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Kazakhstan

Shaimerden Chikanayev & Lola Abdukhalykova
GRATA International

Overview of the current energy mix, and the place in the market of different energy sources

Organisation of the energy sector

Kazakhstan is the largest economy in Central Asia and home to more than 18 million people. As a country rich in coal, oil, natural gas and uranium, Kazakhstan's economic focus remains firmly on its industrial sector and the extraction and processing of its natural resources. There is also enormous potential for renewable energy in Kazakhstan, particularly from wind and small hydropower plants. Kazakhstan's total energy production covers more than twice its energy demand, which is why in 2018 Kazakhstan was the world's ninth-largest exporter of coal, ninth of crude oil and 12th of natural gas.

Energy accounts for about 21% of the country's gross domestic product (GDP), and approximately 62% of its exports.¹ Interestingly, coal represents around half of Kazakhstan's energy mix (50% in 2018), followed by oil and natural gas (both with 25% shares), whereas the share of natural gas in the total final consumption (TFC) was only 13% in 2018.²

Gas

The current status of Kazakhstan's gas industry

The Kazakhstan gas sector has vast potential as its total proved reserves of natural gas at the end of 2019 in Kazakhstan was 2.7 trillion cubic metres³ making it in 2018 the world's 12th largest exporter of natural gas. Most of Kazakhstan's natural gas reserves are in crude oil or condensate-rich fields and, therefore, 90%⁴ of produced gas in Kazakhstan is an associated gas. Much of Kazakhstan's gross natural gas production is reinjected (more than 30% in 2019)⁵ to increase oil production. Natural gas production (gross extraction) has been slowly but steadily increasing in recent years in Kazakhstan – from 19 billion cubic metres (bcm) in 2009 to 23.9 bcm in 2018.⁶ Natural gas production in Kazakhstan is expected by many experts⁷ to remain stagnant and even decrease after 2025, as no new foreign direct investments are expected to be attracted in the near future in exploration and development of new gas fields in Kazakhstan, unless deficiencies of the legislative architecture of the current gas market design will be rectified to improve commerciality for gas, as discussed below.

In terms of regional gas consumption, the western part of Kazakhstan is a significant gas consumer, while in the north and the east of Kazakhstan economies are run predominantly on coal. The south of Kazakhstan uses both gas and coal. This trend is expected to continue.⁸ Domestic consumption of natural gas, however, increased significantly, from 10.1 bcm in 2009 to 19 bcm in 2018,⁹ and it is expected that Kazakhstan's apparent natural gas consumption will grow at about 1.9% per year on average out to 2040.¹⁰ Competition for available commercial gas volumes between domestic consumption and export to China, therefore,

will soon become one of the major problems for Kazakhstan and will require the Kazakh government to make a tough choice – either continue to prioritise domestic consumption and in this way to receive less profit than one's due or instead opt for a more lucrative option of exporting limited gas volumes available to China at the expense of domestic consumption.¹¹ Many experts, therefore, expect that Kazakh gas export to China will probably fall, from 7–8 bcm each to China and Russia in the early 2020s, to less than half that in the late 2020s.¹²

Most of the gas delivered by pipelines in Kazakhstan is consumed in power generation (50%), followed by residential-commercial users (domestic sector) (36%), and industry (14%).¹³ Under the national Green Economy Strategy adopted in 2013,¹⁴ Kazakhstan's programme of gasification and switching the predominantly coal-fired power sector to gas has made good progress in the last five years.

The official target stipulated in the Green Economy Strategy was to reach 20% of all electrical power in Kazakhstan to be produced on gas-fired power plants by 2020, though in practice already in 2019 20.2% of all electrical power in Kazakhstan was produced by gas-fired power plants. The next official target stipulated in the Green Economy Strategy is to reach 25% share of all electrical power to be produced by gas-fired power plants by 2025, whereas the final goal is to reach 30% share by 2050.

A significant part of natural gas resources is concentrated in western regions of Kazakhstan, whereas the biggest and most promising export market¹⁵ for the Kazakh natural gas is in the East – China. With the completion of the Beyneu-Bozoy-Shymkent natural gas pipeline in 2015 and reaching its design capacity of 15 bcm per year in September 2020, Kazakhstan aims for a gas export boost to China. On 12 October 2018, Kazakhstan and China signed a five-year contract for the export of up to 10 bcm/y of gas via Central Asia-Centre China Gas Pipeline System (CAGP) during this period. Over the last decade, therefore, China has replaced Russia as the main export destination for Kazakh gas, but still in 2018, Russia imported 12.3 bcm of gas from Kazakhstan.

Despite all above natural advantages, however, so far, Kazakhstan's gas industry is in stagnation as it has been too long in the shadow of the Kazakhstan's oil industry and long-term politics threatens Kazakhstan's long-overdue gas sector reforms, as discussed herein.

Major gas producers in Kazakhstan

The biggest gas producers in the foreseeable future for Kazakhstan are, according to many experts,¹⁶ the following companies:

1. Tengizchevroil LLP¹⁷ that develops super giant Tengiz oilfield (272 billion cubic feet (bcf) dry marketed gas production in 2017).¹⁸ Shareholders of the Tengizchevroil are: Chevron, 50%; KazMunaiGas, 20%; ExxonMobil, 25%; and LukArco, 5%. Much of the natural gas produced at Tengiz field is high in sulfur, and therefore it requires special handling and is more costly to process.
2. North Caspian Operating Company (NCOC)¹⁹ is an international consortium owned by KazMunaiGas Kashagan B.V. (16.9%), Shell Kazakhstan Development B.V. (16.8%), Total E&P Kazakhstan (16.8%), Agip Caspian Sea B.V. (16.8%), ExxonMobil Kazakhstan Inc. (16.8%), CNPC Kazakhstan B.V. (8.3%) and Inpex North Caspian Sea Ltd. (7.6%). NCOC acts as the Operator of the North Caspian Project (that covers Kashagan field), the first major offshore oil and gas development in Kazakhstan (more than 100 bcf natural gas production capacity).²⁰ Much of the natural gas produced at Kashagan field is high in sulfur, and therefore it requires special handling and is more costly to process. The challenges of this project make it one of the most complex industrial projects ever developed in the world.

3. Karachaganak Petroleum Operating B.V. (KPO)²¹ that develops Karachaganak field discovered in 1979 one of the world's largest gas and condensate fields (about 300 bcf wet marketed gas production in 2017).²² The Karachaganak Venture brings expertise and knowledge from five oil & gas companies – ENI (29.25%), Royal Dutch Shell plc (29.25%), Chevron (18%), Lukoil (13.5%) and KazMunaiGas (10%). Unlike the Tengiz project, which includes a natural gas processing plant, the Karachaganak project has insufficient natural gas processing capacity. Most of the raw marketed production from the Karachaganak field must be exported to Russia to be processed at a natural gas processing plant in Orenburg city.
4. CNPC AktobeMunaiGas (CNPC AMG)²³ that develops the Zhanazhol field, is one of Kazakhstan's largest oil and gas producers. It was CNPC's first project in Kazakhstan and remains a major source of equity production and cash flow for the Chinese national oil corporation. CNPC AMG operates several fields in west Kazakhstan, including the Zhanazhol deposit.

Gas transportation network

Even though significant progress has been achieved in Kazakhstan's gas network development in recent years, the domestic pipeline system in Kazakhstan is still underdeveloped (just about 9.5 million people out of 18.5 million population of Kazakhstan have access to gas in 2020)²⁴ and people in northern and central Kazakhstan still do not have access to network gas, because natural gas reserves are in the western part of the country, whereas population centres are in the north, east and south and there are no pipelines connecting these regions with gas producing western part of the country. The vast distances and relatively low population density in the north, centre, and east make the economics challenging for any potential natural gas pipeline projects to serve those regions. Kazakhstan therefore so far relies on gas imports from Russia and Uzbekistan to meet domestic demand: a gas-swapping arrangement between Kazakhstan and Russia entails the replacement of Karachaganak gas, which has historically been supplied to Orenburg for processing, with imports of Central Asian gas to the southern part of Kazakhstan and Russian gas to the Kostanay region.

The major problem for further development of the gas industry in Kazakhstan, as officially identified by the Ministry of Energy of Kazakhstan in its recently adopted strategic plan for 2020–2024,²⁵ therefore, is gasification, because of high costs of investments into domestic gas distribution and trunk gas pipelines. Despite the above-mentioned difficulties, unlike Turkmenistan and Uzbekistan, Kazakhstan managed to substantially upgrade and extend in the last 15 years its gas transportation system so that it is now widely recognised as the best in Central Asia²⁶ and Kazakhstan's distribution pipelines reached a total length of 49,000 kilometres (km) in 2019. As of 2020, out of 16 of regions in Kazakhstan, 12 are already gasified regions,²⁷ with the four remaining regions in the north and centre of Kazakhstan relying on coal and LPG. More than 3 million people have gained access to piped gas in the past seven years, with connections expanding from 30% in 2013 to 51.47% in 2019.

The approved General Gasification Scheme for 2015–2030²⁸ is aimed at creating conditions to meet Kazakhstan's domestic gas needs through large-scale construction of new gas pipelines, but surprisingly it sets a quite low target of 56% of population to get access to gas in 2030 from 51.47% in 2019. In the last five years, Kazakhstan managed to complete two major infrastructure projects in furtherance of the General Gasification Scheme for 2015–2030. The first one is the Beineu-Bozoy-Shymkent gas pipeline that was commissioned in 2016 that was implemented in partnership with China. Thanks to the Beineu-Bozoy-Shymkent gas pipeline, the gas-rich western region of Kazakhstan is now connected with the densely

populated southern region of the country. With a capacity of 15 bcm/y, the Beineu-Bozoy-Shymkent gas pipeline decreases Kazakhstan's dependency on Uzbek and Turkmen gas and it also connects to the CAGP network and, therefore, enables exports of Kazakh gas to China. The second major investment in the domestic gas trunk network is the construction of the Saryarka gas pipeline. In December 2019, the first section of the Saryarka gas pipeline was commissioned. Once completed, Saryarka gas pipeline's capacity will be 2.2 bcm of gas per year, and it is expected to provide natural gas to the Central Kazakhstan cities of Nur-Sultan, Karaganda, Temirtau and Zhezkazgan, and to 171 settlements along the main gas pipeline (approximately 2.7 million people) by 2040.²⁹ These measures should improve the air quality of the capital of Kazakhstan, Nur-Sultan city, as coal consumption is expected to decrease by 650 kilotonnes (kt) per year.

In addition to development in the domestic pipeline system, Kazakhstan also effectively uses its strategic location to increase the international transit of Turkmen and Uzbek gas through Kazakhstan towards Russia and China. Because Kazakhstan is a landlocked country, diversification of its oil and gas export routes has been and it is still so far one of the major state policies from the energy security perspective.³⁰ Two of the three longest main gas pipelines in the world nowadays pass through the territory of Kazakhstan.³¹ These are the CAGP,³² which traverses the western edge of Kazakhstan on its way to Russia and points further west to Europe, and the Kazakhstan-China pipeline,³³ which traverses the southern edge of the country on its way to China.³⁴

The current gas market design in Kazakhstan

The Kazakh gas market continues to be organised on the basis of central command and control, and quasi-monopolistic principles, with JSC KazMunayGas (KMG)³⁵ as the state-owned and vertically integrated oil and gas company dominating gas production, supply and transportation through its direct and indirect subsidiaries. Gas transportation services in Kazakhstan are provided by a wholly owned subsidiary of KMG, JSC KazTransGas (KTG),³⁶ which is a vertically integrated transmission system operator/distribution system operator holding company. KTG acts as the so-called "national operator",³⁷ whereas JSC "Intergas Central Asia" (a subsidiary of KTG) acts as the so-called "national operator of the main gas pipeline". JSC "KazTransGas Aimak" (another subsidiary of KTG) is the distribution system operator. KTG as a national operator executes on behalf of the Republic of Kazakhstan the state's statutory preemptive right³⁸ to purchase raw gas and commercial gas from subsoil users in Kazakhstan (i.e. most of the gas produced in Kazakhstan is associated gas and therefore, gas production is not a major source of revenue for them) at a less-than-fair value price,³⁹ that disincentivises production of commercial gas and also discourages its efficient use by consumers.⁴⁰

According to the current gas market design (model)⁴¹ in Kazakhstan, therefore, usually the following order of actions is applied:

1. KTG as the national operator executes the state's statutory preemptive right and buys raw or commercial gas from subsoil users at the price determined in accordance with the statutory formula.⁴²
2. KTG⁴³ sells commercial gas to KazTransGas Aimak in all regions of Kazakhstan at the regulated wholesale prices, which differ⁴⁴ for each region of Kazakhstan.
3. KazTransGas Aimak,⁴⁵ in turn, sells gas to the population and other consumers at final (i.e. retail) prices, that are regulated⁴⁶ by the Committee on Regulation of Natural Monopolies of the Ministry of National Economy of the Republic of Kazakhstan⁴⁷ (hereinafter – the "CRNM").

Currently implemented in Kazakhstan domestic gas market design is the so-called “Main Buyer” gas market model, the characteristic features of which are (i) the presence of a single off-taker (i.e. KTG as a main buyer), (ii) very weak competition⁴⁸ in the market, and (iii) high barriers to entry for new players. Mainly thanks to high gas prices and significant export revenues up until 2019, through use of the current gas market design Kazakhstan managed to make good progress⁴⁹ in the increase⁵⁰ of gas production, gasification of its remote areas, modernisation and construction of trunk gas pipelines, which allowed KTG not only to combine all the gas pipelines⁵¹ in Kazakhstan into the unified gas transportation system,⁵² but also to diversify export markets by “drilling a window” to China.

Oil

The current status of Kazakhstan’s oil industry

Kazakhstan possesses about 30 billion barrels of proven oil reserves,⁵³ which, in 2018, placed the country among the top 17 oil producers in the world. Like gas, Kazakhstan’s oil reserves are primarily (70%) located in the western part of the country where they are extracted from deposits in the Caspian Sea and the neighbouring provinces. Kazakhstan’s “Big 3” oil projects are:

1. Tengiz (9 billion barrels of oil proven reserves);
2. Kashagan (13 billion barrels of oil proven reserves); and
3. Karachaganak (2.5 billion barrels of oil proven reserves).

Oil production has been slowly but steadily increasing in recent years in Kazakhstan – from 1,609,000 of barrels per day in 2009 to 1,931,000 of barrels per day in 2019.⁵⁴

Modernisation of the three existing refineries (Kazakhstan has three major oil refineries in: Pavlodar; Atyrau; and Shymkent), completed in 2018, has helped reduce the need to import light crude oil products. Refinery throughput increased 10% in 2018 to 16.4 Mt, providing 93% of the domestic market’s gasoline supplies, 91% of its diesel and 62% of its jet kerosene. The Pavlodar refinery is in north-central Kazakhstan and is supplied mainly by a crude oil pipeline from western Siberia, because Russian supplies are well placed geographically to serve that refinery. The Atyrau refinery uses only domestic crude oil from northwest Kazakhstan, and the Shymkent refinery currently uses crude oil from the oil fields at Kumkol and the nearby area in central Kazakhstan. Aktau also has a smaller refinery that processes heavy crude oil produced at a nearby field to make bitumen for road construction.⁵⁵

Oil transportation network

Kazakhstan’s pipeline system is operated by the state-run JSC KazTransOil (KTO), a subsidiary of KazMunaiGas, which runs approximately 5,378 km of trunk oil pipelines as a so-called natural monopoly.⁵⁶ Because Kazakhstan is a landlocked country, diversification of its oil and gas export routes has been and it is still so far one of the major state policies from an energy security perspective.⁵⁷ The main operative oil export routes are: the Atyrau-Samara pipeline; the Caspian Pipeline Consortium (CPC pipeline); the Atassu-Alashankou pipeline (China-Kazakhstan oil pipeline); and the Aktau sea terminal.

Kazakhstan is an exporter of light, sweet crude oil. Most of Kazakhstan’s crude oil exports travel around or across the Caspian Sea to European markets. That is why the vast portion (75% in 2018) of Kazakhstani oil is exported through the CPC pipeline, which transits through Russia to the Black Sea.

Thanks to the commissioned China-Kazakhstan oil pipeline in 2006, however, Kazakhstan has diversified its crude oil exports and there has been significant growth in oil exports to China since that time. In 2019 alone, Kazakhstan has delivered almost 11 million tonnes of crude oil to China.⁵⁸

Kazakhstan also exports crude oil via the Caspian Sea and via rail. Oil is loaded onto tankers or barges at Kazakhstan's port of Aktau or the smaller Atyrau port and then shipped across the Caspian Sea, where it is loaded onto the Baku-Tbilisi-Ceyhan pipeline or the Northern Route pipeline (Baku-Novorossiysk) for onward transport, mainly to Europe. In addition, Kazakhstan has an extensive rail network, which it uses to transport liquid fuels for domestic consumption and for exports. Continued expansion and diversification of Kazakhstan's petroleum liquids transport capacity, particularly export capacity, are key to its future ability to increase production.⁵⁹

Oil market design

State-owned KMG is an integrated national oil and gas company implementing national policies on oil and gas sector developments and is involved in oil and gas exploration, production, refining, transportation, distribution and servicing. The company also establishes management systems for subsoil use.

Kazakhstan's biggest oil producers are Tengizchevroil LLP, NCOC and KPO, which are responsible for 54 Mt of oil production (60% of Kazakhstan's total output). KMG owns equity in all three projects.

KTO, nominally a subsidiary of KMG, owns the main network, and certain other pipelines are owned and operated by consortiums of investors in which KTO is a shareholder (Caspian Pipeline Consortium [CPC] exports through Russia to world markets, and the Atasu-Alashankou and Kenkiyak-Atyrau pipelines export to China).

The three main refineries are owned directly or indirectly by KMG, although the Shymkent refinery as a joint venture is owned by CNPC Exploration and Development Company Ltd and the JSC Exploration & Production KazMunaiGas.⁶⁰

Coal

Kazakhstan holds 25,605 million tonnes of proven coal reserves as of 2019, ranking eighth in the world and accounting for about 2.4% of the world's total coal reserves. Most of the coal is in Central Kazakhstan (Karaganda Oblast) and North Kazakhstan (Pavlodar and Kostanay Oblasts). The country has more than 400 coal deposits. Most coal production is sourced from two main basins in the central part of the country – the Karaganda Basin, which supplies metallurgical coal from underground mining operations, and the Ekibastuz Basin, which supplies coal to the power generation sector. The smaller deposits of coal found in the east, southeast and southwest of the country have been poorly exploited to date.⁶¹

In 2019, the total production of Kazakhstan's coal amounted to 111 million tonnes, and its export amounted to 28 million tonnes. Historically, Russia has been the primary destination for Kazakhstan's coal (81% of all the coal exported from Kazakhstan in 2016). Other destinations for Kazakhstan's coal include Ukraine and Kyrgyzstan and, in smaller amounts, Belarus, China, Japan and Uzbekistan, among other countries.

Virtually all of Kazakhstan's coal production and exports consist of steam coal, which is suitable for burning in electric power plants or in other applications to generate steam and heat. Kazakhstan also produces smaller quantities of metallurgical coal that are consumed domestically. Kazakhstan is rich in a variety of minerals, and mineral and coal deposits are concentrated in the north and centre of the country. Coal is a major energy source for the mining and smelting industries and for the electricity sector in Kazakhstan.⁶²

Nuclear energy

As of 2020, Kazakhstan has no active nuclear power generation capacity. Despite the fact that Kazakhstan has some of the largest uranium deposits in the world (about 14% of all

explored world reserves) and is the world's largest uranium producer (about 42% of world production in 2019), at this stage there are no concrete plans to build a nuclear power plant in Kazakhstan as popular cry is loud against any such plans. Kazakhstan's only nuclear power plant, a BN-350 nuclear reactor at Aktau, was shut down in 1999.

Still there is huge potential for nuclear energy in Kazakhstan and, therefore, Russia has long been offering to help the Kazakhstanis launch a nuclear power plant.

For now, Kazakhstan exports uranium as a raw material mainly to China, France, Russia, India, USA and Canada. However, in April 2020, JSC KazAtomProm, the world's largest uranium producer, announced a 20% cut in production until 2022 in the wake of COVID-19.⁶³

Renewable energy

Vast hydrocarbon resources are one of the key factors for the slow development of renewable energy and alternative energy sources in Kazakhstan. Kazakhstan government, however, seems to have strong political will to attract investments in renewable energy projects as demonstrated by Kazakhstan's official general policy. The government of Kazakhstan, for instance, made an official commitment to increase the share of renewable energy in domestic electricity generation to 30% by 2030 and 50% by 2050.

By now Kazakhstan generally has a good legal and institutional framework for the development of renewables. Generally, the renewable energy projects in Kazakhstan are procured on an independent power project model, whereby a government entity (i.e. a single off-taker) enters into a long-term (15 years) power purchase agreement with a private sector entity to purchase power at a fixed price from the project.

Kazakhstan has switched from the fixed feed-in tariff support system to the mechanism of auctions to develop renewable sources of energy from 1st January 2018. The auction system made the process of granting renewable energy projects open and transparent and gave impetus to the implementation of the most cost-effective projects.

As of end 2019, about 83 renewable energy facilities with a capacity of 936.8 MW have been operating in Kazakhstan,⁶⁴ however, this accounts for only 0.8% of all electricity generated in Kazakhstan. Renewable energy, therefore, represented mere 1.4% of the energy mix (TPES) in 2018.

Changes in the energy situation in the last 12 months which are likely to have an impact on future direction or policy

COVID-19

Kazakhstan had to reduce shipments of oil and gas to China, where demand fell because of the COVID-19 pandemic and rock-bottom prices.

Eurasian Economic Union

The lack of interest from Russia and Kazakhstan to hasten the process of liberalisation of their domestic gas markets and formation of the EAEU's common gas market, unsurprisingly, has caused sterile debates on different approaches to gas pricing in the EAEU's common gas market without much success for more than four years now. The latest push to agree on the aforementioned matters was made on 19th May 2020, when the heads of the EAEU member states were supposed to come to some consensus on the issue of tariff-setting for gas transportation services in the union's common gas market. EAEU's leaders, however, failed not only to agree to resolve the foregoing issue, but also to adopt a common strategy for development of the EAEU, so now there is a high risk that the current deadline of 1st January 2025 for the official launch of the EAEU's common gas market would not be met. Interestingly, this time Russian President Vladimir Putin clearly rejected the possibility

of imposing a uniform gas transportation tariff on the territory of the EAEU because the “uniform tariff may be realised only on a single market with a uniform budget and uniform tax system”. This means that Putin, apparently, sees the difference between the concepts of a “common gas market” and a “single gas market” and considers a “single gas market” with a “unified tariff” possible only if there is a sufficient political level of integration among EAEU member countries. The elites of Armenia, Belarus, Kyrgyzstan and, surely, of Kazakhstan are, however, not ready to give up particles of sovereignty of their respective countries, even in exchange for subsidies in the form of cheap gas. There is quite a big risk, therefore, that the gas tariff issue will become a dealbreaker not only for the proposed common gas market of the EAEU, but for the EAEU itself.

Developments in government policy/strategy/approach

Reforms are expected in the gas sector of Kazakhstan

So far, it has been important for Kazakhstan to maintain the *status quo* in the gas sector because this way the Kazakh government through KTG has been able to make investments in domestic gas distribution infrastructure and proceed with cross-subsidisation of the local population and industries at the expense of foreign consumers and Kazakh gas producers. The “new reality” of the COVID-19 pandemic and the looming official launch of the Eurasian Economic Union’s common gas market in 2025, however, require urgent gas market reforms. 2020 is to be expected a horrible year for KMG and KTG, because of disappearing demand for gas in China and rock-bottom prices. Most likely from now onwards, KTG should not expect the same level of huge profits from its export of gas and, therefore, it means that KTG would soon hardly be able to bear its social burden of cross-subsidisation. It is reasonable to expect a revival of heated discussions among relevant stakeholders on long-expected reforms and the liberalisation of the Kazakh domestic gas market.

There is still hope that the Kazakh government is, finally, ready to show its political will to proceed with the much-needed reforms of the Kazakh domestic gas market. First, at the end of 2019 the government of Kazakhstan with the technical assistance of the Asian Development Bank engaged⁶⁵ a group of international experts to help Kazakhstan, and prepared a plan for reformation of the country’s gas sector. Secondly, KMG officially announced on 5th June 2020 its plans to spin off KTG that can, effectively, be recognised as the first step for liberalisation of the domestic gas market (i.e. ownership unbundling). Finally, the President of Kazakhstan Kassym-Jomart Tokayev in September 2020 presented a new strategy for further development of Kazakhstan, where he clearly stressed that the new economic course of the country should be based on seven basic principles, including the fair competition. In furtherance of this “fair competition” initiative, on 6th October 2020 Kazakh President signed a presidential decree on the creation of the new Agency for Protection and Development of Competition (hereinafter the “Competition Agency”),⁶⁶ which, among other things, was given the authority in conjunction with the Ministry of Energy of Kazakhstan to reform the gas sector by way of the introduction of competition.

Developments in legislation or regulation

The capacity market was finally launched on 1st January 2019 in Kazakhstan to encourage investment for the renovation of old, as well as the construction of new, power infrastructure facilities. Because of relevant amendments in the Power Law, all generating companies in Kazakhstan must maintain a specific generating capacity and, correspondingly, the participants in the wholesale power market (such as industrial consumers) have an obligation to pay for the availability of the specific generating capacity.

Any investor in the power sector of Kazakhstan, therefore, can now expect two different sources of income and compensation for expenses:

- proceeds from the sale of electric power in the free market under the power purchase agreements (PPAs) within price caps (such as the maximum limits to the prices that power plants can ask for the electricity they produce) approved by the Ministry of Energy; and
- proceeds from the sale of capacity of a power plant (such as the availability of its generating facilities to produce electricity) to a designated-by-law single offtaker under the capacity purchase agreements (CPAs), within price caps established by the Ministry of Energy.

Payments under the PPAs would cover the operating expenses of power plants, whereas payments under the CPAs shall cover the capital expenses of investments in new projects and in the modernisation of existing power facilities.

The Ministry of Energy will determine annually an anticipated deficit of electric power, as well as develop and approve a promising layout of electrical capacities. To meet the forecast deficit of electric power, if any, the Ministry of Energy will hold tenders for the construction of newly-commissioned generating plants and sign the so-called agreements for the construction of newly commissioned generating plants with the tender winner, fixing the commissioning date of the generating plants and the tender winner's liability for failure to perform or for improper performance according to the terms of the agreement. Within 30 calendar days after the signing of the aforementioned agreement, the single offtaker must sign the agreement with the tender winner to purchase services to maintain the electrical capacity of the newly commissioned generating plants at a volume and on the terms specified by the Ministry of Energy.

These legal reforms shall, evidently, give impetus to new investments into the electricity sector of Kazakhstan, though there are still certain legal obstacles that may impede the process of attracting foreign direct investments. The creditworthiness of the proposed single offtaker, in particular, is still questionable. For instance, the law is rather unclear on the enforceability of indirect state guarantee for contractual obligations of the single offtaker under the CPA as currently stipulated in the Power Law. Moreover, current laws require CPAs and agreements for the construction of newly commissioned generating plants to strictly follow standard forms that, apparently, can make them not bankable.

Judicial decisions, court judgments, results of public enquiries

In 2019 the Ministry of Energy issued an order according to which all power generating companies shall have “zero” profitability for the period 2019–2024. This order of the Ministry of Energy was successfully challenged in the court of Nur-Sultan city by an energy-producing organisation, which rightly noted that the state does not have the right to restrict business entities in making a profit, and the tariff should allow one to recover its expenditures and to make profit (see Decision of the Nur-Sultan Court Committee on Civil Cases, dated 7th August 2019, No. 7199-19-00-2a\6180).

Major events or developments

Online auctions introduced

For the first time in the history of independent Kazakhstan, an online auction for the granting of subsoil use rights to develop oil & gas fields will be held in December 2020. It is planned to sell 10 oil and gas subsoil fields and more than 30 applications for participation in the auction already have been received as of the end of October 2020.⁶⁷ All the blocks on offer are located in the Atyrau region in the north-west, with three extending over the border into neighbouring regions. The blocks are expected to contain both shallow and conventional and

possibly deep oil reservoirs. The auction system is expected to make the process of granting oil & gas projects more open and transparent and more cost-effective.

Kazakhstan cuts down public expenses in the energy sector

On 5th November 2020, the President of Kazakhstan signed amendments to the Republican budget and this way has cut back on energy sector public spending. For instance, according to the amendments, just 36.6 billion Tenge is now allocated for the development of the gas transportation system instead of previously allocated 43.7 billion Tenge.⁶⁸

Proposals for changes in laws or regulations

Comprehensive national energy strategy shall be adopted

A considerable role in governing energy relations in Kazakhstan pertain to “soft law” instruments in the form of strategies, concepts and programmes. Although these instruments are not legally binding, they represent a political basis for development of legislation and state policies. One of the main problems of the Kazakhstan’s energy sector is the lack of a comprehensive and up-to-date national energy strategy which clearly formulates the main parameters, aims, and directions of the current Kazakh energy policy. The current Fuel and Energy Complex Development Concept and Gas Development Concept are largely outdated, as they have been promulgated back in 2014, whereas the Ministry of Energy’s Strategic Plan 2020–2024 is, arguably, rather superficial and does not properly address issues the energy sector in Kazakhstan faces now. Moreover, the regulation of the energy sector is now effectively assigned to the competence of several different ministries and state bodies (including, among others, the Ministry of Energy and CRNM) that often pursue only sectional interests or have limited authorities that does not allow Kazakh government to create an efficient unified state authority for solving the accumulated issues and problems in the energy sector.

For instance, the issue of the existing system of tariff formation in the heat power and electric power industries significantly reduces efficiency and has stopped the development of these industries.

The problem of elimination of the cross-subsidisation among different regions and consumer groups in the energy sector is also an issue that cannot be solved without strong political will, a well thought-out national energy strategy and the coordinated work of many state bodies.

New tariff policies shall be introduced in the heat and power industries

Almost half of the existing heating networks are 100% worn out which leads to a high accident rate (in some regions – from 1 to 10 damages per 1 km of pipeline annually, whereas in Western Europe this figure does not exceed 0.1) and high losses of thermal energy during transportation. The wear and tear of electrical networks is 70% in Kazakhstan.

That is why tariff methodologies in the heat power and electric power industries should be changed as soon as possible. Current tariff methodology used in these industries, that are considered to be so-called natural monopolies or regulated, provides no incentive to invest in fixed assets or to improve cost efficiency; to the contrary, it incentivises a company to increase operating expenditures as a basis to calculate approved profit. That is why a new pro-competitive tariff policy and cost-reflective tariffs shall be introduced.

Domestic gas market shall be liberalised

The following are the major shortcomings of the current legislative architecture of Kazakhstan’s domestic gas market that require strong political will to be addressed:

1. State regulation of the wholesale and retail gas prices and issue of cross-subsidisation of local consumers at the expense of foreign consumers and of remote or poor regions of Kazakhstan at the expense of gas producing regions as well as Kazakh gas producers.

2. Lack of transparent and cost-reflective gas transportation tariff.
3. Undeveloped exchange (i.e. gas hubs) trading of natural gas.
4. State's preemptive right of KTG and the need to liberalise gas exports.
5. Incomplete privatisation and division of the activities of the monopolists (KMG and KTG) by type of activity (i.e. ownership unbundling).
6. Unresolved issue of non-discriminatory third-party access to trunk and distribution gas pipelines.

Kazakhstan's gas market liberalisation is, therefore, urgently required as it will eliminate inefficiency in the country's gas sector and create ample opportunities for foreign and local lenders and investors for the development of new gas fields and to proceed further with the gasification of the remote regions of Kazakhstan. A failure to reform Kazakhstan's domestic gas market in time, evidently, because of the lack of political will in the government of Kazakhstan, can jeopardise the proper functioning of the EAEU's common gas market and will negatively affect the competitiveness and effectiveness of Kazakhstan's domestic gas market.

* * *

Endnotes

1. See *The World Bank DataBank*. Available at: <https://databank.worldbank.org/reports.aspx?source=2&country=KAZ>.
2. See IAE's Kazakhstan Energy Profile dated April 2020 at: <https://www.iea.org/reports/kazakhstan-energy-profile>.
3. See *BP's Statistical Review of World Energy 2020* at: <https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2020-full-report.pdf>, p.32.
4. See *Strategic Plan of the Ministry of Energy of Kazakhstan for 2020–2024* as approved by the Decree of the Ministry of Energy of Kazakhstan No.445 dated 31st December 2019 (hereinafter – “Ministry of Energy Strategic Plan 2020–2024”), p.9. Available at (in Russian): <https://www.gov.kz/memleket/entities/energo/documents/details/68779?lang=ru>.
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7. See presentation of Ashley Sherman, Principal Research Analyst of the Wood Mackenzie at the joint virtual event of the KPMG and the British-Kazakh Law Association “*Kazakh Oil & Gas: new reality and challenges*” held on 15th October 2020. Available at: <https://www.youtube.com/watch?v=gIk9yUdrirw&feature=youtu.be>.
8. See *The National Energy Report-2019 of the KAZENERGY Association*, Chapter 4. Kazakhstan's Natural Gas Market and Future Challenges to Gasification, p.89. Available at: https://www.kazenergy.com/upload/document/energy-report/NationalReport19_en.pdf.
9. See *BP's Statistical Review of World Energy 2020* at: <https://www.bp.com/content/dam/>

- bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2020-full-report.pdf, p.36.
10. See *The National Energy Report-2019 of the KAZENERGY Association*, Chapter 4, Kazakhstan’s Natural Gas Market and Future Challenges to Gasification, p. 90. Available at: https://www.kazenergy.com/upload/document/energy-report/NationalReport19_en.pdf.
 11. See *The National Energy Report-2019 of the KAZENERGY Association*, Chapter 4, Kazakhstan’s Natural Gas Market and Future Challenges to Gasification, p. 84. Available at: https://www.kazenergy.com/upload/document/energy-report/NationalReport19_en.pdf.
 12. See Pirani, S. n.d. “*Central Asian Gas: Prospects for the 2020s*” OIES Paper. Oxford Institute for Energy Studies. Available at: <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2019/12/Central-Asian-Gas-NG-155.pdf>.
 13. See *The National Energy Report-2019 of the KAZENERGY Association*, Chapter 4. Kazakhstan’s Natural Gas Market and Future Challenges to Gasification, p.90. Available at: https://www.kazenergy.com/upload/document/energy-report/NationalReport19_en.pdf.
 14. See the Decree of the President of the Republic of Kazakhstan dated 30th May 2013 No. 577 “*On the Concept of transition of the Republic of Kazakhstan to a “green economy”*” (hereinafter – the “Green Economy Strategy”). Available at (in Russian): https://online.zakon.kz/Document/?doc_id=31399596#pos=224;-45.
 15. The main buyers of Kazakh natural gas in 2019 were China, which accounts for 36% (1.1 bcm), Russia – 16 % (888.1 million cubic metres) and Ukraine – 18% (566.9 million cubic metres). See: Kazakhstan Stock Exchange (KASE) report on Kazakhstan’s oil & gas industry dated July 2019, p.6. Available at (in Russian): https://kase.kz/files/presentations/ru/KASE_OilGas_industry_2019.pdf.
 16. See presentation of Ashley Sherman, Principal Research Analyst of the Wood Mackenzie at the joint virtual event of the KPMG and the British-Kazakh Law Association “*Kazakh Oil & Gas: new reality and challenges*” held on 15th October 2020. Available at: <https://www.youtube.com/watch?v=gIk9yUdrirw&feature=youtu.be>.
 17. See Tengizchevroil’s official website at: <http://tengizchevroil.com/en/products#drygas>.
 18. See data of the U.S. Energy Information Administration (EIA), Table 1. Available at: https://www.eia.gov/international/content/analysis/countries_long/Kazakhstan/pdf/kazakhstan_bkgd.pdf.
 19. See NCOC’s official website at: <https://www.ncoc.kz/en>.
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 23. See CNPC AMG’s official website at: http://www.cnpc-amg.kz/?p=o_nas.
 24. See the report of the Minister of Energy of Kazakhstan to the populace dated 27th May 2020. Available at (in Russian): <https://rfc.kegoc.kz/news/detail/otchet-ministra-pred-naseleniyem>.
 25. See *Strategic Plan of the Ministry of Energy of Kazakhstan for 2020–2024* as approved by the Decree of the Ministry of Energy of Kazakhstan No.445 dated 31st December 2019, p.11. Available at (in Russian): <https://www.gov.kz/memleket/entities/energo/documents/details/68779?lang=ru>.

26. See analytical material on this topic that was published by the Russian portal Nasledie.ru on 25th May 2016. Available at (in Russian): <http://nasledie.ru/?q=node/6254>.
27. See *Strategic Plan of the Ministry of Energy of Kazakhstan for 2020–2024* as approved by the Decree of the Ministry of Energy of Kazakhstan No.445 dated 31st December 2019, p.10. Available at (in Russian): <https://www.gov.kz/memleket/entities/energo/documents/details/68779?lang=ru>.
28. See the Resolution of the Government of the Republic of Kazakhstan dated 4th November 2014 No. 1171 “*About approval of the General scheme of gasification of the Republic of Kazakhstan for 2015–2030*”. Available at (in Russian): https://online.zakon.kz/Document/?doc_id=31631561#pos=5;-108.
29. See KTG’s annual report for 2019, p.4. Available at: https://www.kaztransgas.kz/images/01_reports/annual-2019-eng.pdf.
30. The Foreign Policy Concept of the Republic of Kazakhstan for 2020–2030 as approved by the Decree of the President of Kazakhstan No.280 dated 6th March 2020.
31. See data of the U.S. Energy Information Administration (EIA), figure 3. Available at: https://www.eia.gov/international/content/analysis/countries_long/Kazakhstan/pdf/kazakhstan_bkgd.pdf.
32. Central Asia-Centre pipeline: capacity 60.2 bcm/y; length on the territory of Kazakhstan – 3,962 km, but the total length of the pipeline is 5,000 km. Operator on the territory of Kazakhstan – Intergas Central Asia JSC.
33. Kazakhstan-China (A, B and C lines) gas pipeline has a capacity of 55 bcm/y and length of 2,618 km, however, it is just a part of the “Central Asia-Centre China” gas pipeline, that has a total length of 7,000 km. The operator of the Kazakhstan-China gas pipeline is Asian Gas Pipeline LLP. Implementation of the Kazakhstan-China gas pipeline project helped Kazakhstan to diversify its gas exports and loosen its dependence from Russia.
34. For more information on current trunk gas pipelines and transit gas pipelines in Kazakhstan refer to KTG’s website: <https://www.kaztransgas.kz/index.php/ru/o-kompanii/magistralnye-i-tranzitnye-gazoprovody-srednej-azii-i-kazakhstana>.
35. KMG and its affiliated group of entities accounts for 25% of crude oil and gas condensate production, as well as 15% of natural and associated gas production domestically. KMG is largely responsible for arranging the licensing tenders for oil and gas blocks. KMG also plays a role in almost all contracts with foreign oil and gas companies. See official website of KMG at: https://kmg.kz/eng/kompaniya/obshaya_informaciya/.
36. KTG’s group of companies included 12 subsidiaries and affiliates, including, among others, JSC “Intergas Central Asia”, “Asian Gas Pipeline” LLP and “Beineu-Shymkent Gas Pipeline” LLP, that are responsible for operation of trunk gas pipelines.
37. In accordance with the Kazakh Gas Law, a “national operator” legal status is granted to KTG as a legal entity responsible for improving and developing the country’s gas infrastructure and ensuring that domestic gas demand is met. The list of legal authorities of KTG as a national operator, including the state pre-emptive right to purchase raw gas and commercial gas, is specified in Article 9 of the Kazakh Gas Law.
38. State pre-emption right relate to a situation when a Kazakh subsoil user intending to sell raw or commercial gas has to offer them first to the Republic of Kazakhstan represented by the KTG before being able to sell them to outsiders. See Article 15 of the Kazakh Gas Law.
39. Some subsoil users in Kazakhstan indicate that the price they receive from commercial gas is less than the cost of production “by many multiples”. So far, reinjection has become the preferred solution for both producers and the government, therefore, as greater liquids production generates higher revenues for producers and additional

- revenues for government (through taxes and export duties) and avoids operational and financial challenges associated with gas processing. See: The National Energy Report-2019 of the KAZENERGY Association, Chapter 4: *Kazakhstan's Natural Gas Market and Future Challenges to Gasification*, p.87. Available at: https://www.kazenergy.com/upload/document/energy-report/NationalReport19_en.pdf.
40. See *The National Energy Report-2019 of the KAZENERGY Association*: Chapter 4. Kazakhstan's Natural Gas Market and Future Challenges to Gasification, p.84. Available at: https://www.kazenergy.com/upload/document/energy-report/NationalReport19_en.pdf.
 41. I.e. approaches, principles and mechanisms of functioning of the market.
 42. See the Order of the Minister of Energy of the Republic of Kazakhstan dated 13th November, 2014 No. 121 "On approval of the rules for determining the maximum price of raw and commercial gas purchased by a national operator under the state's pre-emptive right".
 43. As of 2019 KTG is the only gas supplier for retail gas sellers in Kazakhstan (i.e. the wholesale commercial gas market in Kazakhstan is monopolised). Available at: <https://inbusiness.kz/ru/news/v-minekonomiki-rassmatrivayut-razdelenie-roznicnoj-realizacii-gaza-ot-transportirovki>.
 44. See the Order of the Minister of Energy of the Republic of Kazakhstan dated 18th May, 2020 No. 196 "On approval of the maximum prices for wholesale sales of commercial gas in the domestic market of the Republic of Kazakhstan".
 45. As of 2019 KazTransGas Aimak holds the 95% market share in Kazakhstan's retail gas market (i.e. KazTransGas Aimak is *de facto* a monopolist). Available at: <https://inbusiness.kz/ru/news/v-minekonomiki-rassmatrivayut-razdelenie-roznicnoj-realizacii-gaza-ot-transportirovki>.
 46. See the Order of the Minister of National Economy of the Republic of Kazakhstan dated 1st February, 2017 No. 36 "About approval of Rules of pricing for socially important markets".
 47. The Committee for regulation of natural monopolies of the Ministry of national economy of the Republic of Kazakhstan is a state body of the Republic of Kazakhstan that controls and regulates activities related to the sphere of natural monopoly and socially significant markets. See official website of the CRNM at: <https://www.gov.kz/memleket/entities/krem?lang=en>.
 48. E.g. as mentioned above the wholesale commercial gas market in Kazakhstan is monopolised by the KTG, whereas KazTransGas Aimak holds the 95% market share in Kazakhstan's retail gas market.
 49. E.g. see some history information on development of gas sector in Kazakhstan at: https://online.zakon.kz/m/Document/?doc_id=31509377.
 50. E.g. see some statistical information at: <https://www.petroleumjournal.kz/index.php?p=article&aid1=111&aid2=585&id=1353&outlang=1>.
 51. To date, KTG manages more than 19,000 km of trunk gas pipelines and more than 48,000 km of gas distribution networks. Importantly, more than one-third of the current length of the trunk pipelines has been built over the past five years, i.e. unlike many other former USSR countries, Kazakhstan does not just operate main gas pipelines it inherited from the USSR, but also builds the new ones.
 52. It is widely accepted that Kazakhstan's gas transmission system is in excellent condition and is capable of passing up to 85 bcm/year of gas, with the prospect of increasing the volume of pumping up to 120 bcm/year. See: <https://neftegaz.ru/analysis/transportation/328523-gazotransportnye-sistemy-stran-sng-dinamika-i-perspektivy-razvitiya/>.

53. See *BP's Statistical Review of World Energy 2020* at: <https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2020-full-report.pdf>.
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55. See data of the U.S. Energy Information Administration (EIA). Available at: https://www.eia.gov/international/content/analysis/countries_long/Kazakhstan/pdf/kazakhstan_bkgd.pdf.
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60. See official website of the Shymkent refinery: <https://www.petrokazakhstan.kz/eng/pages/shareholders.html>.
61. See Debo Adams, IEA Clean Coal Centre, UK. *An overview of the Kazakh coal industry* dated October 2019. Available at: <https://www.iea-coal.org/wp-content/uploads/2019/10/Debo-Adams-Kazakhstans-beating-heart.pdf>.
62. See: Debo Adams, IEA Clean Coal Centre, UK. *An overview of the Kazakh coal industry dated October 2019*. Available at: <https://www.iea-coal.org/wp-content/uploads/2019/10/Debo-Adams-Kazakhstans-beating-heart.pdf>.
63. <https://stockhead.com.au/resources/nuclear-power-rises-with-shifting-political-tides/>.
64. <https://primeminister.kz/en/news/za-2019-god-v-moshchnosti-vie-kazahstana-uvlichilis-vdvoe#:~:text=In%20Kazakhstan%2C%20there%20are%2083,and%203%20bioelectric%20power%20plants>.
65. See the news dated 4th November 2019 available at (in Russian): <https://inbusiness.kz/ru/news/abr-mozhet-posodejstvovat-reforme-gazovoj-otrasli-kazahstana>.
66. See official website of the Kazakh Competition Agency at: <https://www.gov.kz/memleket/entities/zk/about?lang=en>.
67. See the news at: <https://kaztag.kz/en/news/10-oil-and-gas-subsoil-fields-to-be-sold-through-online-auction-in-kazakhstan>.
68. <https://lsm.kz/v-kazahstane-sokratili-rashody-na-energetiku-i-nedropol-zovanie>.

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