

# Accessing the Boom: Oilfield Services in Kazakhstan

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With new fields at both the exploration and production stages, both onshore as well as offshore in the Caspian Sea, Kazakhstan is a potential market for nearly every category of oilfield services. Depending on the oilfield service provider's risk profile and its relations with its Kazakhstan customers and partners, there are a variety of choices as to how to approach this market from a legal standpoint. This article briefly reviews some of the more important legal aspects of accessing the oilfield services market in Kazakhstan.

## Accreditation

The first step is to establish a legal presence (accreditation) without which most oilfield service contracting opportunities are off limits.

Kazakhstan law provides three options for gaining accreditation, namely establishing: (i) a representative office (*predstavitel'stvo*), (ii) a branch (*filial*), or (iii) a Kazakhstan legal entity. In selecting the appropriate form of accreditation, a service provider should take into consideration such matters as existence of liability firewalls, possible management structure and equity holding arrangements, applicable currency control rules, the governing tax regime, and licensing and work permit issues.

A representative office ("RO") offers the most limited form of accreditation. Conceptually, the RO simply provides informational and liaison services for the parent. An RO may open bank accounts, lease office space and provide visa support, but it should not engage in commercial activities, such as rendering services with on-the-ground personnel. An RO offers no limitation of liability for its parent.

The second option for accreditation is a branch office ("Branch"). A Branch offers a more flexible form of accreditation, and can engage in most of the same activities as a legal entity described below. Like the RO, however, the Branch offers no limitation of liability for its parent.

A Kazakh legal entity (an "Entity") is the third option for accreditation in Kazakhstan. An Entity en-

joys full accreditation, and limits the liability of its parent. However, unlike an RO and a Branch, an Entity is treated as a resident for purposes of currency control regulation and, as such, has limited ability to transact in foreign currency.

## Legal Entities

The two forms of Entity that an oilfield services company might consider are a limited liability company ("LLP") or a joint stock company ("JSC").

LLPs in Kazakhstan are analogous to limited liability companies in the West, and are preferred as the most flexible and useful form for conducting business. The transferability of a participant's interest in an LLP is limited by certain statutory preemptive rights of the other participants, however, unlike a JSC, an LLP permits its participants to avoid the administrative burden involved in issuing shares and registering share distributions. The participants of an LLP also have more flexibility to create an appropriate management structure.

Kazakhstan JSCs are analogous to corporations and joint stock companies in many western jurisdictions. Recently, however, JSCs in Kazakhstan have become less popular because the newly adopted Joint Stock Company Law abolished the closed joint stock company structure. As a result, structures based on preemptive rights of various JSC shareholders may be difficult to enforce, while the transfer of large shareholdings is subject to various formalities and constraints (known as the "30% rule" in many other jurisdictions). In addition, JSCs are required to have burdensome management structures and are subject to numerous statutory limitations on so-called "major" and "interested-party" transactions.

## Licensing and Permits

The second step is to determine which licenses and permits might be required to provide a given type of oilfield services.

Service companies must attend to permit and licensing requirements prior to commencing their activity since penalties for operating without a license or permit can be severe. Unfortunately obtaining licenses and permits in Kazakhstan is usually document intensive and time consuming.

Kazakhstan has an extensive list of licensed activities and over 30 licensing bodies. For example, and in particular to the oilfield service industry, state licenses are required for planning and operation of upstream and downstream facilities, as well as drilling and construction, while certification of equipment is also mandatory.

### **Local Content and Procurement**

Kazakhstan actively promotes the employment of Kazakhstani citizens and, unless any of the exceptions apply (such as the position of the head of a Branch), Kazakhstan law requires employers to obtain work permits for foreign labor. There is a limited number of work permits that can be granted each year, which naturally creates difficulties in obtaining these permits.

The next step is to understand how oilfield services contracts are awarded in Kazakhstan.

A variety of Kazakhstan laws affect procurement requirements and procedures, including the Subsoil Law, the Petroleum Law and the State Procurement Law. In addition, the subsoil use contracts concluded with oil companies likewise contain various requirements and procedures, just as one might find in the internal policies of the subsoil users (oil companies) themselves. Tender requirements for service providers are also affected by which entity is carrying out the procurement, i.e. whether the operator is private, or whether the procurement falls under the category of government procurements (including by Government controlled companies and affiliates) and natural monopolies. In addition, there is an overlay of administrative oversight by Kazakhstan government agencies as well.

Aside from the obvious issues of price and quality, the Kazakhstan law-driven requirements also affect the determination of awards of service contracts in procurement tenders. Among the more important of these criteria are: special preferences to local suppliers and manufactures (i.e., local

content requirements), and applicable tender requirements.

In 2004, the Subsoil Law was amended to increase local content requirements, escalating the local content requirement from a prerequisite for operation to a condition for granting “E&P” (exploration and production) use rights at all. Indeed, tender proposals by oil companies seeking subsoil (E&P) rights must specify how and to what extent the applicant will use local goods and services. Furthermore, tenders must express an additional commitment to local content by including proposals for the development of high technologies and for new production processes and pipelines locally. The PSA (production sharing agreement) Law establishes specific criteria on local development for determining awards of PSAs: first priority is given to a participant’s proposal for high technology, second priority to a participant’s proposals for forming and using new processing and production operations and pipeline facilities and third priority is given to a participant’s proposals for the construction and joint use of infrastructure and other facilities.

Work programs must likewise include proposals on local content, addressing the use of domestic content requirements, escalating the local content suppliers and “additional requirement from a prerequisite for operation to a commitment” to local content as well. Subsoil use contracts may be terminated because of a contractor’s failure to comply with the work programs, including local content requirements.

### **Conclusion**

Although every oilfield service provider will have its own considerations in accessing the Kazakhstan market, some general recommendations proved to be useful. Kazakhstan joint ventures can maximize local content while still applying foreign skills and management. The key, of course, is balancing the foreign and Kazakhstan interests in such ventures, not only economically, but also in terms of the appropriate contributions of skills and management. Given the recent changes in the Subsoil Law and related procurement procedures, no oilfield service provider will succeed in this market without a demonstrable commitment for the preferential use of local employees and facilities. □