



## **What's new in subsoil use regulation: Subsoil and Subsoil Use Code**

Dear friends,

A new Kazakhstan Subsoil and Subsoil Use Code has been adopted and is due to enter into force on 29 June 2018<sup>1</sup>, replacing the current Subsoil and Subsoil Use Law.

The Code was drafted to execute steps 74 and 75 of the President's "100 Steps" National Plan and establishes new and progressive mechanisms for regulating subsoil use, which should go a long way towards changing the entire subsoil use industry<sup>2</sup>.

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<sup>1</sup> Code of the Republic of Kazakhstan № 125-VI dated 27 December 2017 (the "Code")

<sup>2</sup> According to materials from a Mazhilis Committee for the Ecology and Use of Natural Resources roundtable discussing the legal treatment of subsoil use within the framework of the Draft Kazakhstan Subsoil and Subsoil Use Code from 27 October 2017

The Code, among others, stipulates the following key amendments:

### Conceptual changes:

- a new simplified procedure for providing subsoil use rights, establishing and classifying mineral resources
- simplified subsoil use right procedures similar to the Australian “First Come, First Served” licensing model
- a transition to international reserve estimation procedures
- open access to geological data and its digitisation
- stricter eco-based subsoil accident response provisions
- other significant amendments

### General part: Basic principles and definitions

#### Principles of legal regulation:

Subsoil use relations are regulated based on:

the rational management of state subsoil reserves	subsoil use in return for a fee
ensuring ecological security during subsoil use	the presumption of subsoil user integrity
the accessibility of subsoil use information	the stability of subsoil use conditions

#### Principle of access to information

The principle of transparency in subsoil use operations has been replaced with the principle of access to subsoil use data, which means the state is obliged to guarantee unobstructed access to information, such as:



### **Principle of contract stability**

Kazakhstan guarantees the legal stability of subsoil use conditions.

The Code guarantees the stability of contracts concluded before the Code was adopted, except for when legislation is amended to ensure national and ecological security; regulate health, tax and customs issues and protect competition.

Code amendments and additions that worsen the results of a subsoil user's entrepreneurial operations ("Operations") do not extend to contracts concluded and licenses issued before the given amendments and additions entered into force.

### **Subsoil title**

The subsoil is owned by the state. Violations of state subsoil ownership are punishable by law. Transactions concluded in violation of state subsoil property will be made null and void.

## **Classification of subsoil use terms**

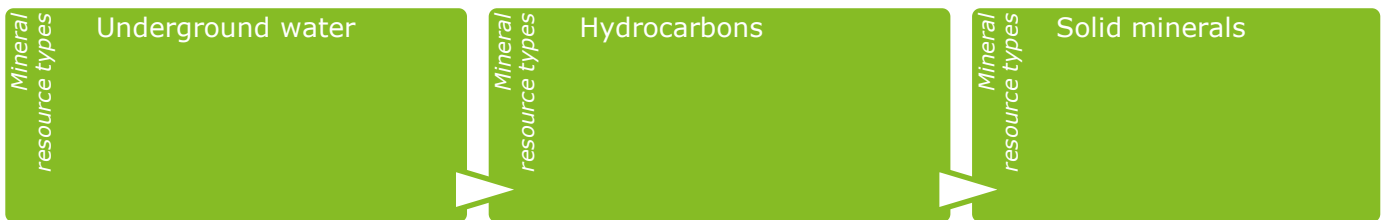
### **Subsoil and resources**

The Code establishes the following types of subsoil resources:



**Types of mineral resources**

The Code divides minerals into the following groups according to their economic value and the relevant subsoil use conditions:



- Oil, sour gas and natural bitumen are recognised as **hydrocarbons**.
- **Petroleum** includes crude oil, gas condensate and hydrocarbons generated after crude oil refining and processing slate coal, petroleum bitumen rock or resinous sand.
- **Crude oil** is any hydrocarbon, irrespective of its specific mass, recovered from the subsoil in liquid form under normal atmospheric conditions and pressure, including untreated natural, associated and slate gas, methane from coal seams and non-hydrocarbon gases in them.
- **Associate gas** is any polyblend of hydrocarbons and non-hydrocarbon gases contained in petroleum in a soluble state in a seam and removable from it once pressure is reduced.

- **Solid minerals** are identified as natural mineral formations, organic substances and their compounds in solid form in the subsoil or on the surface. Solid minerals are divided into ore and non-ore minerals.
- **Man-made mineral formations** are accumulations of waste from extraction, processing and power generation containing mineral components and (or) minerals.

## Man-made mineral formations

Ownership of man-made mineral formations arising from subsoil user activities at a specific subsoil section remains with the subsoil user for the period subsoil use rights are in force.

Subsoil users are entitled to own, use and dispose of man-made mineral formations generated by subsoil activities, and transfer them to third parties.

Man-made mineral formations remaining after subsoil use rights have terminated or after a landfill has been closed will be treated as solid minerals for the purpose of the Code.

## Deposit types

Deposits are divided into giant and non-giant fields and then by mineral type.

## Use of the subsoil: conceptual issues

### Subsoil use rights

Subsoil use rights are described as an opportunity protected by the Code to make use of a specific subsoil plot for business purposes over a specific period, in return for a fee.

A right to use the subsoil is a non-divisible proprietary right.

### Subsoil plot as the object of subsoil use rights

A subsoil plot is a geometrised subsoil area with fixed borders that has been granted to a subsoil user for use. At the same time, its borders are marked at ground level or on the bottom of a body of water (subsoil plot), as per a subsoil use contract or license, and conditionally to the centre of the Earth. In specific cases, a subsoil plot granted for use under a contract may be limited by depth.

### Holders of subsoil use rights

Subsoil use rights may be held by individuals and legal entities, unless otherwise stipulated by the Code. One subsoil use right may be held jointly by several entities simultaneously, with each entity's share specified.

In those cases directly described by the Code, only one entity may hold a specific subsoil right.

Except when directly stipulated by the Code, subsoil use rights (interest in the same) may transfer from one entity to another for reasons provided in civil law.

## Grounds for the origin and acquisition of subsoil use rights

Subsoil use rights are granted on the basis of:	Subsoil use rights are acquired when:
<ul style="list-style-type: none"><li>• a subsoil use license</li></ul>	<ul style="list-style-type: none"><li>• granted</li></ul>
<ul style="list-style-type: none"><li>• a subsoil use contract</li></ul>	<ul style="list-style-type: none"><li>• transferred (interests in the same) based on civil and legal transactions</li></ul>
	<ul style="list-style-type: none"><li>• transferred in accordance with legal succession procedures following corporate reorganisation, except for reformation or inheritance</li></ul>

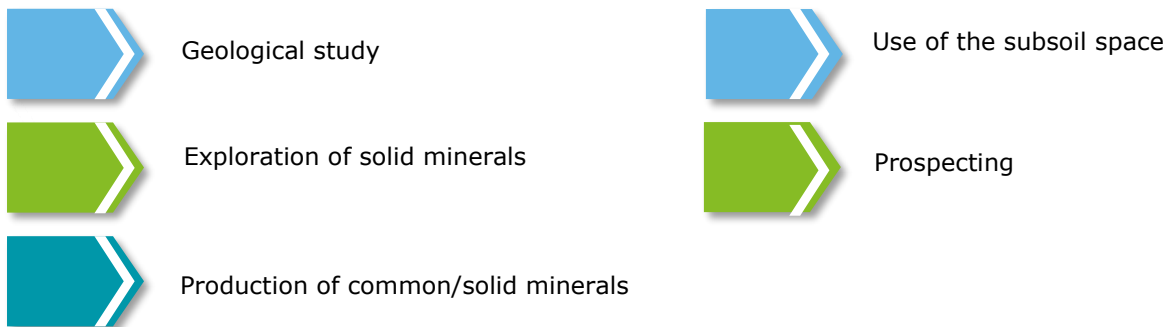
## Grounds for the termination of subsoil use rights

The Code allows subsoil use rights to be forfeited only for the reasons established by it and other Kazakhstan laws.

Subsoil use rights terminate when subsoil use licenses or contracts expire.

### Subsoil use licensing

Subsoil use rights are provided to perform the following licensed operations:



## General licensing issues

Subsoil use licenses are not regulated by permit and notification law and are granted for use at a specific subsoil plot.

An entity may be granted an unlimited number of subsoil use licenses, except in those cases established by the Code.

Licenses are granted according to applications from interested parties published on the licensee's website on the issue date.

The state authority granting subsoil use licenses keeps a register of licenses granted in accordance with the procedure established by the competent body.

If two or more entities hold a subsoil use right, the corresponding license should refer to each entity's percentage holding of the subsoil use right.

Subsoil use licenses are amended by the body that issued them, after which the amended license is published on the licensee's website.

A subsoil user may dispute a refusal to reissue a license in accordance with Kazakhstan law within 10 business days of receipt of the same.

## License invalidity and consequences

Under the Code, licenses may be recognised as invalid in court when:



Interested parties<sup>3</sup> or the prosecutor are entitled to apply to a court to have a license recognised as invalid, while the licensee is entitled to do so for the reasons stipulated in the Code. The statute of limitation for license invalidity disputes is three months from the day the plaintiff becomes aware or should have become aware of circumstances acting as the grounds for recognising a license as invalid.

## Subsoil use contractual treatment

### General characteristics of contractual treatment

Hydrocarbon exploration and production, and uranium production are regulated by contracts, which grant subsoil users access to one subsoil plot, except in certain cases established by the Special Part of the Code, when several subsoil plots may be added through amendments and additions.

Entities may enter into an unlimited number of subsoil use contracts, except in those cases established by the Code.

The competent body keeps a register of concluded contracts.

<sup>3</sup> An interested party is one whose rights to a license and legal interests have been violated or may be violated if a license is issued

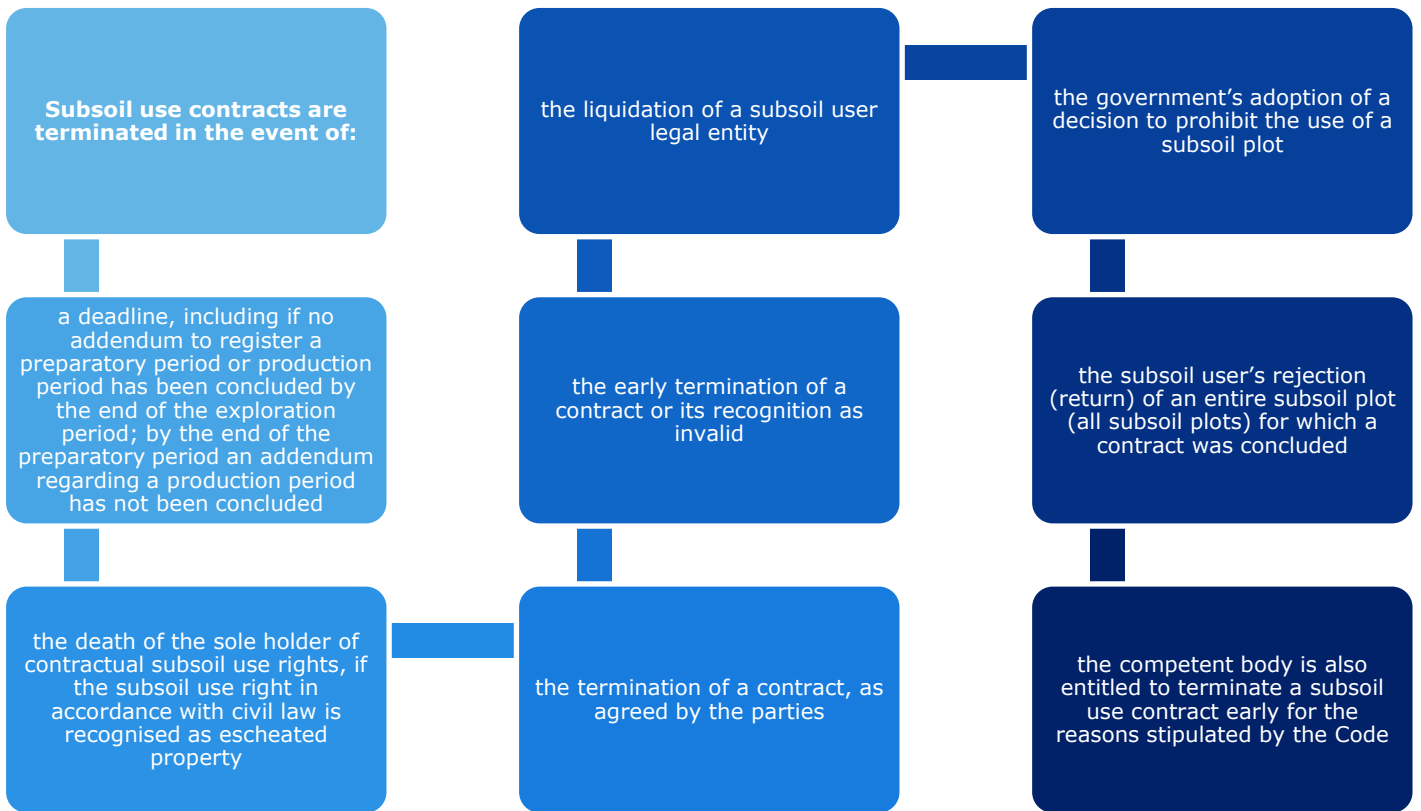
### Amendments and additions to subsoil use contracts



Subsoil user applications for addendums are processed within 20 business days. The competent body's refusal to conclude an addendum does not disqualify the subsoil user from reapplying.



### Subsoil use contract termination

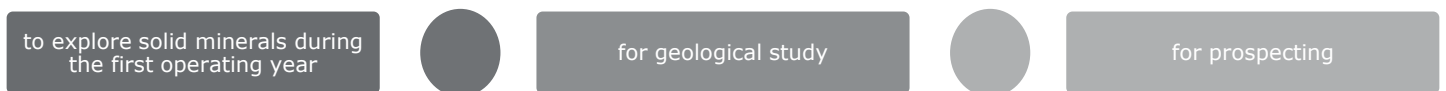


### State control of the transfer of subsoil use rights

#### Transfer of subsoil use rights

Subsoil use rights are transferred to other entities through civil and legal transactions or in other cases stipulated by Kazakhstan law.

Subsoil use rights (or interests in the same) in the following licenses may not be transferred:

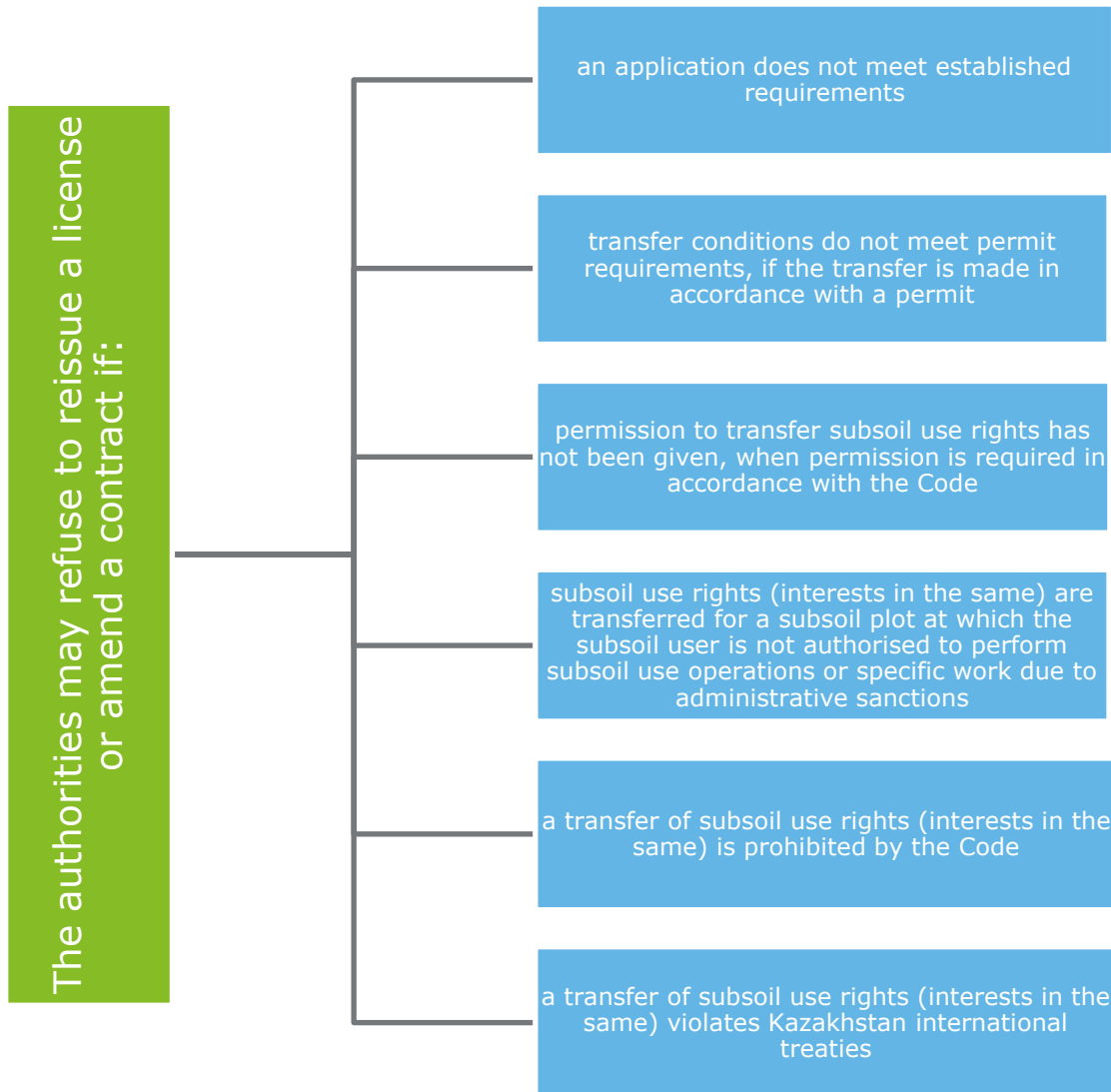


Subsoil use rights (interests in the same) are transferred by reissuing a license or, correspondingly, amending a subsoil use contract.

To reissue a subsoil use license or amend a subsoil use contract, the right holder should apply to the state body that issued the license or contract.

The state body will reissue or conclude an agreement amending a subsoil use contract or provide a justified reason for refusing to do so within seven business days of the receipt of an application.

### Grounds for a refusal to reissue a license or make amendments



The state body considering an application should notify the applicant of a refusal to reissue a license or amend a contract within two business days of the date of the refusal.

By law, the right holder may dispute a refusal within 10 business days of the publication of notification.

A refusal to reissue a license for the reasons, stipulated in the Code, will not disqualify the right holder from reapplying to reissue a license or amend a contract; a refusal to reissue a license and (or) amend a contract for the reasons, stipulated in the Code, will not disqualify the right holder from reapplying for permission to transfer subsoil use rights.

### Transfer of objects related to subsoil use rights

The following are recognised as a transfer of objects related to subsoil use rights:

disposal	Based on onerous\free civil and legal transactions, including in the event of the liquidation of a legal entity, and their classification as a charter capital contribution
sanction	Facilities related to subsoil use rights, including under pledge
creation of rights	To an object related to subsoil use rights, as a result of the acceptance of a new partner, co-owner or share placement, except for a change in the ratio of interest, units, shares or other equity instruments
legal succession	Transfer objects related to subsoil use, based on an act of transfer or separation balance sheet following the reorganisation of a legal entity
inheritance	Transfer subsoil use related objects in accordance with inheritance
public offering	Transfer subsoil use related objects on an organised securities market

### Notification

An entity purchasing objects related to subsoil use rights should notify the competent body of the same by the 1<sup>st</sup> of the month after the purchase date. This rule does not extend to an entity purchasing an object related to subsoil use rights on an organised securities market in Kazakhstan and (or) stock exchange operating in another country.

### Procedure for issuing permission to transfer subsoil use rights and (or) objects

Entities intending to acquire subsoil use rights (interests in the same) based on a subsoil use contract, solid minerals exploration license or production license, or objects related to subsoil use rights, should apply to the competent body for a permit.

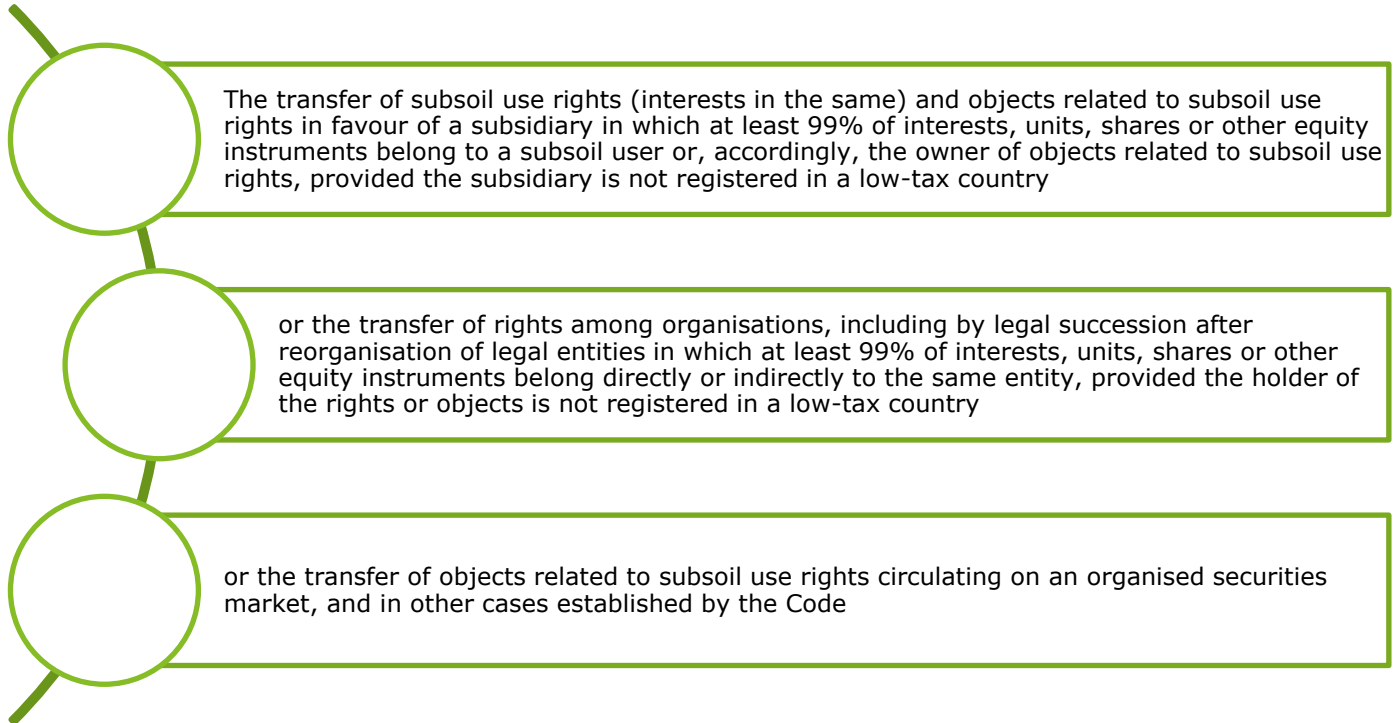
The competent body considers applications for a month from the application date (for strategic subsoil sites – three months).

The competent body will refuse to issue a permit in those cases established by the Code, including if a transfer of subsoil use rights (interests in the same), objects related to subsoil use rights lead to a concentration of subsoil use rights or a failure to observe national security; and if a transfer results in a concentration of rights within the framework of a subsoil use contract and for other reasons.

The Code recognises a concentration of subsoil use rights as one entity or group of entities from one country holding a total interest in subsoil use interests and (or) objects related to subsoil use rights that is capable of creating or has created a threat to the national security of Kazakhstan.

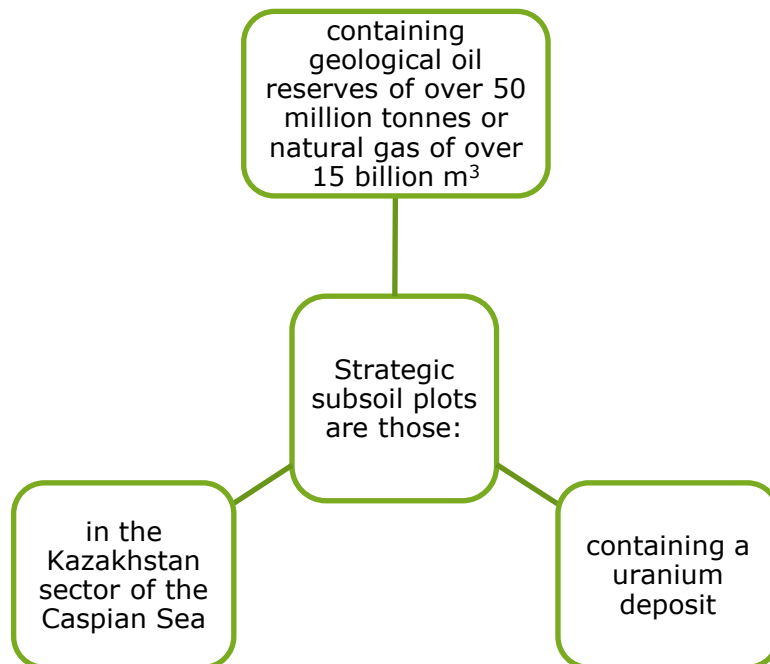
A concentration of rights in a subsoil use contract is the interest of one of the joint holders of subsoil use rights in a contract with Kazakhstan, enabling that participant to define subsoil use activities in accordance with the contract.

### Cases when permission to transfer subsoil use rights and related objects is not required



### State pre-emptive right

In subsoil use contracts, the state has a pre-emptive right over other entities and organisations, including those with pre-emptive rights based on Kazakhstan laws or treaties, to acquire subsoil use rights (interests in the same) to strategic subsoil plots and objects related to strategic subsoil plots for sale on an organised securities market.



The list of strategic subsoil plots is approved by the government.

The government's pre-emptive right does not apply if subsoil use rights (interests in the same) do not require the competent body's permission.

The competent body is responsible for determining the procedure for exercising pre-emptive rights<sup>4</sup>.

Pre-emptive rights are realised in the state's interests by the national holding company or a national company, by decision of the competent body.

The Code contains a detailed procedure for receiving an opinion from the national security authorities when transferring a subsoil use right.

### **Notification of a change in control**

Under the Code, subsoil users holding subsoil use rights (interests in the same) based on a subsoil use contract, exploration or production license for solid minerals, should notify the state body that granted the rights of any change in the persons and (or) organisations directly or indirectly controlling them within 30 days of the changes.

### **Encumbrance of subsoil use rights**

Subsoil rights may not be transferred to trustee management except to the national company.

A pledge of subsoil use rights (interest in the same) not prohibited by the Code is registered by the competent body in accordance with the rules established by the registration of movable property law.

## **Safe use of the subsoil**

### **Ecological and industrial safety**

Subsoil use operations, including the forecasting and planning of production and other facilities should meet ecological law requirements. The ecological condition of the subsoil is ensured by setting maximum permissible emissions and restricting or prohibiting specific activities or a part of them.

Subsoil operations, including planning production and other facilities, should meet industrial safety requirements.

In those cases established by the Code, subsoil use is prohibited without a positive industrial safety review and (or) a positive state ecological review opinion.

### **Emergency response measures**

A more detailed emergency response procedure have been provided. A subsoil user's emergency response obligations may be secured by a guarantee, bank deposit and (or) insurance.

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<sup>4</sup> Ministry of Investment and Development

## State subsoil reserves

### State subsoil reserves management programme

The Code contains a provision governing a programme to manage state subsoil reserves and ensure rational subsoil management (the "Programme").

The Programme contains the geographical coordinates of plots used in:

- the exploration or production of solid minerals and hydrocarbons based on an auction
- specially protected natural areas, land used for health, recreational, historical and cultural purposes
- the defence and national security of populated areas and water resources

### National database of mineral resources and the geological study of the subsoil

The national database of Kazakhstan mineral resources stores and provides geological data on the subsoil and subsoil use. The national operator collecting and processing geological data will be responsible for managing the national database.

State geological subsoil surveying findings will be openly available at least two months after they are accepted.

## Subsoil user reporting

Subsoil users, in those cases stipulated by the Code, should provide reporting on subsoil use operations, which may be one-off (on a specific issue) or periodical (over a specific period).

Subsoil users, at the written request of the competent body, should provide documentation for review that supports subsoil work done and expenses incurred, within 20 business days of the receipt of a request to do so.

Subsoil users exploring and producing mineral resources, except base construction materials and prospecting, should provide the competent body with reporting stipulated by the initiative for production industry transparency. Reporting forms and guidelines have been drafted and approved by the state body authorised to realise and develop the initiative in Kazakhstan.

## Review of subsoil user contractual conditions

Subsoil user compliance with contractual conditions, including production sharing agreements and (or) subsoil use licenses, are reviewed by the competent body.

Subsoil users' compliance with contractual (license) subsoil use obligations is monitored by the competent body (a state body that is a party to a contract and (or) that issued a subsoil use license) by analysing reports provided by subsoil users in accordance with the Code, and data received from other sources in accordance with Kazakhstan law.

The deadline for correcting violations should not exceed six months, for financial obligations – three months, and other contractual terms – one month from the receipt of written notification.

## Special part

### **Geological study**

Licenses allow the holder to perform geological survey, geophysical and reconnaissance work on underground water for three years.

Licenses may perform aerophysical surveying at subsoil plots provided to another entity without the latter's consent.

The holder of a geological research license is entitled to freely dispose of geological data obtained by it from geological surveying.

### **Hydrocarbon exploration and production**

Hydrocarbon exploration and production rights are provided based on an auction regulated by the Code, or if involving a national company – based on direct negotiations.

Exploration periods last between 6 and 12 years, while for offshore or complex plots - 9 and 18 years.

Production periods last at least 25 years, while at major and unique deposits – at least 45 years – with the possibility to extend for up to 25 years.

An integrated state subsoil use reporting system has been being introduced with respect to the production and processing of oil, sour gas, uranium and coal.<sup>5</sup>

The joint development of one or several deposits is allowed.

### **Uranium exploration and production**

Uranium exploration and production rights are given to the national uranium company based on direct talks.

The pilot production period lasts no more than four years and should generate a positive review opinion.

The maximum production period is 25 years.

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<sup>5</sup> Integrated state subsoil use management system – information system for collecting, storing, analysing and processing subsoil use data

## Exploration and production of solid minerals

### General provisions of solid mineral licenses

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Licenses to explore and produce solid minerals are granted according to the Australian "First Come First Served" principle

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Solid mineral production licenses are valid for up to 25 years and may be extended a number of times for a period that does not exceed the original validity period

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The opportunity for exclusive rights to receive a license to produce solid minerals at a subsoil site located within an exploration site, combined site and subsoil in the absence of a mineral resource deposit or insignificant resources

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Solid mineral exploration licenses are issued for six years with an option to extend for up to five years

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The payment of a subscription bonus and lease payment for the use of a land plot in accordance with tax law

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The opportunity to transform plots for the exploration or production of solid minerals by changing their borders

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Annual minimum expenses as set by the Code for the exploration of solid minerals are paid

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A requirement to notify within 30 calendar days from the date the persons with direct or indirect control over subsoil users change

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Control means the ownership of a 25% interest in an organisation, 25% or more of voting rights in senior management, 25% or more of distributable net income, the right to determine a resolution of another organisation according to an agreement or by law

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### Detention status

A subsoil use may be given "detention status", giving it the right to defer solid mineral production for up to 10 years.

### Treaty to process solid minerals

Treaties to process solid minerals include state obligations to provide concessions and licensee obligations to invest in the processing of solid minerals.

## Prospecting

The Code introduces the term "prospecting". Under a prospecting license, Kazakhstan nationals have the exclusive right to produce precious metals and stones manually or using low-power machinery.

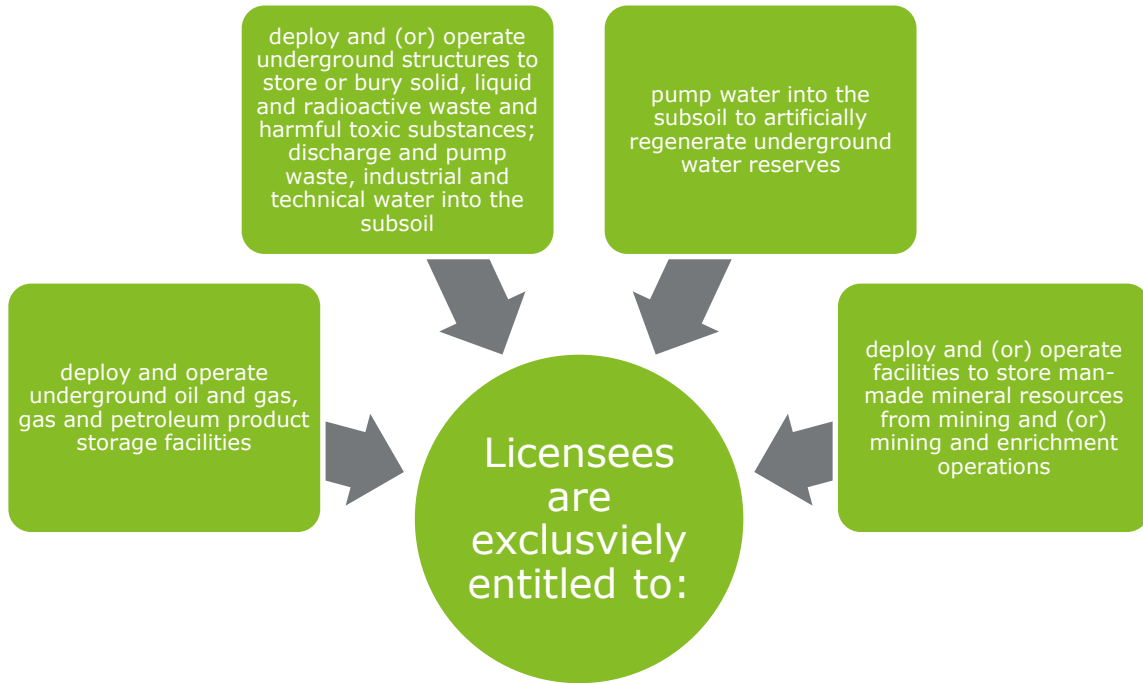
Exploration and production licenses are granted according to the "First Come First Served" principle.

Subsoil use rights under a prospecting license may not be transferred and (or) encumbered.



## Subsoil space use

Licenses are granted according to the "First Come First Served" principle.



## Procedure for the entry into force

### Transitional provisions

The new Code has a transitional nature, meaning a number of its provisions will be introduced in stages.

Ignoring specific exceptions, the Code covers subsoil use operations arising after it enters into force. Subsoil use licenses, permits and contracts issued and concluded before the Code entered into force and all related acts issued by the executive authorities will remain valid, except for those cases stipulated by the Code itself.

The Code obliges holders of subsoil use rights to produce underground water to obtain a special water use permit within three years of the date the Code enters into force.

The Code requires subsoil users to provide certain reports for subsoil use contracts concluded before the Code enters into force.

The state is entitled to unilaterally terminate subsoil use contracts concluded before the Code enters into force in those cases when national security is threatened.

Contracts for solid minerals (except for uranium) concluded before the Code enters into force may be amended.

Entities with solid mineral and hydrocarbon contracts concluded before the Code entered into force are entitled to transition to subsoil use regimes stipulated by the Code.

**Do you require legal assistance?**

<b>Why Deloitte?</b>	<b>Why now?</b>	<b>Who can benefit?</b>
<ul style="list-style-type: none"> <li>• A leading consultant in subsoil use sector, advising some of the major oil and gas players</li> <li>• We are recommended by such leading agencies as the Legal 500 and EMEA</li> <li>• Our experts have trained in Kazakhstan and overseas, and have worked in-house in the oil and gas sector</li> <li>• By working closely with our tax and financial experts and having access to the best practices of our European offices, the integrated approach to client interests puts us in a unique position as a consultant providing top quality, comprehensive support to our clients on any subsoil and ecological issue</li> </ul>	<ul style="list-style-type: none"> <li>• The New Code significantly changes the rules for doing business in the subsoil use sector</li> <li>• The system of state reporting and the licensing concept have changed significantly</li> <li>• The authority and rights of the authorised body for subsoil use have been expanded, which means they need to be studied closely to ensure effective interaction with the state authorities</li> <li>• The grounds for terminating subsoil use rights have been expanded and clarified, meaning compliance with a range of requirements needs to be taken into consideration</li> <li>• Code transition provisions assume that licenses for various types of subsoil use will be required for a certain period</li> </ul>	<p>Companies operating in the subsoil use sector, as well as service companies that provide services and work for subsoil users in order to:</p> <ul style="list-style-type: none"> <li>• guarantee full compliance with the new Code</li> <li>• mitigate the risk of sanctions and subsoil use right termination.</li> <li>• familiarise themselves and prepare staff for new subsoil use rules</li> <li>• defend their position before the state authorities in court</li> </ul>

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