

# Kazakhstan's New PSA Law

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Kazakhstan's new PSA Law, signed on July 8 2005 by President Nazerbayev, is one of several interlocking statutes governing oil exploration and production in Kazakhstan, however, it is the only law devoted exclusively to Kazakhstan's offshore Caspian oil. It is also the only one custom-tailored to production-sharing agreements (PSAs). For these reasons, in regards to Caspian oil investments one might say that the 2005 PSA Law is the "first among equals."

**KazMunaiGaz (KMG) is the Future of the Caspian:** Under the 2005 PSA Law Kazakhstan's state oil and gas company, KazMunaiGaz, continues its accent towards becoming the national powerhouse of the oil and gas industry in Kazakhstan. Several provisions lock-in KMG's role and primacy for offshore development. This is perhaps a milder form of oil sector consolidation now underway in Putin's Russia, and is consistent with the global trend for oil-producing states. Although the vast majority of oil production arrangements in Kazakhstan are currently of the royalty-based type, with the new 2005 PSA Law Kazakhstan appears to be moving into the PSA zone occupied by most other oil-producing countries.

**Local Content Rules of the Game for Oil Field Service Companies:** Finally confident of its standing as a key producer, Kazakhstan is asserting greater determination to structurally integrate local content. This determination to more highly involve the local economy in the oil sector is enshrined in key provisions in the 2005 PSA Law, however the economic wisdom of that policy remains to be seen in practice. In general, operators under existing PSAs will find it hard to resist this trend, notwithstanding the possibility that the current procurement practices may be protected by grandfathering provisions.

**Operator Issues:** Operations in particular will need to accommodate a greater array of legal parameters for offshore development in Kazakhstan's portion of the Caspian, taking into account the 2005 PSA Laws. These laws often overlap national laws with respect to petroleum operations,

as well as over 38 treaties (arguably) covering the Caspian. The operator's parameters will also be affected by the PSA itself, and by any Joint Development Agreement (JDA) that may be applicable.

## 1. Applicable to Caspian Sector

The 2005 PSA Law establishes the legal and economic foundations for PSAs between the Republic of Kazakhstan and contractors with respect to petroleum operations in the Caspian Sea. In particular, the Law establishes rules for granting the right to conduct petroleum operations, entering, amending and terminating PSAs, and defines the main terms and conditions to be included in PSAs.

In the event of conflicts between the Law and other Kazakhstan legislation related to PSA's, the provisions of the Law prevail by virtue of Article 2.2. The exception from this rule is established by Article 2.3 under which international treaties prevail over the Law.

## 2. Terms of PSAs

PSAs may be entered into for the maximum period of 35 years for exploration and production works, 25 years for production works exclusively, and 45 years for deposits with unique reserves (Article 6.2). Provided the contractor has complied with its obligations under the old agreement, a new agreement can be signed however to extend the length of the PSA.

## 3. Role of State Oil Champion KazMunaiGaz

KMG will have a share in all new offshore blocks to be tendered by the Kazakhstan Government in accordance with Article 5.1 of the Law.

With respect to certain blocks in the Kazakhstan portion of the Caspian and Aral seas, the Government may provide those blocks without holding a tender. KMG, which will have at least 50% interest in those blocks, may upon agreement with the relevant authorities, identify the type of contract for joint production or joint exploration and production (Article 3).

#### 4. Stabilization Provisions

Under Article 21.2, the contractor pays taxes arising in connection with the PSA in accordance with the tax legislation of Kazakhstan in effect at the time the PSA was originally signed, as well as in accordance with the PSA itself.

The terms of the PSA are in force throughout its life and may only be amended by the agreement of the interested parties (Article 25.1). However, in the case of legislative changes that affect the commercial results of the contractor positively or negatively, the PSA must be amended to ensure that the contractor obtains the commercial results which it would have obtained had there been no changes in legislation (Article 25.2). The stabilization provision of the Law does not apply to cases when (i) international treaties are adopted or amended which change the terms and procedure of import, production and sale of excisable goods, and (ii) amendments to legislation are made to ensure national and environmental security, health and morals protection.

#### 5. Local Content

Under Article 13.3, the local content requirement is provided by the tender terms, which adds a new wrinkle to Kazakhstan. The full text of Article 13 stipulates:

*"The tender terms shall be developed by the competent authority with the participation of interested state bodies and the national company based on technical and economic calculations, and shall contain the main economic, technological, geological and other parameters relating to the production sharing agreement.*

*The tender terms shall address the following issues:*

*Kazakhstan content when conducting joint exploration and production or production of oil;*

*Mandatory delivery for processing of specific volumes of oil on the Kazakhstan territory;*

*Proposal for development of high technologies, new and processing productions, network and other pipelines, construction and joint use of infrastructure and other objects and other objects.*

*Proposals for development of high technologies, new and processing productions, network and other pipelines, construction and joint use of infrastructure and other objects and other objects shall be formed taking into account the needs of the Republic of Kazakhstan in the procedure established by Kazakhstan legislation on subsoil and subsoil use."*

How this provision will interact with Kazakhstan's other local content legislation is a matter now under consideration by oil field service companies as well as government officials.

#### 6. Conclusion

The 2005 PSA Law is a more confident statement of intention by Kazakhstan regarding oil exploration and production in the Caspian than previous legislation, a vision buoyed by the recent high oil prices. The development of the Caspian however, poses technological challenges and a difficult and fragile operating environment. Whether the 2005 PSA Law is capable of meeting these challenges, or is simply a bold but troublesome and over-optimistic proclamation will be seen in coming years as major projects enter their initial production phases.

### Annex 1: List of Relevant Laws and Regulations

**2005 PSA Law:** Parliamentary Law No. 68-III On Production Sharing Agreements (Contracts) Related To Petroleum Operations At Sea (adopted on July 8, 2005 and effective as of July 15, 2005).

**Subsoil Law:** Presidential Edict No. 2828 On Subsoil and Subsoil Usage (adopted, with the force of law, on January 27, 1996).

**Petroleum Law:** Presidential Edict No. 2350 On Petroleum (adopted, with the force of law, on June 28, 1995).

**Resolution No. 1333:** Government Resolution No. 1333 Concerning Some Issues Of Improving the Regulation Of Investment Activities Of Subsoil Users In The Republic Of Kazakhstan (adopted on September 12, 1997).

**Civil Code:** Parliamentary Law No. 268-XIII The Civil Code General Part (adopted on December 27, 1994).□