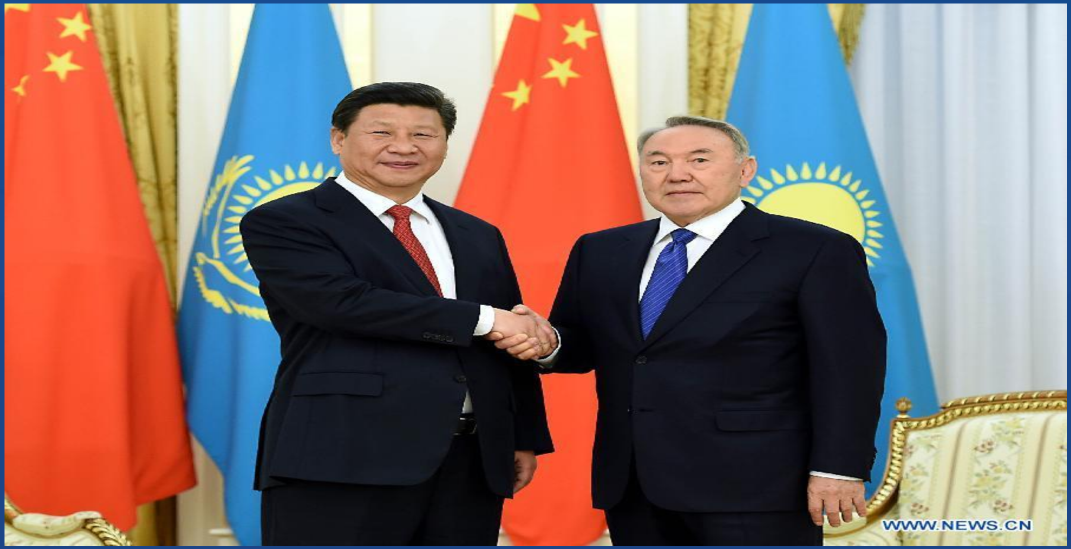
Right **Moves**
Effective **Solutions**

Kazakhstan: the "buckle" in One Belt One Road

Shaimerden Chikanayev (February, 2017)



A Silk Road for Oil & Gas

"Today, as I stand here and look back at that episode of history, I could almost hear the camel bells echoing in the mountains and see the wisp of smoke rising from the desert"

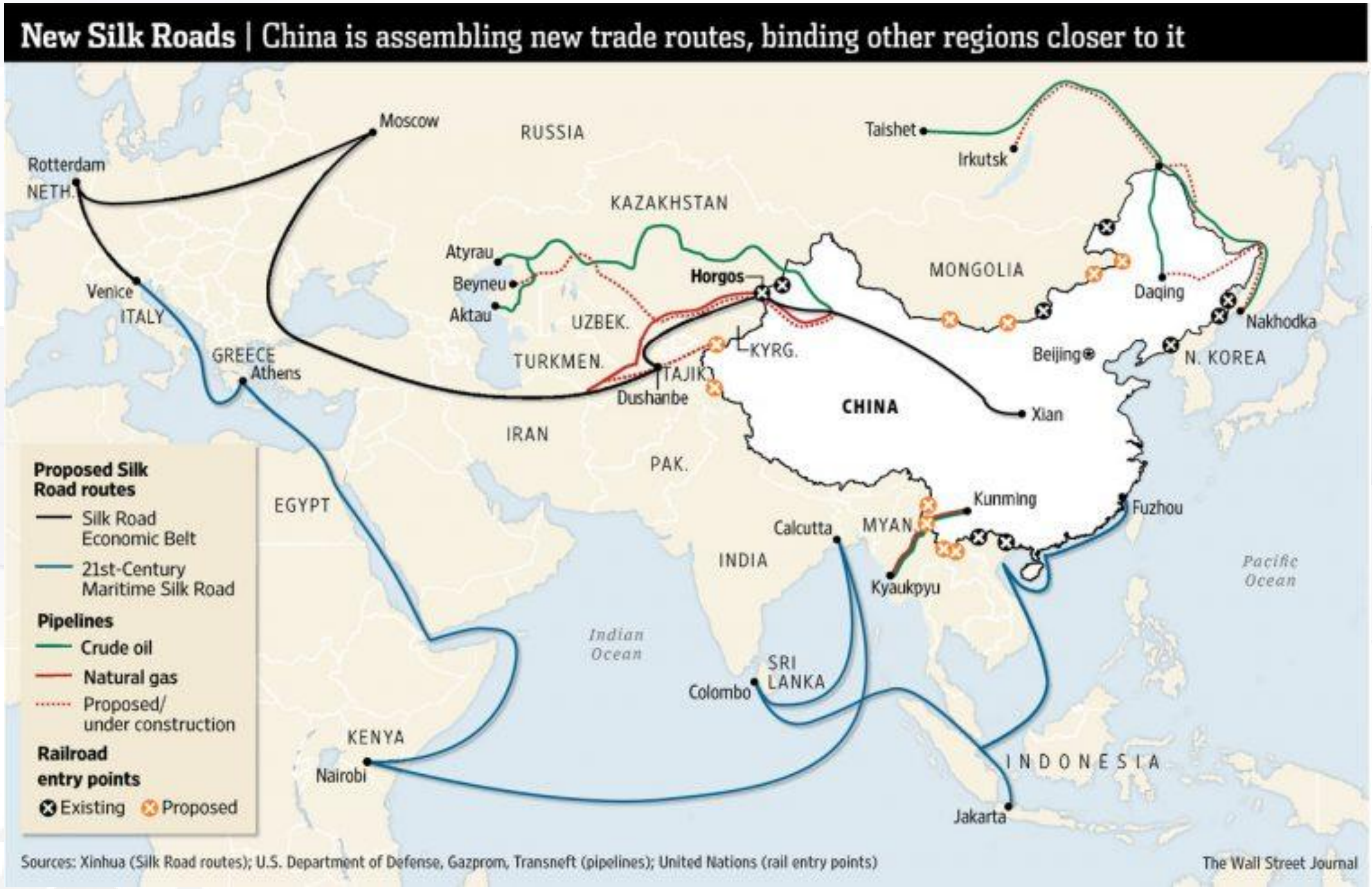
Speech by H.E. Xi Jinping, President of the People's Republic of China At Nazarbayev University. Astana, 7 September 2013

Why Kazakhstan is so important for energy security of China?

- Kazakhstan oil, gas, coal and uranium reserves are among the **ten biggest** in the world.
- Kazakhstan has a **strategic geographical location** to control oil and gas flows from Central Asia to East (China) and West (Russia, global market).
- Its **geographical proximity**, the **safety** of the transportation routes, and the **absence of any hostile rivals** in the region are the main advantages of Kazakh energy for China.
- As of end 2014 from 27 bln USD of Chinese FDIs in the CIS**, 23.6 bln. USD** have been made into Kazakhstan, whereas Russia received only 3.4 bln. USD, that is 7th time less.

Right Moves
Effective Solutions

Kazakhstan - an ideal junction between China and the West



Major Chinese energy investments in Kazakhstan - Oil

- The **Kazakhstan–China Oil Pipeline** is China's first direct oil import pipeline allowing oil import from Central Asia. It runs from Kazakhstan's Caspian shore to Xinjiang in China.
- The pipeline is owned by the China National Petroleum Corporation (CNPC) and the Kazakh oil company KazMunayGas. At the end of 2015, oil transportation through the Atassu-Alashankou pipeline in the direction of China constituted 11.8 million tons of oil.
- Unprecedented **international treaty** between Kazakhstan and PRC was signed on 8 December 2012, that created **specific legal framework** for this particular project, that prevails over any conflicting Kazakhstan legislation.

Major Chinese energy investments in Kazakhstan - Gas

- The 3,666km **Central Asia -China Gas Pipeline** predated the new Silk Road but forms the backbone of infrastructure connections between Turkmenistan and China.
- Chinese-built, it runs from the Turkmenistan/Uzbekistan border through Kazakhstan to Jingbian in China and cost $7.3bn.
- Unprecedented **international treaty** between Kazakhstan and PRC was signed on 18 August 2007, that created **specific legal framework** for this particular project, that prevails over any conflicting Kazakhstan legislation.

Major Chinese energy investments in Kazakhstan - Power

- The **Moinak Hydro Power Plant** is a hydro power plant on the Sharyn River south of Almaty city.
- It is funded by Kazakhstan Development Bank and China Development Bank and with an investment of USD 360 million, this project is the first significant infrastructure cooperation project between China and Kazakhstan **other than the development of resources**. EPC contractor – China International Water& Electric Corp. The plant is equipped with two 150MW Pelton turbines for an annual power output of 1,027GWh.
- **Unprecedented** (i.e. first ever) **corporate guarantee** from JSC NWF Samruk-Kazyna, a sovereign wealth fund which owns, either in whole or in part, most of important quasi-sovereign companies in Kazakhstan, including the state oil and gas company KazMunayGas, the state uranium company Kazatomprom and others.

Roadblocks and Pitfalls for Chinese FDIs: Lessons Learned

- A Chinese investor planning an energy project in Kazakhstan will face an **unsettled legal and regulatory environment** including uncertainty regarding the continuity of existing laws and enforceability of contracts. There are, among others, inherent risks that a project company will be unable to obtain or renew necessary licences/contracts and approvals to complete a project or operate it in the long term.
- Major Chinese energy FDIs made in Kazakhstan so far, therefore, can be distinguished by **specific approaches which the Chinese investors take** in terms of obtaining **additional legal protections** in one form or another, which otherwise are not provided for in the **general law** (e.g. specific covenants from the Kazakh Government under an international treaty, that prevail over any conflicting local legislation) OR **not available in practice** for a foreign investor **from another country** (e.g. corporate guarantee from JSC NWF "Samruk-Kazyna" or **amendment of the relevant legislation** at the request of the Chinese investor).

What is needed legally for successful Chinese FDIs in Kazakhstan? (Case Study)

- Just to make **Central Asia - China Gas Pipeline project** bankable, an unprecedented international treaty (the "**IGA**") between Kazakhstan and China has been signed and ratified by the Parliament of Kazakhstan, that created **specific legal framework** for this particular project, that **prevails** over any conflicting Kazakhstan legislation.
- An international treaty is, therefore, proved to be one of the possible ways for Chinese FDIs in energy sector to obtain specific covenants (as discussed below) from the Kazakh Government, that are not available under general Kazakh law.

Case Study – Issue 1
(Supply Risk: Ship-Or-Pay Obligations under Kazakh law *vs.* IGA)

1) For instance, under Kazakh law transportation of gas industry is so-called natural monopoly and, therefore, transportation of gas, generally, shall be construed as so-called “regulated services” and has to be contracted based on the model gas transportation agreement (Model GTA), which does not provide for the transportation of gas on a "ship or pay“ (SoP) basis and the terms of the Model GTA cannot be changed (i.e. it is, generally, impossible to add any new provision, including SoP obligation, in a gas transportation agreement (GTA) based on the Model GTA). Moreover, **Kazakh law does not expressly recognize the concept of a “SoP obligation”** and, therefore, even if such SoP arrangement is provided in a Kazakh law governed GTA, **its enforceability would be questionable**.
2) As the key risk to a pipeline financing is that there are insufficient supplies to take up the pipeline’s capacity, the **SoP obligations in the GTA are essential** from the international lenders’ perspective (e.g. CDB, ICBC etc).
3) Just because of the **IGA, that overrides conflicting provisions** of the Natural Monopoly Law, therefore, the SoP obligations could be introduced in the Central Asia - China Gas Pipeline project, to make it bankable.

Case Study – Issue 2

(Lenders' security over the proceeds of the GTAs)

- International lenders normally expect to be able to take security over the proceeds of the GTAs for the pipeline project to be bankable.
- The Natural Monopoly Law says that a Kazakh natural monopoly company cannot pledge or assign their rights related to "regulated services.
- Transportation of gas for domestic consumption in Kazakhstan is so-called "regulated service" and, therefore, receivables under a GTA in respect of transportation of gas for domestic consumption gas still cannot be pledged or assigned as a security.
- Just because of the Central-Asia- China Gas Pipeline project, however, the Natural Monopoly Law have been amended in 2015 to exclude transportation of gas for **export and transit** purposes from the list of regulated services. It is possible, therefore, now to pledge receivables under export and transit GTAs.

Case Study – Issue 3

(Tariffs for transportation of gas: under Kazakh law *vs.* IGA)

- As discussed above, gas/oil transportation agreements in international project finance are typically structured on an availability/ship-or-pay basis, such that the project company is being paid a capacity fee if the pipeline is operational.
- International lenders, therefore, normally expect a revenue stream (i.e. capacity fee) generated by the pipeline owner from transporting the gas/oil to be sufficient to cover interest and principal on the project finance loan and other fixed costs.
- The Natural Monopoly Law says, that a Kazakh natural monopoly company's tariffs for regulated services have to be within tariff limits set by the maximum tariffs approved by the relevant state agency.
- Transportation of gas for domestic consumption in Kazakhstan is so-called "regulated service" and, therefore, tariffs under a GTA in respect of transportation of gas for domestic consumption gas still cannot be freely agreed by the gas transportation company and its consumers at their own discretion, even if the maximum tariffs approved by the state agency are not sufficient to cover interest and principal on the attracted project finance loan.
- **Just because of the IGA**, however, **tariffs in the Central Asia - China Gas Pipeline** project, are, generally, **exempted from the tariff regulation** of the Natural Monopoly Law.
- Just because of the Central Asia – China Gas Pipeline project legislative amendments have been initiated, so that **export and transit** of gas are **not regulated services** from 2015 and, therefore, they are **not subject to any tariff limitations** of the natural monopoly legislation any more.

Kazakhstan’s Multi-Vector Energy Policy : implications for the OBOR

- China already controls up to **30%** of oil industry of Kazakhstan.
- Since 2000 year Kazakhstan has moved from being fully dependent on Russia for oil & gas export toward more diversification, but now there are concerns, that Kazakhstan became dangerously dependent from China.
- Kazakhstan **has legal tools handy to prevent further expansion of Chinese control** in energy sector, if needed, that may be an obstacle for some of the energy projects initiated by China under the OBOR initiative:
  - ✓ State’s priority right to purchase/permission to transfer so-called “strategic assets”.
  - ✓ State’s priority right to purchase/permission to transfer in the sphere of subsoil use.
  - ✓ State’s priority right to an interest of no less than 51% in any new trunk pipeline projects.


"SAVE ME FROM MY FRIENDS!"

„Nurly Zhol" and Privatisation programs: synergy with the OBOR

- Kazakhstan has high ambitions in OBOR as it is geographically an ideal junction between China and the West and its interest in OBOR is indisputable – with Kazakh government already being involved in Nurly Zhol (Path of Light), a $9 billion **domestic economic stimulus plan** to develop and modernize roads, railways, etc
- Kazakhstan plans to sell **1,008 state-owned objects and facilities** to private owners within the privatization program in **2014-2020**.The Privatisation List of the companies to be privatised/transferred to the competitive environment includes, *inter alia:*
  1) **Oil and gas**: JSC "National Company "KazMunayGas" (IPO), "PetroKazakhstan Oil Products" LLP, "Atyrau Oil Refinery" LLP, JSC "KazTransGaz Almaty", "BeineuMunayGas" LLP;
  2) **Energy**: JSC "National Company "Kazatomprom" (IPO), JSC "Samruk-Energy" (IPO), JSC "Almaty Electric Power Plants", JSC "Alatau Jaryk Kompaniyasy", "AlmatyEnergoSbyt" LLP etc.

China's New Silk Road: focus on Kazakhstan

- Kazakhstan's climbed the World Bank's Ease of Doing Business index and is now ranked **35th**. and it is one of the **20 most attractive** countries in the world for investors.
- With the intention of promoting industrialization and diversification of Kazakhstan's economy, the law provides a **system of benefits and preferences (e.g. tax and customs duties exemptions)** which supports direct investments in certain areas, that include, among others, manufacture of refined petroleum products.
- In 2015 the PPP Law has also been adopted and **public-private partnerships** can now be used to implement projects under the PPP Law framework in any sector of the economy.
- **Green tariffs** and **guaranteed offtake** have been introduced to facilitate development of the renewable energy projects.
- Chinese energy FDIs under the OBIOR initiative, therefore, may and shall be implemented under the general legislation framework, that is already **very investor friendly**.

ANY QUESTIONS?

Shaimerden Chikanayev
Partner, GRATA Law Firm
Almaty, Kazakhstan
E-mail: schikanayev@gratanet.com
Mobile: +77017878020

Contact information

Kazakhstan

Almaty Office:
104, M. Ospanov Street, Almaty
050020, Republic of Kazakhstan
Phone: +7 (727) 2445-777
Fax: +7 (727) 2445-776
info@gratanet.com

Astana Office:
Office VP 27, 12/1, D.Kunayev Street, Astana
010000, Republic of Kazakhstan
Phone: +7 (7172) 689-908; +7 (7172) 689-928
Fax: +7 (7172) 689-928
astana@gratanet.com

Uzbekistan
51-A, S. Azimov Street
100000, Tashkent, Uzbekistan

T.: +9 (9871) 233-2623
F.: +9 (9871) 233-0924
tashkent@gratanet.com

Azerbaijan
13A, Koroglu Rahimov Street, ABU Park, Baku
AZ1072, Azerbaijan
Phone: +994 (12) 465-43-65; +994 (50) 516-38-80
Fax: +994 (12) 465-43-66
baku@gratanet.com

Kyrgyzstan
Office 2, 33/1, Razzakova Street, Bishkek
720040, Kyrgyzstan
Phone: +996 312-31-40-50; +996 775-97-35-83
Fax: +996 312-31-40-50
bishkek@gratanet.com

Tajikistan
4a, Ayni Str., Business Center, Office 502, 5th floor
Dushanbe 734012 Republic Tajikistan
Phone: + 992 (44) 620-41-63
Fax: +7 (727) 2445-776
dushanbe@gratanet.com

Mongolia
Phone: +7 (727) 2445-777; +7 (701) 787-80-20
Fax: +7 (727) 2445-776
ulaanbaatar@gratanet.com

Russia
Office 3044, 21/5, Kuznetsky Most Street
Moscow, 107996, Russia
Phone: +7 (495) 660-11-84
Fax.: +7 (495) 660-11-64
moscow@gratanet.com

Georgia
Phone: +7 (727) 2445-777; +7 (701) 725-12-69
Fax: +7 (727) 2445-776
tbilisi@gratanet.com