

New opportunities for investors: obtaining subsoil use right for hydrocarbons through auction

I. Introduction

If an investor wishes to commence oil and gas activity (exploration/production) in the Republic of Kazakhstan (“**RoK**”), it shall obtain a relevant subsoil use right (“**SUR**”), which is formalized by execution of a relevant subsoil use contract (“**SUC**”).

An investor may obtain SUR either directly (SUR acquisition from an acting subsoil user or from the state) or indirectly (by buying shares in a subsoil user or its direct or indirect parent company (so-called “objects linked to SUR” (“**Objects**”). Besides, a SUR may be obtained in cooperation with the national company, which has the right to obtain SUR from the state through direct negotiations (all other persons may obtain SUR from the state only at a relevant auction (“**Auction**”). At last, a SUR or Objects may be obtained through a public sale initiated by a pledgeholder or bankruptcy manager during enforcement process.

The RoK Code on Subsoil and Subsoil Use dated 27 December 2017 (“**Code**”) which came into force on 29 June 2018 in general did not introduce substantial changes to any of the above options, except for the option when a SUR is acquired through an Auction.

This article outlines how an interested person may obtain SUR from the state through an Auction.

II. Auction procedure

2.1. Territory

An Auction may be held only with regard to subsoil plots included into the relevant map of territories available for hydrocarbons subsoil use operations set out in Enclosure 3 to the State Subsoil Fund Management Program (“**Program**”). The latest version of the map may be viewed at <https://gis.geology.gov.kz/geo> (please see the map valid as of 25 June 2019 in Annex hereto).

If the territory of interest is not included into the Program, any person may address the RoK Ministry of Industry and Infrastructural Development (“**MIID**”) with the request to include a subsoil plot into the Program. The application shall contain information on coordinates of corner points, type of operation (*i.e.* exploration or production), type of mineral (e.g. hydrocarbons), as well as the location of the subsoil plot. The MIID requests the opinion of the Ministry of Energy (“**MoE**”) and after the consideration either adopts amendments to the Program (with inclusion of new land plots) or refuses to do so with references to grounds for refusal.

2.2. Which person may apply for an Auction?

A person, interested in acquisition of a SUR (“**Applicant**”), shall meet the following criteria (“**Criteria**”):

- (a) not being at the stage of liquidation, corporate restructuring or bankruptcy;
- (b) absence of outstanding debt on tax payment and other obligatory payments to the budget;
- (c) availability of financial assets, sufficient for execution of minimal requirements to volumes and types of work on the subsoil site during the exploration period.

If an Applicant applies for an offshore SUR, in addition to the above Criteria, it shall have a positive professional practice in conducting subsoil use operations at the RoK continental shelf or inland waters, or at sea outside the RoK territory (“**Offshore Practice**”). The Offshore Practice is also deemed complied with if the Applicant’s shareholder has the relevant professional practice and owns not less than 25% of shares in the Applicant.

Please note that under Article 154.6 of the Code, if SUR is granted for a land plot at sea, “National Company “KazMunaiGas” JSC shall have not less than 50% of shares in such SUR.

2.3. Preliminary stage

If the Applicant meets the Criteria, it may file with the MoE either:

- (i) the application for holding an Auction, if the Auction has not been yet announced (“**Application (Initiation)**”); or
- (ii) the application for participation in the announced Auction (“**Application (Participation)**”).

Both applications are made under the same format set out in Article 96 of the Code.

Application (Initiation)	Application (Participation)
Consideration by the MoE (from the date of its receipt)	
<p>Twenty (20) business days.</p> <p>Upon consideration the MoE either publishes the Announcement (as defined in Section 2.4 below) or rejects the application.</p>	<p>Ten (10) business days.</p> <p>Upon consideration the MoE either admits the application and allows the Applicant to participate in the Auction or rejects the application.</p>
<p>Auction is organized by the MoE and is conducted by the commission for the holding of an Auction (“Commission”) according to the Code.</p>	
Grounds for rejection by the MoE	
<ol style="list-style-type: none"> 1) the application was filed later than Filing Term (as defined in Section 2.4 below); 2) the application does not comply with the requirements of the Code (<i>i.e.</i> Article 96 of the Code); 3) the Applicant fails to comply with the requirements of the Code (<i>i.e.</i> comply with Criteria); 4) within three (3) years before filing of the Application, the MoE/MIID prematurely terminated the SUC concluded with the Applicant or with the person which either directly/indirectly controlled the Applicant or was controlled by the Applicant; 5) the Applicant being a subsoil user has outstanding breaches of obligations under another SUC, which were indicated in notification of the MoE/MIID; 6) the Applicant was earlier acknowledged as a winner of an Auction, but did not pay the signature bonus; 7) requested subsoil plot is not indicated in the Announcement. 8) the Applicant has submitted inaccurate information; 9) granting the SUR entails a threat for national security including concentration of rights within the SUC and/or concentration of SURs. <p>The MoE’s refusal to admit the application on the grounds provided for by paragraphs 1), 3), 4), 6), 8) and 9) above deprives the Applicant of the right to re-apply.</p> <p>Rejection of the application shall contain information regarding the grounds for rejection excluding the cases, provided for by paragraph 9) above.</p>	
<p>Only above paragraphs 2)-6), 8) and 9) are applicable.</p> <p>In addition, the MoE may rejects the application, if:</p> <ul style="list-style-type: none"> • the requested subsoil plot is not included in the Program; • within three (3) years before filing the application, the Applicant already filed another application, but failed to register itself as a participant of an Auction. 	<p>All paragraphs of the above list are applicable.</p>

2.4. Arrangements for an Auction

If the MoE positively considers the Application (Initiation) it shall publish an announcement on conducting an Auction (the “**Announcement**”) on its web-site and periodicals distributed throughout the RoK territory in Kazakh and Russian. The Announcement shall contain information set out in Article 95.2 of the Code. If an Auction relates to a subsoil plot for which the relevant SUC was terminated earlier, the Announcement shall additionally contain information set out in Article 95.3 of the Code.

The term for filling Applications (Participation) is two (2) months following the date when the Announcement was published (“**Filling Term**”).

The date of the Auction shall be not later than two (2) months following the last day of the Filing Term.

Persons interested in participation in Auction may obtain information, related to the Auction within the Filing Term.

The amount of payment for participation in an Auction is determined by the MoE based on the amount of expenses for preparation, conducting, and summarizing the results of Auction, payment for labour of the experts involved. Such payment is non-refundable.

2.5. Conducting the Auction

If within the Filing Term no Application (Participation) has been submitted and/or if upon the results of the consideration of applications, no Applicant has been admitted to participate in the Auction (except for the person that filed the Application (Initiation)), the Commission within three (3) business days from the final date of Filing Term or from the date of termination of the period for consideration of Applications (Participation), decides to cancel the Auction.

In this case, the SUC is concluded with the Applicant that submitted the Application (Initiation) and it shall be concluded under the procedure set out in Article 100 of the Code for concluding a contract with the Auction winner provided that such Applicant has paid the initial amount of the signature bonus.

Information on the cancellation of the Auction shall be placed on the MoE’s web-site, and also published in periodicals distributed throughout the RoK territory in Kazakh and Russian within three (3) business days from the date of adoption of the relevant decision by the Commission.

Until 1 January 2020 Auctions are in a standard format (*i.e.* personal participation is required in the appropriate place). From 1 January 2020, all Auctions will be conducted in electronic format on the MoE’s web-site.

The participant that offered the largest amount of the signature bonus wins the Auction.

The winner of an Auction shall within twenty (20) business days (“**Payment Term**”) after results of the Auction have been published shall:

- 1) pay the signature bonus determined upon results of the Auction or, if there was only 1 registered participant – the initial amount of the signature bonus;
- 2) send to the MoE a confirmation of payment of the signature bonus and the countersigned SUC.

Also the Auction winner additionally shall develop a program of works containing the scope, description and deadlines for the work during the exploration period and complying with the minimal requirements to the scope and types of work on the subsoil plot in the exploration period and attach it to the SUC as its integral part.

The SUC shall contain annex thereto, as is integral part, establishing subsoil plot in accordance with Article 110 of the Code, on which the subsoil user has a right to conduct operations on exploration and/or production of hydrocarbons.

The MoE within twenty (20) business days from the date of receipt of the signed SUC and payment confirmation from the Auction winner, executes the SUC and sends its signed copy to the winner.

If during the Payment Term, the Auction winner failed to pay a signature bonus and/or to submit to the MoE the countersigned copy of the SUC, such person is deprived of the right to conclude the SUC and the relevant subsoil plot is repeatedly put up for the Auction.

2.6. Grounds for acknowledging Auction as void

Auction can be acknowledged as void by court upon request of a participant or the MoE under the following grounds:

- 1) violation of Auction holding rules set out by the Code, which affected the selection of the Auction winner;
- 2) establishment of facts that the person, with which the SUC was concluded based on the Auction results, submitted the misleading information to the MoE, that affected its decision to admit such person to the Auction

The Auction participants are entitled to appeal against the Auction results through judicial proceedings on the grounds of clause 1) above within three (3) months from the date of publication of the Auction result.

In case of disputing the Auction validity before conclusion of the SUC, execution of the SUC shall be suspended until resolution of the dispute by court.

Acknowledgement of the Auction as invalid entails invalidity of the SUC concluded based on the Auction results.

If the Auction is acknowledged invalid on the ground indicated in clause 1) above, the person selected as the Auction winner is entitled to demand the return of the signature bonus paid by such person.

III. Conclusions

Summarizing the above, apart from the previous subsoil use legislative acts, the Code set out a more transparent procedure for obtaining SUR through Auctions. The major positive developments are: the possibility to see the territory of all potential Auctions and to include the interested subsoil plot into the Program, detailed list of restrictions to potential Applicants, possibility to conclude SUCs for exploration and production (earlier mostly separately for exploration and for production), forthcoming amendments setting out that from 1 January 2020 Auction will be conducted in electronic format.

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Map indicated territories for exploration/production of hydrocarbons (auction) included in the Program (a screenshot from <https://gis.geology.gov.kz/geo/>)

