension and prescheduled termination of the contract. The Competent Body has the right to suspend the Contract in the following cases: in case of implementation by the Contractor of the activity which was not foreseen by the Work Program and by the Contract; in case of infringement by the Contractor in the course of its activity of the State legislation regarding protection of subsoils, of the surrounding environment and safe conducting of the works; infringement by the Contractor in the course of its activity of the order of payment of taxes and other mandatory payments established by the Contract; at transfer by the Contractor in full or partially the rights under the Contract to the Third party with infringement of provisions of the Contract; at interruption by the Contractor of production under the framework of the Work Program for the term above the term established by the contract except for the cases connected with force majeure circumstances (force-majeure); At infringement of conditions about observance of confidentiality of the information under the present contract. The contract can be also terminated ahead of schedule only in the following cases: refusal of the Contractor to eliminate the reasons which have caused the decision-making on suspension of carrying out of E&P, of combined E&P operations or building and (or) operation of the underground constructions not supporting E&P operations or if the named reasons were not eliminated on time sufficient for their elimination; if subsoil user will not start operations on subsoil use in the terms established by the Contract; if it is impossible to eliminate the reasons which have caused suspension of operations on subsoil use and caused threat to health and life of people; in case of essential infringement by the Contractor of the obligations established in the Contract or the Program of Works; Recognition of the Contractor as the bankrupt according to the Republic of Kazakhstan’s current legislation except for a case when the subsoil right is the subject of the pledge according to the Civil Code; if the Contract is recognized void according to the legislation about the subsoil use. While working out of the Draft contract on subsoil use the Model Contract is used as the exemplary contract and its conditions must be used by the parties at development of their own Draft contracts.

The Draft contract on carrying out of E&P of commonly occurring minerals is prepared by the subsoil user on the basis of the Model Contract and is submitted not later than in 30 days from the moment of the decision-making by the relevant Akim.

To estimate the economic parameters of the project the Competent Body considers the financial and economic model jointly with the Ministry of Economy and Budget Planning of the Republic of Kazakhstan and the RK Ministry of Finance. As for commonly occurring minerals - it is the function of the regional managements of economy and the territorial tax bodies.

The Draft contract approved by the parties before its signing must pass through the mandatory economic and tax examination within 30 days from the moment the Ministry of Economy and Budget Planning of the Republic of Kazakhstan and the RK Ministry of Finance receive the Draft contract.

The Draft contract must be approved within 30 days by the Ministry of Justice. As for commonly occurring minerals - the draft contract must be approved by the corresponding territorial body of the Ministry of Justice of the Republic of Kazakhstan and also within 15 days from the date of its reception by the following ministries and bodies: concerning environmental protection - with the Ministry of Environmental Protection of the Republic of Kazakhstan. As for commonly occurring minerals - with the territorial bodies; concerning use, protection of subsoils and definition of barren sites suitable for building and/or operation of the underground constructions not related to E&P - with the Committee of Geology and Protection of Subsoils of the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan. For commonly occurring minerals – with the territorial bodies; in respect to health issues – with the RK Ministry of Health. As for

---

commonly occurring minerals - with its territorial subdivisions; concerning safe conducting of works – with the RK Ministry of Emergency Situations.

In the course of development of the contractual conditions the Competent Body has the right to involve independent advisers and experts. All expenses connected with attraction of independent advisers and experts are reimbursed by the contractor according to the procedures established by the Government of the Republic of Kazakhstan.

After the conducted negotiations, examinations and approval of the Draft contract, the Contract is signed by the CEO, the deputy or any authorized person and an authorized representative of the subsoil user. At that, the Contractual conditions cannot be less favorable for the Republic of Kazakhstan in comparison with the conditions of the competitive bid. Refusal of the winner of the tender/competition to conclude the Contract on the terms not less favorable for the Republic of Kazakhstan in comparison with the conditions defined by the competitive bid is considered an essential infringement of obligations of the winner of the Tender/Competition.

The contract grants the right to E&P only for that kind of minerals which is specified in the Contract. In case of detection of reserves of the minerals which are not falling under the list of the kinds of the resources indicated in the Contract, the Competent Body has the right to define conditions for production of such minerals through entering of respective changes and additions in the Contract.

The parties have the right based on their mutual consent to introduce changes and/or additions to the Contract through conducting of written negotiations. Approval and examination of the accepted changes and/or additions is carried out only with those ministries and bodies to which competency these changes and/or additions are referred. The made changes must not be less favorable for the Republic of Kazakhstan in comparison with the conditions defined in the competitive bid.

The contract after it is signed is subject to the mandatory state registration in the state body that has concluded it. The state body that registers the Contracts conducts the register for the state registration of contracts.

The document that certifies registration of the Contract is the certificate of the established format issued to the subsoil user by the Competent Body.

Changes and additions to the Contract are also subject to registration by the corresponding state body by way of entering in the register of the State registration of Contracts. The contract and changes and/or additions to it come in force from the moment of their registration.

Keeping and storage of the concluded contract is ensured by the corresponding state body which has made its registration. The copy of the Contract after its registration by the Competent Body is sent to the Ministry on Environmental Protection and the RK Ministry of Finance in the mandatory manner.

Besides an order for conclusion of the subsoil contracts the RK legislation regulates the issues of development of oil and gas deposits during execution of contracts to carry out oil operations including the issues of protection of subsoils in the course of development of mineral deposits and processing of mineral raw materials.

The Single Rules of the Republic of Kazakhstan for development of oil and gas deposits approved by the RK Governmental Decree as of June 18, 1996 № 745 establish the basic norms and requirements to all stages of development and industrial development of oil and gas oil fields located in the Republic of Kazakhstan, to geological study of oil fields, calculation and account of reserves, design and creation in the deposits of rational systems for production, to building and operation of wells of all categories and necessary field constructions, management
of the production processes, protection of subsoils and environment. The Rules are developed according to the Laws of April 17, 1995 “About Licensing”, of June 28, 1995 “About Oil”, of January 27, 1996 “About Subsoils and Subsoil Use” and other legislative and statutory acts.

The Rules define the sequence of the works to be conducted on designing and on the adequate performance of operations on industrial development of deposits based on the objective conditions such as progressive obtaining of the needed information and detailed images about the deposition of oil and gas for a long period of time starting from wildcat operations up to finishing of production. Due to this there is a need of double or even triple designing, performance of architectural supervisions and analyses of development with a change if needed of the earlier accepted technological solutions with entry of the corresponding adjustments in contracts (agreements).

The Single Rules on Protection of Subsoils (ЕПОН) for development of mineral deposits in the Republic of Kazakhstan approved by the RK Governmental Decree as of July 21, 1999 № 1019 are developed according to the requirements of the Law of 29.01.1996 “About Subsoils and Subsoil Use” and of 28.06.1995 “About Oil” and other legislative-normative acts. The given Rules contain a complex of requirements about the rational and comprehensive use of subsoils and their protection at all stages of subsoil use. The applied terms and definitions of the Rules correspond to the accepted terms in the legislation on subsoils and also in the acting interbranch and branch normative and technical documents (provisions, instructions and methodological instructions), that regulate development of mineral deposits. Fulfillment of the Rules is mandatory for all legal and physical persons irrespective of their patterns of ownership which carry out E&P, designing, conducting and operation of wells, conduct production operations, field development and building of support field constructions, preparation of technological liquids, energy sources and dumping of waste. The Rules do not cancel the requirements of the acting interbranch and branch normative documents in the field of protection of subsoils in that part which does not contradict the present Rules and the current legislation about subsoils.

According to Article 5 of the Law of the Republic of Kazakhstan as of June 28, 1995 “About Oil”, Article 63-1 of the Law of the Republic of Kazakhstan of January 27, 1996 “About Subsoils and Subsoil Use” the Government of the Republic of Kazakhstan approved in November 28, 2007 under № 1139 the Rules on purchase of goods, works and services to carry out operations on subsoil use that regulate purchase of goods, works and services to carry out operations on subsoil use including during carrying out of oil operations to develop oil and gas deposits. The specified rules provide for purchase of goods, works and services to carry out operations on subsoil use which include open or closed competitions, purchase of goods (works and services) from one source, purchase of goods (works and services) by inquiry of price offers, purchase of goods (works and services) through the system of electronic purchases and purchase of goods through open commodity exchanges. The Rules regulate the procedure to conduct purchases of goods, works and services to carry out operations on subsoil use in various ways. The procedure on carrying out of tenders to purchase goods, works and services is regulated especially in detail for conducting operations on subsoil use. The action of the Rules does not specifically cover the organizers who are conducting purchase of goods, works and services to carry out operations in respect to the commonly occurring minerals or according to the legislation of the Republic of Kazakhstan that regulates the state purchases.

Analysis of the legal regulation to settle the disputes relating to oil and gas contracts in the Republic of Kazakhstan.

Article 9 of the Civil Code of the Republic of Kazakhstan (General part was adopted in December 27, 1994, the Special part was adopted in July 1, 1999, further CC) establishes that protection of the civil rights is carried out by the court or the arbitration court. The state arbitration court as the independent organization is liquidated in Kazakhstan and nowadays it is part of the general courts; that is why we deal only with the state court and the arbitration court in Kazakhstan.
The basic normative act that regulates settlement of property related disputes is the Civil-Proceeds Code of the Republic of Kazakhstan adopted in July 13, 1999 (further - CPC).

CPC establishes the main rules of the court jurisdiction and arbitrability. Besides the usual civil cases, courts consider cases with participation of foreign citizens, persons without citizenship, of foreign organizations, of foreign legal entities, organizations with foreign participation and also of international organizations if it is not provided otherwise by the international treaties or by legislation of the Republic of Kazakhstan or agreements of the parties (Item 6 of Article 24 in CPC).

The RK courts (further, RK) consider cases with participation of foreign persons if the organization-respondent has a residence in the RK territory (Item 1 of Article 416 of CPC). A number of cases is also defined when the RK courts consider cases with participation of foreign persons (when the branch or representation of the foreign person is in the RK territory, the respondent has property in the RK territory, the claim follows from the contract in respect to which a full or partial execution must be ensured or was ensured in the RK territory, and others) (Item 2 of Article 416 of CPC).

The affairs connected with the rights on real estate located in the RK are under the exclusive competence of the RK courts; affairs about claims to the carriers following from contracts on transportation; affairs about divorce of the Kazakhstani citizens with foreign citizens or persons without citizenship if both spouses have the place of residence in the RK; action proceedings (Article 417 of CPC).

The court jurisdiction of the affairs referred by the legislation of the Republic of Kazakhstan to the competence of the RK courts is defined by the general rules of jurisdiction (Article 418 of CPC).

According to Item 1 of Article 3 of the RK Constitutional Law as of December 25, 2000 “About judicial system and the status of judges of the RK”, the judicial system of the RK is made of the Supreme Court and local courts. Local courts include:

1. Regional courts and the courts equal to them (the city court of the capital of the Republic, the city courts of the republican value, the specialized court – the Military court of the RK armies and others);

2. District courts and the courts equalized to them (the city, interdistrict, specialized court – the military court of the military reservation and others).

The civil cases where one of the parties is an international or foreign organization are cognizable to the regional courts and the courts equalized to them (Item of Item 2 of Item 1 of Article 28 in CPC).

According to Article 3 of the Law on the judicial system and the status of judges of the Republic of Kazakhstan the specialized interdistrict economic courts are created. However they cannot consider cases where one of the parties is an international or foreign organization. They consider civil cases on property and non-property disputes where the parties are citizens who carry out entrepreneurial activities without formation of the legal entity (including foreign citizens).

The affairs where one of the parties is a foreign citizen who is not a businessman are cognizable to the regional courts and the courts equivalent to such courts.

The CPC does not limit the right of the parties to choose the place for consideration of disputes. Article 419 in the CPC states that the competence of a foreign court can be provided based on the agreement of the parties except for the cases specified by Article 33 of the CPC. Article 33
of the CPC is devoted to the exclusive jurisdiction of the Kazakhstan courts and covers claims about the rights on the real estate, about clearing of the property from arrest (the claim is issued in the location of the property); claims of creditors of the estate-leaver who bring a suit before acceptance of the real estate by devisees; claims to the carriers arising from contracts on transportation of cargoes\(^\text{16}\).

In case of the agreement about the competence of a foreign court (known as “the propagation agreement”) the court based on the petition of the defendant leaves the claim without consideration if such petition is declared prior to beginning of the trial on the merits (examination of a case on its merits). The propagation agreement is similar to the arbitration agreement and the only difference is that the arbitration agreement defines the jurisdiction of commercial (non-state) courts while in the propagation agreements of regular courts\(^\text{17}\).

The characteristic feature of the propagation and arbitration agreements is legal autonomy of the contract. The destiny of the agreement, its legal validity does not depend on validity of the main contract. It is the basic principle of the international commercial arbitration. It is fixed, for example, in part 2 of Articles 16 of the Law of the Russian Federation of July 7, 1993 “About the International Commercial Arbitration”\(^\text{18}\). And this principle equally operates in respect to the commercial arbitration and to the courts of general jurisdiction.

There was a number of cases in the judiciary practice of the RK when judicial bodies broke the principle of inadmissibility of consideration of an affair in the courts of general jurisdiction if arbitration or progression agreements are available referring to the fact that the contract with the foreign participant was nullified and accordingly the agreement on jurisdiction must be nullified too.

For instance, the Supreme Court of the RK has acted so during consideration of a case about the claim of “Kazakhstan Minerals Resources Group (KMRG)” against “Trans World group (TWG)”. The parties had an agreement on consideration of the case in the British Virgin Islands (BVI) however the RK Supreme Court having nullified the contract has nullified the given agreement too\(^\text{19}\).

Specific problems in the sphere of differentiation of the competences arise about oil and gas disputes, in particular, in relation to contracts on subsoil use.

The contract on subsoil use is linked with use of subsoils. The subsoil rights according to the RK legislation act as the property Law. Subsoils are considered as real estate. Therefore according to Article 417, 33 of the CPC all the disputes about subsoil use as soon as they are linked to the real estate must be considered exclusively in the courts of the RK.

Objections which can be stated against such interpretation of disputes about subsoil use are brought to the following:

1. Article 417, 33 of the CPC deals with the disputes connected with the rights on the real estate. The contract on subsoil use does not cover disputes on the rights to subsoils as the real estate;


2. The contract on subsoil use does not concern subsoils; it concerns the minerals which are referred to the movables;

3. Many international contracts (Energy Charter Treaty, Convention on encouragement and mutual support of investments and others) foresee in terms of the subsoil contracts consideration of disputes in the international arbitration. Owing to the priority of the norms of the international contracts they will prevail over the national legislation.

Legal status of the arbitration court and of the international commercial arbitration in Kazakhstan

In his speech at the 4-th International Conference “NeftGazPravo/RusEnergyLaw-2004” the Chairperson of the Supreme Arbitration Court of the Russian Federation Yakovlev V.F. (November 10-11, 2004) talked about carrying out of the judicial reform in Russia aimed at simplification of the legal proceedings. As one of directions of this simplification he named development of alternative procedures to consider disputes (АПРС) and in particular the mediation procedures and the arbitration court.

Unfortunately, everything is done on the contrary in Kazakhstan. One can get the impression that the authorities aim to destroy the Arbitration Courts.

As a result of targeted actions of the State Office of the Public Prosecutor, the Ministry of Justice, the Government and Constitutional Council of the RK the Arbitration Courts are on the verge of disappearance in the RK. After tragical and in many respects of a by-chance error of the Civil-Proceeds Code of the RK of 1999 (further the CPC) the norm about compulsory execution of decisions of the arbitration court disappeared. The RK Supreme Court tried to correct this mistake having accepted the normative Decree in October 19, 2000 which has obliged the courts to ensure compulsory execution of decisions of the Arbitration Courts. However in the result of constant attacks of the State Office of the Public Prosecutor and the RK Government it was compelled to suspend this decision (in June 28, 2002).

The RK Constitutional Council accepted in February 15, 2002 a very strange and legally incorrect decision (not to say more) by which it established that consideration of disputes in the arbitration court does not exclude a repeated consideration of the same dispute in the state court.

In the result of all these actions the system of the Arbitration Courts in Kazakhstan was destroyed.

Both the opponents and supporters of the Arbitration Courts have come to the common opinion that the only way out of this developed situation is to promptly adopt the Law about the Arbitration Courts.

At the same time based on the initiative of the Council of Foreign Investors the Draft of the Law “About the International Commercial Arbitration” was developed.

The original Drafts of Laws “About the Arbitration Courts”, “About the International Commercial Arbitration”, “About introduction of changes and additions in some legislative acts concerning activity of the international commercial arbitrations” were developed in 2001 by the Scientific-Research Institute of Private Law and were submitted for consideration to the Ministry of Justice. The Draft of the Law “About the International Commercial Arbitration” was entirely based on the UNCITRAL MODEL LAW “About the International Commercial Arbitration”. The Draft of the Law “About the Arbitration Courts” was designed as reference to the Law “About the International Commercial Arbitration” and contained some organizational issues.
Unfortunately, the Government while submitting to the Parliament the Drafts of the Laws “About the Arbitration Courts”, “About the International Commercial Arbitration” and “About introduction of changes and additions in some legislative acts concerning the issues of activity of the Arbitration Courts and arbitrations” has digressed from this provision. Drafts of laws were developed by different groups, in many respects they are repeated and duplicate each other and have digressed from the conceptual moments of the UNCITRAL Model Law.

I hold the opinion that the legal regime of the Arbitration Courts created in the territory of the Republic of Kazakhstan must correspond to the legal regime of the activity of the international commercial arbitration. Probably, the legal regulation of activity of the Arbitration Courts created in the RK territory must be carried out under the frame of the same Law “About the International Commercial Arbitration” which also regulates the activity of similar international commercial arbitrations. At that, we think that the main objective of development of the Law on the Arbitration Courts is the maximum approximation of its norms to the norms of UNCITRAL Model Law “About the international commercial arbitration” because the Republic of Kazakhstan is a member of the United Nations and has joined a number of the international conventions on arbitration and about execution of arbitration decisions.

The work of the Arbitration Courts is based on two postulates/provisions.

Postulate 1: The arbitration court is not included in the judicial system. It is not the body of justice. The Constitutional Council of the RK confirmed this. Therefore the norms of the CPC applicable to the state courts as to the bodies of justice are simply inapplicable to the Arbitration Courts.

The arbitration court is the non-state body and its choice is implementation of the constitutional rights of citizens to choose any way of protection (Article 13 of the RK Constitution). The country citizens themselves choose their judge and agree that they will obey the judge’s decisions.

And we must not treat the Arbitration Courts from the point of view of the public justice. The state must not interfere with the work of the Arbitration Courts and to check the content of their decisions at all. The only thing that the state must do is to check observance of the procedural rights of the parties and to ensure compulsory execution of decisions of the Arbitration Courts.

Proceeding from it, in the overwhelming majority of the countries of the world the decisions of the Arbitration Courts are never checked by the competent courts on the merits and are final. Almost anywhere in the world the courts do not check the legislative basis for consideration of disputes. Because the law interpretation can be different and the competent court can see infringement of legality where there is not any infringement because it is the civil-law dispute and in any civil-law dispute there are always different views on the Law and interpretations of the Law. The whole judicial system of any country including Kazakhstan is built on this. But the arbitration court is not included in the judicial system. The competent court can check only the remedial moments.

If these principles are not observed then such an organization which is called the arbitration court in fact is not the arbitration court. It translates in an appendage to the judicial system and actually there is no need in it.

Postulate 2. The arbitration court and the international commercial arbitration are one and the same thing. The difference only in the structure of participants, a foreign element appears in the latter. Therefore all procedural provisions must coincide. Basically it must be a single law. Also the Law about the international commercial arbitration cannot fix the provisions that ensure advantages to foreigners. This is infringement of the rights of our citizens and of our domestic businessmen.
Application of double standards is inadmissible, one to the international arbitration and the other to the arbitration court.

Two norms of the Law on the Arbitration Courts contradict these postulates.

1. Item 7 of Article 5 of the Law stipulates: "The Arbitration Courts are not authorized to consider the disputes concerning the interests of the state, of the state enterprises, of minors, the persons recognized incapable according to the procedure established by the Law, of the persons who are not participants of the arbitration agreement, disputes about the contracts on granting of services, performance of works, production of the goods by the subjects of natural monopolies, the subjects occupying a domineering position in the market of commodities and services, and also on affairs of bankruptcy, except for the cases provided by Laws of the Republic of Kazakhstan".

There is not such norm in the Draft of the Law about the international commercial arbitration.

The given norm contradicts Item 1 of Article 13 of the Constitution about the right of citizens to choose ways to protect their rights. Citizens and legal bodies have the right to transfer any civil-law dispute to the arbitration court. The legislative acts (Laws about bankruptcy, about labor, marriage and family) have already established all the necessary restrictions which are quite well-grounded and innumerous. As for the proposed norm, it is really boundless and will allow the Office of the Public Prosecutor and to the party which does not give its consent for consideration of the dispute in the arbitration court to stand against practically any arbitration agreement about transfer of the dispute to the arbitration court.

The wording "disputes which concern the interests of the state" are especially dangerous. This wording gives a chance to do everything under this statement and to take away cases from the Arbitration Courts. Such indistinct wordings are inadmissible in the Law. It is not clear why the state enterprises, natural monopolies and especially the subjects occupying a domineering provision in the market cannot participate in the arbitration trials?

There are not such restrictions is any Law on arbitrations. On the contrary, the Law on Arbitration of April 1, 1999 of Sweden in Article 1 states that "The arbitrators have the right to consider the issues about the civil-law consequences of the legislation about competition in the part that concerns the parties".

2. On the basis of Article 43 of the Law it is allowed to appeal against the decision of the arbitration court on the basis of infringement of "the principle of legitimacy". The arbitration court is not included in the judicial system and it is not the body of justice. This is a private business of subjects of civil relations which have refused from the judicial consideration and have decided to consider their dispute in the non-state court created by them. The state does not interfere with this business. The help of the state to enforcement of justice is needed only when there is an infringement of the arbitration agreement (as well as of any civil-law contract): when the procedural rights of the parties (stipulated in advance) are broken and when the lost party refuses to execute the decision of the arbitration court. Cancellation of the decision and refusal in execution of the decision are possible only in respect to the procedural infringements stipulated in advance (not any infringements of the CPC norms but only those infringements which are specified in the Law).

All over the world the main principle of an arbitration trial is in that the competent court has no right to consider the decision of the arbitration court on the merits. This is fixed in Item 1 of Article 47 of the Law too.

But the principle of legitimacy is in conformity with any normative-legal act (subtem 2) of Article 4 of the Draft). It means that to establish a fact of infringement of the principle of legitimacy the competent court must check the case on the merits. In case of cancellation this decision of the
The principle of legitimacy is not mentioned in the Law on the International Commercial Arbitration.

Thus, foreign citizens and legal bodies are in a privileged provision in comparison with the citizens and legal entities of the RK. The Kazakhstani citizens are put in unequal and humiliating provision in comparison with foreigners. And this happens when the President and the Government have proclaimed the policy of support to national investors and businessmen!

Quite often the Decree of the RK Constitutional as of February 15, 2002 is cited as the grounds to appeal on the merits or to refuse in compulsory execution of the substantial basis. This is absolutely unreasonable. The Decree of the Constitutional Council has relation neither to lodging a complaint nor to compulsory execution.

The Decree as of February 15, 2002 states:

“Conclusion by the parties of the civil-law contract to transfer a dispute to the arbitration court’s consideration does not exclude in the subsequent period a possibility for consideration of the given dispute by the courts of the RK judicial system in the order established by the current legislation”.

We are talking here about an absolutely new consideration of disputes which has nothing to do with the arbitration consideration of a case. Neither there is any relation to appeals and more over to compulsory execution of a court decision.

In the above-stated phrase from the Decree of the Constitutional Council the key paragraph is: “… in the order established by the current legislation”. In other words the possibility for a repeated consideration of a dispute is allowed only in case if it is fixed by the legislation.

There are not such norms at present. On the contrary subtem 5 of Article 249 of the CPC fixes that the court leaves the motion without consideration if between the parties according to the Law the contract is concluded on transfer of the given dispute to the court’s consideration. That is, if there is an arbitration agreement, the competent court does not consider the dispute irrespective whether it was considered in the arbitration court or not. The opponents of the Arbitration Courts like to refer to the first Decree of the Constitutional Council of February 15, 2002. But this additional Decree was specifically adopted by the Constitutional Council to specify and correct the errors admitted in the Decree of February 13, 2002.

In the Decree of April 12, 2002, the Constitutional Council rejected the attempts of the Office of the Public Prosecutor to recognize subtem 5 of Article 249 in the CPC as unconstitutional. Moreover, in the Decree part it specifically noted about the availability of subtem 5) of Article 249 of CPC that establishes the existing order to appeal to the state court.

The Law “About the International Commercial Arbitration” in many respects repeats the Law “About the Arbitration Courts” however it does not give any answer to the main question: no accurate differentiation between the competences of the arbitration court and the international commercial arbitration has been made.

A slightly improved provision in comparison with the last versions is repeated in the Law: “...the disputes arising in the result of contractual and other civil-law relations with participation of physical and legal bodies and also of commercial organizations if at least one of the parties is a
non-resident of the RK (Item 4 of Article 6 of the Law)” can be transferred to the Arbitration Courts on the basis of agreement of the parties.

The unclear concept of “the non-resident” is used again which is understood in different ways in the currency, tax and other legislations.

It is not clear why it was impossible to use a clear definition of Article 1 “Scope of Application” of the UNCITRAL Model Law. The corresponding Article could be worded as follows:

1. Only the following cases can be transferred to the international commercial arbitrations by way of agreement of the parties:

1) Disputes arising from the contractual and other civil-law relations, arising at implementation of foreign economic and other kinds of international economic relations if a commercial enterprise of at least one of the parties is located abroad;

2) Disputes of enterprises with foreign investments and of international associations and the organizations created in the territory of the Republic of Kazakhstan between themselves, disputes between their participants and their disputes with other legal entities of the Republic of Kazakhstan.

1. For the purpose of Item 1 of the present Article:

1) If the party has more than one commercial enterprise then only the one which has the greatest relation to the arbitration agreement is referred to the commercial enterprise;

2) If the party has no commercial enterprise then its permanent residence (location) is taken into consideration.

3. The present Law does not concern action of any other Law of the Republic of Kazakhstan due to which certain disputes cannot be referred to the arbitration or can be referred to the arbitration only according to the provisions that are otherwise stipulated versus the present Law.

The stated critical comments basically concern the Law on the Arbitration Courts. The Law on the international commercial arbitration does not contain anything of those restrictions which are included in the Law on the Arbitration Courts. Therefore investors have no reason to worry and can come to Kazakhstan without any concerns. They will receive both judicial and arbitration protection. All-in-all, enforcement of arbitral awards is also well managed. Kazakhstan has joined the New-York Convention on recognition and enforcement of foreign arbitral awards and the Kazakhstan courts observe this Convention.

Now there are more than 15 arbitration (arbitration) courts in Kazakhstan. The most known of them are the Arbitration Commission at the Union of the Trade-Industrial Chambers of the RK, the International Arbitration Court “IUS”, the International Arbitration Court of the RK. However, with acceptance of Laws “About the Arbitration Courts” and “About the International Commercial Arbitration” the number of arbitration (arbitration) courts, undoubtedly, will increase. And in this relation I can inform that the International Commercial Arbitration was set up and I was elected the chairman of it. The Kazakhstan International Arbitration considers disputes between residents of the RK and disputes with participation of non-residents of the RK.

Despite my critical mind I want to conclude saying that acceptance of Laws “About the Arbitration Courts” and “About the International Commercial Arbitration” is undoubtedly an important stage in development of the Arbitration Courts in Kazakhstan. They create certain legal base for activity of the Arbitration Courts; their practical work makes it possible to find merits and weak points of laws and will allow improving them to such degree that Arbitration
Courts in Kazakhstan will take a worthy place in the world system of the international commercial arbitration.

It is necessary to note also that the work on improvement of the specified laws and exclusion of their unsuccessful provisions is conducted now under the framework of the developed and approved Concept of improvement of the legislation about the arbitration and Arbitration Courts.

**The Law about foreign investments in Kazakhstan: modern tendencies**

The investment climate in this or that country has many components: the general attitude to foreign investments, political stability, the national treatment/regime, restrictions concerning the property, the rules regulating currency exchange, stability of the rate of exchange, the tax structure and etc.

We can say that by all these elements Kazakhstan until recently was referred to the countries with favorable investment climate. Attraction of foreign investments has been recognized one of the main conditions for economic development of Kazakhstan. Political stability and high level of the international and religious consent is characteristic for Kazakhstan; there is not a single exception/withdrawal from the national treatment/regime of foreign investments in the country, including in the sphere of privatization and energy. There are no restrictions in Kazakhstan concerning property (except for the right to housing); there is free exchange of KZT for any currency; KZT is one of the steadiest currencies in the CIS countries; there is a stable tax structure, in particular, the contractual definition of taxes for subsoil users and etc.

One of the important elements of the favorable investment climate is the investment legislation. In Kazakhstan, the developed investment legislation was formed, especially in the sphere of subsoil use.

Thanks to it an inflow of foreign investments to Kazakhstan has considerably increased. For the last 10 years the inflow of private capital to oil and gas and mining branches has totaled to 87.5 billion US dollars.

At present there is a tendency to change the investment policy. The concept of import replacement is being strongly promoted. One of its components is to balance the rights of foreign and national investors and to more actively involve the national capital in the RK economy.

Changes in the investment policy are related with strengthening of the state intervention in the private entrepreneurial activity. It also concerns the investment activity, including foreign.

The RK investment legislation has passed a long way of development. The first Law «About Foreign Investments in the Kazakh Soviet Socialist Republic» was adopted in December 7, 1990. It established a number of tax privileges for foreign investors and played a big role in attraction of investments to Kazakhstan. It incorporated quite naive things but it was quite admissible for the first years of independence. For example, in Article 25 it was written down: «Nationalization of property of the enterprises with foreign participation is not allowed in the Kazakh Soviet Socialist Republic».

The Law «About Foreign Investments» of December 27, 1994 was the Law of the second generation. The changes that were introduced in it in the years 1997, 1998 and 1999 took into account the changes in the country situation and the state policy in relation to investors.

The second Law which regulated till 2003 the investments relations was the RK Law of February 28, 1997 «About the State Support to Direct Investments».
Investment relations are also regulated by the Laws of January 27, 1996 «About Subsoils and Subsoil Use» (further, the Law “About Subsoils and Subsoil Use) and of June 26, 1995 «About Oil» (further, the Law “About Oil”).

It is also necessary to mention international treaties: bilateral - about encouragement and mutual support of investments, and multilateral and the most important of them is the Energy Charter Treaty.

In 2003, Kazakhstan has passed through the regular stage in development of the investment legislation - cancellation of the Law on Foreign Investments. In many countries there are no Laws on Foreign Investments. It means that foreign and national investors are in equal provision. The Law on Foreign Investments is of temporary nature. Generally, it has been adopted for differentiation of foreign investors in any way from local investors or to ensure exceptions from the national treatment/regime for them; or to ensure special privileges to foreign investors, to create favorable investment climate in the country.

Now, Kazakhstan faces a challenge to attract the national capital and to grant favorable conditions to national investors.

One more Law was Adopted «About Investments» on the basis of two Laws: «About Foreign Investments» and «About the State Support to Direct Investments». The Law was adopted in January 8, 2003.

The main weak side of the new Law is in that while aspiring to create single rules for the national and foreign investors, the developers of the Law have excluded all the norms concerning foreign investors. In the result of it many very important norms dropped out of the Law (for example, the treatment/regime applied to investments, guarantees of export of capital abroad, indemnification at force majeure circumstances and etc.).

In fact, the Law consists of two parts: the legal treatment/regime for investments (that part which was in the Law «About Foreign Investments») and the state support to investments (substantive provisions of the Law «About the State Support to Direct Investments»).

The Law on Foreign Investments of 1994 has fixed application both of the national treatment/regime and of the most-favored-nation treatment (MFN treatment) to foreign investments; and by the way only the most favorable of them was applied.

Unfortunately, this norm was not included in the new Law on Investments therefore it is necessary to apply other legislative acts. The national treatment for foreign persons is fixed in the RK Constitution of 1995 (Item 4 of Article 12), in the RK Civil Code (the General part) of December 27, 1994 (further CC of the RK) (Article 3, Item 7).

As for application of MFN treatment: it is fixed in many international treaties. In particular, the ECT fixes precisely the same norm that was included in the cancelled Law on Foreign Investments (Article 10 (7) of the Energy Charter Treaty). MFN is fixed in the Treaty on Trade Relations (for example, Article 1 of the Agreement on Trade Relations between the RK and the USA of May 19, 1992), in bilateral agreements about support and mutual protection of capital investments (for example, Article 3 (1) of the Treaty between the RK and FRG about support to and mutual protection of capital investments of January 29, 1993).

It is necessary to state that there is reduction of guarantees in comparison with the Law on Foreign Investments. And the reduction has concerned primarily the guarantees to foreign investors.

**Let’s consider some basic guarantees:**

...
Continuity/General Guarantee. A new norm was included in Law on Investments: «The Investor is provided with full and unconditional protection of the rights and interests ensured by the Constitution of the Republic of Kazakhstan, by the present Law and other normative-legal acts of the Republic, and also by the international treaties ratified by the Republic of Kazakhstan».

This phrase is, of course, just a declaration, but it can be regarded as the Republic’s obligation to protect the rights of investors.

Stability of the legislation (the grandfather provision). The Law on Foreign Investments included quite a clear norm (Article 6) that in case of worsening of situation of a foreign investor in the result of changes in the legislation then for 10 years (or before the expiration of the term of validity of the long-term contracts) the legislation that was in force at the moment of implementation of investments will be applied to foreign investments.

Here we mean the so-called “the grandfather provision”. We can take different variants of “the grandfather provision”: a wider one – the RK Law, narrower - the Russian Law on Foreign Investments. But in any case this norm must be extremely definitive and accurate.

In the first versions of the Law about Investments this guarantee was not ensured at all. In the adopted Law it was included but unfortunately there is no legal clearness in statement of this norm. It sounds as follows:

«The Republic of Kazakhstan guarantees stability of the contracts concluded between investors and the state bodies of the Republic of Kazakhstan except for cases when changes in the contracts are introduced by agreement of the parties» (Item 3 of Article 4 of the Law on Investments).

What do these guarantees mean and what do they include? Liabilities to reimburse losses? In what is the stability of the contract conditions expressed? Infringement of the contract by the state body – Is it stability? And changes in the legislation?

There is no answer to the main question: what happens to the contract if the legislation changes? Are old or new norms applied? If the investor’s situation gets worse or in any other cases?

In the second part of this norm you can find indirect answers to these questions:

«The present guarantees do not extend on:

1) Changes in the legislation of the Republic of Kazakhstan and (or) coming into force, and (or) changes of the international treaties of the Republic of Kazakhstan which will cause changes in the order and conditions of import, production, sale of excise goods.

2) Changes and additions introduced in the RK legislative acts to ensure the national security and ecological safety, public health safety and morals».

As soon as it is an exception of the rule a conclusion can be made that in other cases a change in the legislation does not influence stability of the terms and conditions of contracts. This norm can be interpreted as follows: The Republic of Kazakhstan guarantees to investors that conditions of the concluded contracts in case of a change in the legislation “maintain their force” … . In other words, the former legislation is applicable to the contracts’ terms and conditions. At that, there is no need even to prove worsening of the investor’s situation.

An essential difference of Article 6 of the Law on Foreign Investments is in that at present the guarantee is related to the contracts concluded with the state bodies. Hence, the guarantee
about stability is not applicable to the usual investors who invest in Kazakhstan and have not concluded any agreement with the state body.

**Guarantee to use the investor’s own currency assets.** Such a guarantee as the guarantee to use the investors’ own currency assets is not included in the new Law, in particular, free export of currency assets. However, the consequences of this exception do not look catastrophic. The matter is that under the Law on Foreign Investments currency transactions were conducted according to the currency legislation of the Republic of Kazakhstan. The currency legislation has not changed; it is liberal enough in Kazakhstan. Free export of the currency lawfully purchased or received in Kazakhstan is allowed, free conversion of KZT in foreign currency and back is ensured; the non-residents can make their settlements in any currency.

**Compensations and indemnifications for losses.** Such a guarantee as compensation and indemnification of losses to foreign investors is also excluded. But it is rather unbeneﬁcial for Kazakhstan than for investors. In Article 9 of the Law on Foreign Investments it was ﬁxed to apply the principle of national treatment for foreign persons to compensate damages incurred in the result of force-majeure circumstances (war, revolution and etc., and also due to acceptance of unlawful normative acts and decisions or execution of unlawful actions by ofﬁcials of the state bodies). In other words, compensation was stipulated for losses but only partial. With cancellation of this norm the general rule of the Civil Code comes into force: the caused losses must be compensated in full.

**Other guarantees. The new Law has preserved the following guarantees:**

- Guarantees for use of income (Article 5);
- Publicity of activity of the state bodies concerning investors (Article 6);
- Guarantees during implementation by the state bodies of control and supervision over the activity of investors (Article 7);
- Guarantees of the rights of investors during nationalization and requisition (Article 8).

Modern tendencies in the sphere of the rights of foreign investments are strengthening of intervention of the state in economic activities of investors and refusal of the guarantees ensured to investors.

The main blow on foreign investors was made in respect to two major and basic principles of the foreign investor’s legal status: stability of the concluded contract and the arbitration trial of disputes.

1) The new Tax Code was adopted on December 10, 2008. Item 2 of Article 308 of the Tax Code (further-TC) has stipulated the following provision:

The tax regime shall be preserved defined in PSAs concluded between the Government of the Republic of Kazakhstan or the Competent Body and a subsoil user till January 1, 2009 that has past through the mandatory tax examination, and also defined in the contracts on subsoil use approved by the President of the Republic of Kazakhstan for taxes and other mandatory payments to the budget in respect to which according to provisions of such agreement (contract) the stability of the tax regime is directly foreseen; it is in force exclusively concerning the parties to such agreement (contract) and also in respect to the proxies (operators) for the whole term of the agreements/contracts’ action, but it does not extend on the persons who are not the parties to such agreement (contract) or proxies (operators) and can be changed based on mutual agreement of the parties.

It is possible to make a conclusion based on the text of the Law that tax stability is applicable to PSAs concluded till January 1, 2009, and to the contracts approved by the RK President. It means that in respect to usual contracts the tax stability provision is not applied. Actually, this provision is stipulated in Item 1 of Article 308 of the TC:
«Calculation of tax liabilities on taxes and other mandatory payments to the budget on the activity carried out under the frame of the contract on subsoil use is made according to the Tax Laws of the Republic of Kazakhstan which are in force at the moment of occurrence of obligations on their payment except for the cases specified in Item 2 of the present Article».

Were not the PSA abolished by the new Tax Code? Please double-check. We can add to this that with adoption of the new Law on subsoils and subsoil use it is planned to cancel the Law on PSAs. PSAs shall be totally withdrawn from the RK Laws and shall be inapplicable in Kazakhstan.

This means that new contracts cannot include the provision about stability of contracts. However the norm about cancellation of stability extends on the earlier concluded contracts also because only PSAs and the contracts approved by the RK President are named in the Article.

This kind of worsening of the situation causes serious alarm of foreign investors for future of their investments in Kazakhstan. As they declare from the moment of adoption of the Law about Foreign Investments of 1994, Kazakhstan assured that contracts will be stable and that the state will observe conditions of the contracts. Such guarantees were ensured for the contracts and also according to the Law on Investments, the Law on Subsoils, the Law on Oil, the Law on PSAs and Tax Codes of 1995 and 2002. If such earlier given guarantees will be unilaterally cancelled by the state with acceptance of the new Tax Code then the current and future investors will be concerned and cautious about any other guarantees and promises of the Government provided by the contracts or the legislation irrespective of whether they are ensured in the oil and gas, mining or in any other sector of the country economy.

2). The reason of essential worsening of the foreign subsoil users’ situation is in the procedure established in the Draft of the Law about Subsoils and Subsoil Use to consider disputes only in the courts according to the RK legislative acts. Thus, the order for arbitration the possibility of establishment of which is provided by the acting Laws (about investments, about subsoils, about oil, about PSAs and others) with acceptance of the new Law becomes inapplicable.

3). Contract cancellation unilaterally and unilateral refusal from contract execution. The Law of October 24, 2007 introduced changes and additions to article 42-3 and a new Article 45-3 is included of the Law about Subsoils and Subsoil Use.

At that, in contradiction to the Civil Code where contract cancellation is made only through the judicial procedure while unilateral refusal from execution through the extrajudicial procedure, in the Law of October 24, 2007, both cancellation and unilateral refusal (as it arises from the text) is made without intervention of the court. But how to differentiate them is not clear now.

Contract cancellation is applied, in particular, if the subsoil user does not fulfill the conditions about the priority right of the state when the subsoil user sells the strategic property/target to the third parties, in case of serious infringement by the contractor of the obligations established in the contract or program of works and so on.

A unilateral refusal from execution of the contract conditions can be made even without giving any reasons for it. Article 45-3 of the Law on Subsoils and Subsoil Use fixes:

«1. At the initiative of the Government the Competent Body has the right to refuse unilaterally to execute the contract if the actions of the subsoil user at carrying out of operations on subsoil use in respect to the subsoil blocks (deposits) of strategic value lead to essential infringement of the economic interests of the Republic of Kazakhstan that creates a threat to the national security.

2. In case of a unilateral refusal from the contract execution the Competent Body must warn the subsoil user about it not later than two months in advance».
So simple! It means that the Competent Body declares about the essential infringement of the economic interests of the RK and warns an investor about two months in advance and then good-bye, Dear Investor!

So far this right has never been used by the RK. But the threat of a contract termination is widely applied as means for economic blackmails. A vivid example of this - negotiations with the consortium of foreign investors headed by AGIP about the oil field Kashagan conducted in the same 2007, for this purpose the Law of October 24, 2007 was adopted.

The last example - the Kazakhstan content. The Ministry of Energy and Mineral Resources of the RK.

MEMR has recently demanded from the subsoil users (that are operating on the basis of contracts providing payment of taxes and royalty and PSAs) to make changes to their contracts concerning obligations about the Kazakhstan content. In the official letter of MEMR it was specified that if subsoil users do not sign agreements to enter the required changes within a short period of time established by MEMR in its letter then MEMR has all rights to terminate the corresponding contracts unilaterally.

At present the Draft of the Law about the state property and the Law on subsoils and subsoil use strengthen the priority right of the state to acquisition of strategic assets that are sold by the proprietor. The foreign literature speaks about three kinds of nationalization: direct, indirect and indiscreet. The priority right can be referred to indirect nationalization because the investor sells its asset to the state against its will.

However this circumstance is carefully disguised. There is an assertion that there is no nationalization at all, the proprietor sells the asset to the state on its own will and in exchange receives compensation. But after all this is called nationalization because the proprietor is obliged compulsorily and by force to transfer the asset to the state.

It is necessary to declare fairly that the state owing to its sovereignty has the right to nationalization, including natural resources.

The Draft of the Law about the State Property includes one section about nationalization. We heard objections: we mustn't scare foreign investors by nationalization. But we think that investors, on the contrary, will feel less concerned if they will see clearly written and transparent procedure of nationalization with adoption of the special Law on Nationalization.

However, some big problems were encountered here. In the Draft of the Law about the State Property it is fixed that the Law does not extend on regulation of natural resources. The Draft of the Law on subsoils and subsoil use does not mention anything about nationalization. It is a paradox: the norm about nationalization covers all objects except for the right on subsoil use.

However, all these provisions about worsening of foreign investors' situation are stated from the foreign investor’s stand point. However, there is also the point of view of Kazakhstan. A question arises, why does the Government of Kazakhstan do it all? The answer is very simple: the economic situation and the situation of Kazakhstan have changed; it has become an economically independent and developed state. In these conditions the public, deputies of the Parliament and Kazakhstani businessmen pay more attention to the conditions of the oil contracts concluded in 90-s. Kazakhstan at that time was facing the conditions of the rigid economic crisis, foreign investments were (alongside with privatization) the only way to attract cash, to revitalize the economy, to put the collapsed enterprises on their feet. If we add to it inexperience of Kazakhstan in terms of contracts' concluding, corruption of the officials, the form of contracts in the form of PSAs, it will be clear why these contracts were concluded on unbefitting terms for Kazakhstan and at times simply extortionate conditions.
Now the situation has changed. Kazakhstan has got stronger, the national bourgeoisie developed and oligarchs grew up who wish to get their own piece of the oil cake.

Kazakhstan cannot openly reconsider the terms of the contracts but it strives to pursue the policy that induces and forces foreign investors to share part of their enormous profits received from pumping out from subsoils of Kazakhstan of our natural resources.

It’s an inevitable process, it will go on and foreign subsoil users will have to reconcile with this situation.

As a citizen and patriot of Kazakhstan I support this process. As the lawyer who professionally deals with these issues I can’t but see that this process is carried out by the legally incorrect and at times unlawful methods. This explains the criticism with which I have always acted in mass media and at scientific forums.

That is why I think it very important to include in the Draft of the Law about the state property the section about nationalization. It is necessary to extend the provision of this section on the subsoil use rights too.

The right to nationalization is a sovereign right of each state and the legislative stipulation of the detailed process on carrying out of nationalization will serve as some kind of a reminder to foreign investors about the final result to which they can possibly come in case they refuse to limit the size of their super profits.

The world economic crisis can bring essential changes in the policy of the RK Government in respect of subsoil users. However most likely it will concern investments in other spheres of the economy, not the sphere of subsoil use, especially in development of oil deposits. At any oil prices and at any restrictions for getting profits oil operations have always been and still are beneficial.

The developers of the Draft of the Law about Subsoils and Subsoil Use do not take into consideration a simple fact that Laws of the RK cannot contradict the international treaties.

By this time Kazakhstan has ratified about 40 bilateral agreements about encouragement and mutual protection of investments.

Now the Agreement on encouragement and mutual protection of investments in member states of the Eurasian Economic Community (Belarus, Kazakhstan, the Kirghiz Republic, the Russian Federation, Tajikistan and Uzbekistan) is in the Parliament for ratification.

Besides, Kazakhstan in December 1994 signed and was one of the first states that ratified the Energy Charter Treaty (further: ECT) which was signed by 50 states. In case of contradiction of the norms of the RK Laws to these treaties then these agreements will prevail.

In particular, in the Draft of the Law about subsoils it is planned to give up the international arbitration for settlement of disputes of the investor with the state. At that, it is not taken into account that according to ECT the investor has the right to apply to any of three arbitrations specified in article 26 of (ICSID, the Arbitration Institute of the Chamber of Commerce in Stockholm according to the rules of UNCITRAL). ECT as the international treaty is above our laws and that is why interdiction for arbitration in the sphere of energy (oil, coal, uranium and electric power) will be useless.

**Stabilization measures in oil and gas contracts.**
The root of the matter is to find out if there is the so-called “grandfather clause” or provision on stability of the legislation which was so accurately formulated in the famous Article 6 of the Law on Foreign Investments or if there is not.

Let’s analyze Item 3 of Article 4 of the Law on Investments which says:

“The Republic of Kazakhstan guarantees stability of conditions of the contracts concluded between investors and the state bodies of the Republic of Kazakhstan except for cases when changes in the contracts are made on the basis of the agreement of the parties.

The present guarantees do not cover:

- Changes in the legislation of the Republic of Kazakhstan and (or) coming in force and (or) changes of the international treaties of the Republic of Kazakhstan which change the order and conditions of import, production and sales of excise goods;

- Changes and additions made in the acts of the Republic of Kazakhstan to ensure the national and economic security, public health and morals”.

If we literally interpret part 2 of Item 3 of Article 4 of the Law on Investments it turns out that that the cases not foreseen by this part are covered by the guarantees. It means that in case of changes in the legislation the Republic of Kazakhstan guarantees stability of conditions of the contracts concluded between investors and the RK state bodies except for cases when changes are made in the contracts based on the mutual agreement of the parties. It means that if the oil contract is concluded for 20 years and in 5 years after its conclusion changes are made in the legislation that impact the contract terms and conditions then the guarantee about stability of the contracts terms and conditions shall be in force. Changes are not applicable; the former legislation is applied that was acting at the moment of the contract conclusion.

It is the same "grandfather clause" only in even more preferential regime for the investor because there is no need to prove deterioration of the investor’s situation in the result of changes in the contract.

1.2. Concept of the contract

Article 23 of the Law on Investments is devoted to stability of the contract. It fixes that "the privileges ensured on the basis of contracts concluded with the authorized body on investments before introduction in force of the present Law preserve their action till expiration of the term established in these contracts".

I have already come across the interpretation of this Article: in the sense that it fixes stability of contracts for all investors including subsoil users20. It is incorrect.

We must not forget that the section of the Law on investments devoted to the state support of investments has no relation to oil operations because it is applied in the priority kinds of the activity that need support (for example, agriculture, production infrastructure, building of Astana, processing industry: housing constructions; objects of social sphere and tourism). Oil exploration and production is not referred to such kinds of activity.

20 Such interpretation is given for example in «Research of access conditions to investments in exploration and production of oil and gas resources - the comparative analysis of the legislation of Azerbaijan, Kazakhstan, Russia, Turkmenistan and Uzbekistan» presented for discussion by the Group on investments of the Energy Charter Treaty 26 of May 28, 2003 (p. 16).
Nevertheless, we need to consider the notions "contract" and "agreement" as they are used in the Law.

The notion "contract" is defined in the Law as agreement to implement investments providing for investment preferences (sub Item 8 of Article 1).

At the same time Item 3 of Article 4 of the Law is about the agreements concluded between investors and the state bodies of the Republic of Kazakhstan.

It means that various notions are used in the Law: contract – about relations between the authorized body on investments and the investor on granting of preferences; and the agreement – about all relations of investors with the state bodies including not related to granting of preferences.

The notions of the state bodies also vary: in respect to granting of preferences – it is the authorized state body on investments (now - Committee on investments of the Ministry of Industry and Trade of the Republic of Kazakhstan); in respect to agreements related and not related to preferences – these are the state bodies with which investors conclude agreements (for example, agreements to carry out oil operations – the Ministry of Energy and Mineral Resources).

This is a very important provision. In particular, it results from the fact that provisions of the Law on investments concerning conclusion and termination of contracts and also the norms of the Law on stability of the contract are not applied to the contracts not connected with preferences, in particular, to contracts on subsoil use.

The notion "contract" by the Law on investments cannot be mixed with the notion of "contract" by Laws on oil and subsoils and subsoil use. For example, in Article 1 of the Law on Oil the contract is understood as agreement between the contractor and the Competent Body on carrying out of oil operations (similarly: subparagraph 6 of Article 1 of the Law on Subsoils and Subsoil Use).

Thus, the notion of the contract is different in respect to priority investments and to usual investments, including investments in oil sector. Therefore norms of Article 23 of the Law on Investments cannot be applicable to contracts on subsoil use.

Recently the Government of the RK tries to conduct the work on revision of some conditions of contracts on subsoil use. At that, it was guided by provisions of Article 6 of the Law on Foreign Investments which states: "In case of improvement of the foreign investor’s situation caused by changes in the legislation and (or) by coming into force and (or) change of conditions of the international treaties, some conditions of contracts between the foreign investor and the authorized state body that represents the Republic can be changed based on the mutual consent of the parties to achieve balance of economic interests".

A similar provision is fixed in Article 285 of the RK Code "About taxes and other mandatory payments to the budget" (Tax Code) of June 12, 2001 № 210-II: "In case of improvement of conditions of taxation of the subsoil user caused by changes in the tax Laws updating is to be made in the contracts on subsoil use of the terms and conditions on taxation for the purpose of restoration of economic interests of the Republic of Kazakhstan".

Due to the fact that in 2000 the size of some types of taxes were lowered (the value-added tax, the social tax) the Government declared that the balance of economic interests of the parties to the contracts on subsoil use has changed, the situation of foreign investors has improved and the Government suggested to subsoil users to enter the negotiations about revision of their contracts. It is necessary to tell this attempt was not successful. Negotiations are still being conducted but the Government does not undertake any special forceful actions.
1.3. The retroactive force of the Law due to adoption of the Law about Investments.

The action of the normative-legal act does not extend on the relations which have arisen before its coming in legal force (Article 37 of the RK Law of March 24, 1998 № 213-1 “About Normative-Legal Acts”). Hence, the Law on investments does not extend on the relations which have arisen before its coming into force. In particular, it is not applied to the contracts concluded before its coming into force. The Law on Foreign Investments and, in particular, Article 6 of this Law is applied to these contracts. Hence, the legislation that was in force at the moment of execution of the contract will be applied to these contracts before the expiration of the contract terms.

This is an important provision. It makes it possible to avoid the effect of the so-called “consequences of the law enforcement”. The new Law is applied to those rights and duties which will arise after enforcement of the Law (see, for example, the Decree of the Supreme Council of the RK of December 27, 1994 № 269 - XIII “About enforcement of the Civil Code of the RK (the General Part”) If Article 6 of the Law on Foreign Investments didn’t act then the Law on investments would not be applied to contractual relations that acted before enforcement of the Law on investments but it would be applied to the relations maintained by the contract.

The norms of our own Laws are applied to the contracts on subsoil use. In Article 71 of the Law on subsoils and subsoil use and in Article 57 of the Law on Oil it is fixed that “changes and additions in the legislation that worsen the situation of the subsoil user are not applied to the contracts issued and concluded before such changes and additions”.

1.4. Application of transitory provisions about licensing

Here Article 2 of the RK Law of August 11, 1999 is meant which cancelled licenses. However the action of the already issued licenses is still valid. In respect to suspension, calling back, termination and also recognition as void of licenses on subsoil use the norms of the Law on subsoils are applied in the edition which operated before introduction of changes.

In this respect a dispute started about specific situation when owing to the change in the structure of subsoil users changes were introduced to the contract. An issue arose about the need to introduce changes in the license. Two legal firms which advised the participants of the given contract on subsoil use have come to different conclusions. One firm considered that changes must be introduced in the license the other that there is not need in it.

The matter is in that according to Article 2 of the Law of August 11, 1999 the former legislation is applied to suspension, calling back, termination of licenses and also to recognition of them as void. The list is exclusive; there is nothing about the issue of changes in the license in it. Therefore it is possible to consider that changes in the license are not included in the list of issues solved according to the former legislation. More over it is practically impossible now to achieve introduction of changes in the license because the licensing body is the Government.

Therefore, according to the new legislation changes are introduced not in the license; they are made in the contract. And it will be enough.

Nevertheless, this interpretation of the Law is disputable enough. In the Draft of the Law about subsoils this issue is solved very simply: all the issues connected with licenses are transferred to the Competent Body. It is offered to include in the Law on subsoils Article 74-1 of the following content: functions of the Licensing Body (The RK Government) in respect to the issued and acting licenses on subsoil use are assigned to the Competent Body.

1.5. Law on the state regulation of production and turnover of oil derivatives
On April 7, 2003 the Law of the RK was adopted “About the state regulation on production and turnover of some kinds of oil derivatives”.

Initially the Draft of this Law was prepared by the Working Group under my supervision under the umbrella of the Ministry of Energy and Mineral resources but then the Draft was transferred to the Ministry of Finance. In the final end the state intervention was strengthened in the industrial activity of oil refiners. The Ministry of Finance was appointed as the Authorized Body. The Ministry of Energy is referred to other state bodies.

Licensing for production of oil derivatives is introduced. Establishment of the minimum volumes of production of oil derivatives is introduced on condition of approval by the Ministry of Energy and Mineral Resources of the volume of deliveries of crude oil and (or) gas condensate to the domestic market of Kazakhstan. Single electronic database on production and turnover of oil derivatives is introduced since January 1, 2004.

Sales of oil derivatives from gasoline stations and storage bases of oil derivatives will be permitted from 1.01.04 on condition of availability of the computerized system for record-keeping and account with transfer to the Authorized Body of the information about the volumes of acquisition and sales of oil derivatives. Other measures directed on strengthening of the state regulation of production and turnover of oil derivatives are also introduced.

The state regulation strengthening policy extended on production and turnover of oil too. Simultaneously with the main Law the RK Law was adopted "About introduction of changes and additions in some legislative acts of the Republic of Kazakhstan concerning the state regulation of production and turnover of some kinds of oil derivatives" on April 7, 2003. Among other changes, the changes to the Law on Oil were made too.

Article 1 has been complemented by the notion of the single database about volumes of production and (or) turnover of the oil formed on the basis of the information provided by the contractor in the order established by the Government of the Republic of Kazakhstan.

Competence of the RK Government is expanded. Article 5 is complemented by four new subparagraphs. According to new Items, the RK Government:

6-1) Regulates export of oil including by approval (change) of rates of excises, customs, protection, antidumping and compensation duties, quotas for oil export;

6-2) Establishes quantitative restrictions (quotas) on oil transportation by various types of transport;

6-3) Defines the procedure for introduction of the single database on production and turnover of oil;

6-4) Organizes the monitoring system for observation of safety requirements to technological process of production, storage and turnover of oil.

The competencies of the Competent Body were extended (Ministry of Energy and Mineral Resources) too. Now the ministry carries out the state regulation of oil production according to the project of development of the oil field and also of its turnover.

The additions made in Article 5 of the Law "About Oil" subparagraphs 6-1)-6-4) contradict the purposes and objectives of the Law on Oil and are not related to the subject of regulation of the given legislative act and in some cases are unsuccessful in terms of editing.
For example, issues of export and import concern the subject of regulation of the Law on licensing; the quota arrangement which is not preconditioned by any provisions breaks the rules of the Law on licensing and ECT according to which such restrictions are permitted only for reasons of the state security, implementation of the state monopoly, to ensure rule of law and for protection of environment, property, life and health of citizens.

The same can be said about quotas on transportation. This contradicts the principles of the free disposition of property, non-admission of ungrounded limitation of moving of goods, works and services (Item 3 of Article 2 of the CC, Item 3 of Article 13 of the Law "About protection and support to private business").

The same can be said about regulation of the turnover of oil.

Acceptance of the given changes in the Law on Oil creates conditions for intervention of the state bodies in the economic activities of subsoil users that are engaged in oil operations through determination of quaintly and price for selling of produced oil in the domestic and foreign markets, determination of routes for transportation of the extracted oil and types of transport by which oil transportation is to be carried out and also by regulation of the activity of subsoil users not connected with oil operations, on sales and (or) oil refining. The Law also creates a basis to lobby interests of some transport organizations which can load their transport capacities through establishment of restrictions by the state bodies to subsoil users on oil transportation by other types of transport (for example, restriction of transportation by pipelines and railways will lead to loading of the motor transport though definitely it will be unprofitable to subsoil users). The given departmental group interests of the state bodies to intervene in the economic activities of the contractors carrying out oil operations is caused by the good purpose to load with raw the oil refineries of Kazakhstan. But it directly contradicts Item 3 of Article 13 of the Law "About protection and support to private business" which forbids the state governing bodies to give instructions to private businessmen (to the persons involved in oil operations also) about delivery of the goods (performance of works, rendering of services) to certain consumers (including certain oil refineries).

Reflections about improvement of the legislation on subsoils and subsoil use. Is there any need in such Law?

After I have studied the Draft of the Law I felt disappointed. The only thing that the authors have done is they have simply joined two Laws in one and even this was done mechanically. There are not many new norms or they could be included as changes and additions as it was done in 1999. It is not absolutely clear what for the Law on Oil was amended. Kazakhstan is one of few oil-producing countries and for the RK oil revenues are the main source of budgetary receipts. It is the specificity of our country. When I headed the group of negotiators of Kazakhstan for the ECT (Brussels, 1992-2000) of 50 countries-participants to the ECT only 4 countries were oil-extracting states - Azerbaijan, Kazakhstan, Norway and Russia, and that is why during negotiations we always acted as one unit.

Hence, it is politically important for Kazakhstan as the oil-producing country to have a separate Law on Oil. Therefore, after gaining of its independence one of the first Laws developed was the Law on Oil. In those days we didn’t have much knowledge about the oil legislation. In 1991 I heard for the first time the words «production sharing». A small article of Konoplyannikov about oil contracts was copied in all possible ways and was read by workers of the oil industry up to holes in the copies. Under these conditions we wrote the Law on Oil. For two years 30 variants of the Draft were developed; we received comments from all oil companies, all international organizations, of all leading lawyers in the sphere of oil rights. More than 100 organizations submitted their comments about the Draft of the Law.

The Law on Oil has turned out quite a comprehensive document. Not without reason it was in force for 14 years and has never been seriously criticized.
Very serious bases are needed to liquidate the existing Law on Oil in the oil-producing country.

Observance of good title can be one of such bases. Really, the Law on Subsoils and the Law on Oil have a lot of repetitions, many oil problems are regulated by the Law on Subsoils instead of the Law on Oil. However, oil production is only one of various kinds of production of mineral resources. If the norms of the Law on Subsoils have general character then with inclusion in it of the section about oil as of one kind of production of minerals a question arises: what about other kinds of minerals? Of course, the main thing is to extract solid minerals therefore the main objective of the new Law if it combines the two new Laws is to develop the norms about solid minerals which have not been so far legislatively regulated. Once there was a Law on gold mining in our country but then it was cancelled.

Meanwhile there are a lot of specificities in extraction of solid minerals one of which is ore processing as one of elements of extraction of minerals. It is difficult to define where extraction comes to end and where processing begins. In a number of countries there are fine codes on mining devoted exclusively to extraction of solid minerals. There was a very good Law in the imperial Russia. If developers wrote a section about extraction of solid minerals all miners would be so grateful to them.

**Preservation of the out-of-date norms in the Draft of the Law**

Developers mechanically transfer to the Draft the norms of the Laws on Oil and Subsoils without thinking that many of them must be revisited or given up. It concerns, for example, the important Article 2 «Legislation on Subsoils and Subsoil Use».

Item 1 of Article 2 of the Draft fixes that the legislation on subsoils and subsoil use consists of the present Law and other normative-legal acts adopted according to the present Law. Item 2 defines that in case of contradictions between the present Law and other normative-legal acts of the RK that contain the norms regulating relations in the area of subsoil use the provisions of the present Law are applied.

Provisions of both items are senseless and contradict the Law on the normative-legal acts (NLA). If NLA of the lowest level is meant than the Law (the Decree of the President, the Governmental order and etc.) then they naturally must be applied in compliance with the Law and cannot contradict the Law. If the Laws are meant in other words the NLA of one level then other Laws are not necessarily applied according to the Law on subsoils. In case of contradictions between the Laws then according to the Law about NLA the norms of the Law are applicable that was adopted as the latest. The Law in force about subsoils was adopted in 1995 when there was no Law about NLA yet. Now inclusion of such norms in the Law is legally illiterate and inadmissible. Norms of Article 2 must be totally excluded from the Draft.

The same can be said about other norms of the Draft. For example, developers have allocated chapter 14 «Liability for infringement of requirements in the field of use and protection of subsoils and settlement of disputes». However two Articles of this chapter about responsibility are legally senseless and in some way contradict the Civil Code. They must be excluded. For the sake of one article about settlement of disputes there is no need to develop one more chapter. Besides, the procedure for arbitration to settle disputes was excluded from this Article which is the roughest infringement of the rights of subsoil users.

**The priority right of the Republic of Kazakhstan**

Trying to include in the Draft some new concepts which have appeared recently the developers make as I think theoretical errors. First of all it concerns the concept of the priority right of the Republic of Kazakhstan.
Article 12 of the Draft is called «The pre-emptive rights of the Republic of Kazakhstan in the sphere of subsoil use». Item 1 states of the pre-emptive rights before other persons for acquisition of the minerals, in Item 2 about the priority right to buy the subsoil rights or a share of participation (block of shares) in the legal entity that has the subsoil rights.

It is mixture of two terms: "pre-emptive right" and «the priority right». At that, pre-emptive rights of the RK are divided in the pre-emptive right and the priority right. Of such a confusion of concepts an attempt is made to link the priority right to the pre-emptive right for purchase of a share in the limited liability company (LLP).

This opinion is expressed in the literature. For instance, A. Bikebaev considers that this right is similar to the pre-emptive right for purchase of a share in the LLP and on this basis he assures that there is no compulsory withdrawal of the property as during sale of the pre-emptive right.

It seems to me that comparison with the pre-emptive right for purchase of a share is inappropriate here. The pre-emptive right for purchase follows from the legal nature of LLPs where in difference from the JSCs personal interests prevail and are very decisive therefore participants of LLP are not interested in occurrence among their participants of outsiders. The pre-emptive right of purchase is the subjective civil right that follows from the corporate civil-law relations.

The priority right of the state is not the subjective civil right. This right is fixed by the norms of the public Law and is out of the civil-law relations between participants. The state has fixed legislatively its right to interfere in the civil-law relations. And it concerns not only LLPs and JSCs but it concerns any contract on subsoil use. And, certainly, this is a compulsory alienation of property. The seller does not express its will for alienation (But A. Bikebaev tries to prove that there is the sellers will). The seller would like to sell a share in LLP or the right of subsoil use to whoever the seller wants to sell it but cannot make it because the state has «the right of the first night». It is better to ask the question what will happen if the owner of a share in LLP or of the subsoil rights refuses to sell a share or the right to the state. The answer is unequivocal: the state will in a compulsorily way take away this right (certainly it will pay the indemnification at a real market cost). But these principles are applied during the property nationalization.

The pre-emptive right of the RK before other persons for acquisition of minerals of the subsoil user is the same as the priority right fixed by the norms of the public Law and which does not have anything to do with the civil-law pre-emptive right. This right is realized against the will of the subsoil user and means a compulsory alienation of the property. (In the acting Law about oil the similar right is called “the pre-emptive right”). I understand that from the point of view on the legal nature of the priority right can be different stand points. In the legal literature everyone can express any point of view. But it is inadmissible to make a mixture of legal concepts in the Law by which subsoil users and the state will be guided. It is even more dangerous because in article 3 of the Draft it is fixed that the civil-law relations connected with the subsoil rights are regulated by the civil legislation if they are not regulated by the norms of the present Law.

The relations considered in Article 12 of the Draft are not settled well in the Draft and that can cause attempts to apply the norms of the civil legislation to relations which by their legal nature cannot be referred to the civil-law sphere.

We need to add that in the Draft the concept "of pre-emptive right" is applied without any explanations to the right of the contractor to conclude the contract on production without any tenders due to commercial discovery made and on the basis of the contract on production (the

---

Draft, article 33). In the acting Law about Subsoils this right is called as exclusive (Item 1-1 of Article 13).

**Can the state implement the priority right through the national company?**

In Article 13 of the Draft it is fixed that in case of intention of the person who possesses the subsoil rights and (or) the asset connected with the subsoil rights or to conduct alienation of the right of the subsoil user (its parts) and (or) the asset connected with it, the state through the national company or the authorized state body has the priority right to buy the rights of subsoil use (its parts) and (or) the object connected with it.

The priority right belongs to the state. Realization of the priority right is realization of the public functions of the state. On behalf of the state the Government implements the priority right. It is fixed in Article 193-1 of the CC. But why the national company or the JSC created by the Government and what does it do here? Acting of the national company on behalf of the state during implementation of public functions contradicts Item 3 of Article 3 of the RK Constitution which has fixed: «The Government of the Republic and other state bodies speak on behalf of the state within the framework of the powers delegated to them». The national company is not the state body. It is a JSC even with the absolute participation of the state. Anyway it is a private pattern of ownership and the joint-stock company cannot speak on behalf of the state during realization of public functions.

**Contracts on subsoil use.** Owing to the fact that the Draft is based as the acting Laws on the contractual (but not on the license-contralual as was till 1999) models of conducting of operations on subsoil use, the norms about contracts take if not the central at least the defining place in the Law.

Value of these norms in many respects is defined by how the legal nature of contracts on subsoil use is defined in them and on their place in the system of the civil-law contracts. Nobody directly dares to deny the fact that the contract on subsoil use is a civil-law contract.

Unfortunately, the Draft is construed on half-words, innuendo and confusion of the things that are clear in general and due to this it can’t solve any issues stated above.

First, what is the ratio of the contract on subsoil use and the civil-law contract? In the acting Laws (Item 1 of article 42 of the Law on Subsoils, Item 1 of article 25 of the Law on Oil) a clear and essentially important provision is fixed that «the order of conclusion, execution, changes or termination of the contract is made according to the present Law and the civil legislation».

And what do we have in the Draft? The same, only the words «and the civil legislation» are excluded.

Also what will follow from this? That the legislation is not applied? No, of course, not. After all there is a norm in the same Draft that «the civil-law relations connected with the subsoil rights are regulated by norms of the civil legislation if they are not regulated by norms of the present Law» (Article 3 of the Draft).

I repeat again that the contract on subsoil use cannot be anything other but as the civil-law contract. And what is not regulated in the Law can be regulated by the Civil Code (offers, acceptances, the principle of appropriate execution of contracts, indemnification of losses and so on).

Secondly, how is the legal nature of the contract defined in the Draft? It is not defined at all. There are four kinds of contracts - on exploration, on production, on building and/or operation of the underground constructions which are not supporting E&P and on the state geological study
of subsoils. And that’s it. Yes, one more thing- they have submitted for cancellation the Law «About agreements (contracts) on production sharing at carrying out of offshore oil operations».

In fact, there is nothing new. We have passed through all of this.

If we look at the history of the legislation on subsoils of independent Kazakhstan we shall have the following picture:

1) The RK Code «About subsoils and processing of mineral raw» as of May 30, 1992 simply speaks about «the contract on using subsoils for production of mineral resources, processing of mineral raw and in other purposes». It is clear that in those days we didn’t know much about different kinds of contracts on subsoil use;

2) Laws on Subsoils and on Oil of 1995-96 already included special articles about kinds of contracts and of their legal content (about production sharing, the service contract, on JV);

3) In 1999 all of them were cancelled, and contracts were differentiated in terms of kinds of operations on subsoil use (contracts on exploration, E&P, on joint E&P, on building of the underground constructions not in support to production)

4) However in 2004 (the Law on introduction of changes and additions in December 1, 2004) the legislator again comes back to the initial classification of contracts, that is according to their legal content and lists the contracts as follows: 1) about production sharing; 2) about concessions; 3) about contracting and free rendering of services (the service contract). Combined contracts are also allowed;

5) We are again coming back to what we refused in the past as senseless and hopeless ideas.

Cancellation of the Law on agreements on production does not cancel the agreement on production sharing, they preceded the Law and they will follow the Law. Cancellation of the recently adopted Law about PSA testifies only about rushes of the legislator to this or that side and of absence of clear and thoughtful strategy for development of the legislation on subsoils. Inefficiency and non-profitability of PSAs to our Republic was already clear in 2005. We several times wrote our legal opinions about the Draft of the Law about PSAs and we wrote about a need to accurately define the legal nature of PSAs from the point of view of the civil legislation.

Nevertheless the Law was adopted. And in three years it was submitted for cancellation and in general they don’t want even to mention about PSAs in the Laws. I strongly suspect that refusal from the distinct and logical classification of contracts on subsoil use is linked with this.

Whatever we call the contract, by its legal nature it can be and must be referred to the certain type of contracts. Designation in the contract name of its type (concession, PSAs and etc.) means that this or that legal treatment/regime will be applied to it: essential provisions of the contract, fundamental laws and duties of the parties and etc. Establishment for contracts on subsoil use of clear and understandable legislative regime/mode essentially facilitates for the subsoil user accession to foreign markets and in particular a possibility to attract loans (fund raising) and investments.

Given a large variety of criteria to divide contracts in these or other kinds two basic types of contracts on subsoil use are differentiated with their further subdivision in the following types:

1. Rent type to which we refer:

1) Concession contracts, and

2) Contracts on building and operation of various underground constructions;
2. Contract type to which we refer:

1) Works contract on geological study of subsoils;

2) Contract (agreement) on production sharing;

3) Service contracts.

The main distinctions must be made between concession contracts and PSAs.

The concession contract is the contract of rent type by which the subsoil user receives a site of subsoils for certain term with the right on production of mineral resources. The property right on the extracted oil belongs to the subsoil users. The state receives its part of the income basically in the form of a royalty and various bonuses.

PSA is the works contract by its type. By this type of the contract the contractor at its own risk carries out production of mineral resources on condition of compensation at the expense of the extracted oil of the incurred expenses (cost-oil). The extracted oil belongs on the property right basis to the state as to the proprietor of the subsoils. The contractor acquires the property right for the share of minerals received at sharing (profit-oil) and also for the minerals transferred to the user for reimbursement of the incurred costs.

In Kazakhstan after cancellation of PSAs practically all contracts on subsoil use act in the form of concession contracts.

Consideration of disputes. An essential cause of worsening of the subsoil users’ situation is related to introduction of the order for consideration of disputes only through the courts according to the RK legislative acts. Thus, with acceptance of the new Law an arbitration procedure (the possibility for establishment of which is provided in the acting Laws) becomes inapplicable for consideration of disputes.

I don’t want to make comments about this provision but I can tell that the given provision fits in the general policy of systematic limitations of the subsoil user rights of as the parties to the contract and to strengthening of the positions under these contracts of the state and the state bodies.
Appendix 1.

Reference literature


