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**CENTRAL ASIAN REPUBLICS OIL &  
GAS SECTOR REFORM PROGRAM  
DELIVERY ORDER NO. 17**

**KAZAKHSTAN**

*Status Report*

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## EXECUTIVE SUMMARY

The purpose of this report is to analyze the current legislative and institutional framework for the oil and gas sector in Kazakhstan, outline current activities aimed at modifying and improving said framework, and recommend changes that would assist in developing its capabilities to fully exploit its oil and gas resources and enhance its ability to attract and manage foreign investment. This report was prepared in partial fulfillment of deliverables required under USAID's Oil and Gas Sector Institutional Reform Project, Delivery Order No. 17 and is a follow up of an earlier report under the same Delivery Order, "Kazakhstan: Oil and Gas Sector Reform, Status Report," dated July 15, 1997.

Kazakhstan has the potential to be a significant producer and exporter of oil and gas within the next decade and has recognized the need to attract foreign investment to develop its energy resources. The Government of Kazakhstan (GOK) has already undertaken several initiatives which are likely to stimulate foreign investment including, (i) enactment of new laws and decrees, (ii) recent changes in the tax code, (iii) reorganization of Government, (iv) restructuring and privatization of certain joint stock companies, (v) oil swaps and pipeline activities, and (vi) cooperation with USAID initiatives.

These initiatives, in conjunction with implementation of the proposals set forth below and resolution of certain external transportation and political issues should provide the framework for sustained growth in foreign investment. The most significant "external" issue requiring resolution is the availability of cost-effective and reliable petroleum transportation routes to hard currency markets.

After comparing the current legal and regulatory climate with an "ideal" for Kazakhstan, the following recommended initiatives and changes are proposed for the Kazakhstan oil and gas sector in order to further enhance investment opportunities:

- ▶ Emphasize investments which take advantage of the regional supply and demand imbalance and support policies which maximize the exportation of oil and gas to hard currency markets
- ▶ Amend the Presidential Decree "Concerning Petroleum" to make it more comprehensive and provide for the creation of an independent Oil and Gas Regulatory Agency (OGRA)
- ▶ Empower the OGRA with responsibility for the promulgation and enforcement of new rules and regulations, and authorize its review of the Former Soviet Union rules and regulations to determine what needs to be continued, revised or replaced

- ▶ Development of a formal program to restructure and privatize KazakhOil and KazakhNefteProvod
- ▶ Adoption of a transparent cost-of-service rate-of-return oil and gas pipeline tariff methodology
- ▶ Adoption of a transparent procedure for negotiating and entering into oil and gas contracts and agreements
- ▶ Creation of a legal and regulatory climate for oil and gas development which complements the Central Asian region

Through an existing Memorandum of Understanding with the GOK, USAID is providing legal and regulatory assistance to the oil and gas sector with respect to certain of the recommended changes. Projects which are currently underway include, (i) development of a cost-of-service oil pipeline tariff methodology, (ii) development of offshore oil and gas rules and regulations, and (iii) creation of a Draft Prospectus for an Aral Sea Consortium. In addition, training on legal, economic and financial issues is currently being provided for GOK officials.

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## **CHAPTER 1**

### **CURRENT OIL AND GAS INVESTMENT ENVIRONMENT**

Kazakhstan recognizes the need for attracting investment and modern technology in the development of its oil and gas resources and has undertaken several important steps, including: enactment of new laws and decrees; recent changes in the tax code; reorganization of Government; restructuring and privatization of joint stock companies (JCSs); oil swaps and pipeline activities; and addressing obstacles to private investment through USAID assistance.

Kazakhstan is endowed with significant oil and gas resources. The country's reserves have been estimated by some sources at 16 billion barrels of oil and 83 trillion cubic feet of gas. It possesses large oil fields such as Tengiz, Korolev, Tenge, Uzen, and Emba, and the Karachaganak gas condensate field. Overall, Kazakhstan has 204 producing oil and gas fields, 83 percent of which are oil and condensate fields. In 1996, Kazakhstan produced 22.9 million tons (approximately 450 thousand barrels per day) of oil and condensate and 4.2 billion cubic meters (410 million cubic feet per day) of gas. A total of 14.5 million tons (290 thousand barrels per day) of oil and condensate was exported. In 1997, Kazakhstan is expected to increase its oil and condensate production to 26.5 million tons (525 thousand barrels per day) and gas production to 5.0 billion cubic meters (480 million cubic feet per day). The recently completed seismic survey of the Kazakhstan sector of the Caspian Sea indicates the potential for large untapped reserves of oil and gas. There is also potential for increasing oil recovery from existing fields and for exploration of onshore areas with modern technology. It is this oil and gas potential that has attracted over thirty foreign oil and gas companies to locate in Kazakhstan.

#### **1.1 NEW LAWS AND DECREES**

Over the past 2 1/2 years, Kazakhstan has enacted a number of laws and decrees that have improved the legislative framework for the oil and gas sector. Most important among these are: Presidential Edict No. 2900 "Concerning Licensing", adopted on April 17, 1995 with subsequent amendments and implementing regulations; Presidential Edict No. 2350 "Concerning Petroleum", adopted on June 28, 1995 which is the umbrella law on oil and gas activities; and Presidential Edict No. 2828 "Concerning the Subsurface and Its Use". A critical review of the legislative framework and other aspects of the Kazakhstan oil and gas sector are described in "Kazakhstan : Oil and Gas Sector Reform, Status Report", dated July 15, 1997 prepared by Hagler Bailly, Inc. for USAID under the Energy Sector Institutional Reform Project, Delivery Order No. 17.

## 1.2 RECENT CHANGES IN THE TAX CODE

The GOK has implemented changes in its Tax Code to provide additional structure to its oil and gas taxation regime and is now working on creating additional implementing instructions. The basic structure of the tax regime remains basically the same. i.e. users of subsurface resources will continue to pay bonuses, royalties, and excess profits tax. The method of determining these taxes is still left entirely to negotiations of the subsurface use contract. There is some, but not enough, clarifying guidance in determining the tax base. An important feature of the tax regime is that it eliminates excess profits tax for production sharing contracts, and attempts to equalize the tax burden for both joint venture and production sharing type contracts.

## 1.3 REORGANIZATION OF GOVERNMENT

On March 4, 1997 President Nursultan Nazarbaev radically downsized the GOK through Presidential Edict No. 3378 "On Measures for Reforming the System of State Organs of the Republic of Kazakhstan." The number of ministries was reduced from 20 to 14, that of State Committees and Commissions - from 13 to six, and that of other agencies from 14 to five. The staff of all State management organizations was reduced by 50 percent. As a result of the Edict, the following new structures have been created:

- ▶ KazakhOil, responsible for managing the GOK's interests in exploration, production, transportation, and refining of hydrocarbons as well as in production sharing contracts.
- ▶ KazakhNefteProvod, responsible for oil pipeline transportation within Kazakhstan and exports. KazakhNefteProvod is to (a) ensure development of a modern integrated network for oil transportation, (b) secure additional investment to finance construction of new trunk lines and reconstruction of existing ones, (c) create a financially stable organization capable of competing in domestic and foreign markets, and (d) facilitate privatization.
- ▶ The Ministry of Energy and Natural Resources, operating through its Division of Oil and Gas, is responsible for approving contracts, issuing licenses, and most upstream regulation of operations. Other Divisions within this new Ministry include Electric Power, Coal and Geology.
- ▶ The State Agency for Control of Strategic Resources, which monitors and oversees the use of Kazakhstan's strategic resources such as the electric power, oil and gas, minerals extraction, telecommunications, and transportation sectors.
- ▶ The State Agency for Strategic Planning, responsible for developing and monitoring strategic plans for the GOK on a sector by sector basis.

- ▶ The State Committee for Investment, which implements an integrated policy to attract large scale investments into the economic development priorities of the GOK.

#### **1.4 RESTRUCTURING AND PRIVATIZATION OF JOINT STOCK COMPANIES**

Kazakhstan has undertaken steps to restructure State-owned entities into JSCs, and initiated a flexible approach to privatization of those entities. Three forms of privatization are prevalent, namely trust management contracts, concessions, and joint stock companies. In selecting participating investors in the oil and gas sector, Kazakhstan has established three criteria: (1) they must be economically and technically qualified; (2) they must make specific, enforceable commitments; and (3) they must pay real value for the acquired interest in the oil and gas projects. Success of the privatization effort (in all sectors) is attested by the fact that during the most recent two year period (1995-97) Kazakhstan will reportedly receive over 900 million US dollar (USD) in bonuses and other payments over and above the pledged investment. During the next five years, an additional 500 million USD are expected to be received in similar arrangements of privatization.

#### **1.5 MARKETING AND PIPELINE ACTIVITIES**

The GOK has entered into a ten year oil swap arrangement with Iran for two to six million tons of oil per year. Kazakhstan will deliver oil by tankers to the northern coast of Iran on the Caspian Sea to swap for an equivalent amount of Iranian crude oil for shipment from Iran's Persian Gulf ports to world markets.

Through a 150 million USD arrangement with Amoco Corporation, KazakhOil has secured a 19 percent share in the Caspian Pipeline Consortium (CPC) system. If the CPC system is constructed from the Tengiz oil field in Kazakhstan to Novorossiysk, Russia, it would provide greater pipeline capacity for both KazakhOil and Amoco to transport their share of Tengiz and other Caspian region production to western markets.

The GOK has recently awarded the operation of over 9000 kilometers of gas pipelines to Tractebel on a concession basis. Kazakhstan's gas pipelines have a capacity of 65 billion cubic meters per year and they serve to connect Uzbekistan and Turkmenistan to domestic, Russian, and western markets. Tractebel's contract ensures a payment of 30 million USD to the GOK to cover back wages and pensions, a royalty of two percent of overall gas volumes in addition to a 40 percent share of the profits, and an investment of 600 million USD for new construction and network improvements. Tractebel also agreed to construct a new 100 million USD Kazakhstan connection which could serve to bypass Kyrgyzstan. The arrangement with Tractebel allows Kazakhstan to better utilize its own considerable gas resources and control crucial Central Asian infrastructure.

## 1.6 OBSTACLES TO PRIVATE INVESTMENT

Many obstacles to private investment still remain and must be addressed. For example, the breaches in the implementation of recent tenders by the GOK, have resulted in a lack of confidence in the Government's commitments, and increased risk perception of investors. Another frequently mentioned issue is that GOK officials do not fully observe existing laws and regulations. It also appears that little coordination between the State, and local oblasts exists, resulting in investors having to comply with multiple, and sometimes contradictory requirements. In addition, there are internal contradictions in legislation that complicate its application by both State officials and investors when concluding contracts and agreements. Frequent changes in legislation and rule making has created a sense of legal and regulatory instability. Kazakhstan's expectation and demands with respect to bonuses, prices of geological data, and sunk costs have sometimes been known to be extreme and unreasonable. It is obvious that the GOK and its enterprises could be more market-oriented, coordinated, and reasonable when arranging investment opportunities.

Additional legal and regulatory obstacles which inhibit investment include: contradictions and voids associated with the Petroleum, Subsurface Utilization, and Licensing Edicts and their implementing regulations; an inadequate pipeline tariff methodology; petroleum project implementation related problems; lack of an independent oil and gas regulatory agency; activities which are subject to compulsory insurance; and inconsistencies in application of customs procedures and unnecessary delays in customs-related transactions.

## 1.7 USAID INITIATIVES

Under its Energy Sector Institutional Reform Project, USAID is already assisting the GOK to institute legal, regulatory, and institutional reforms and frameworks that would resolve some of the obstacles identified above. The following activities are already in progress or are being contemplated:

- ▶ Development of a cost-of-service rate-of-return oil pipeline tariff methodology;
- ▶ Establishment of an independent Oil and Gas Regulatory Agency (OGRA);
- ▶ Development of offshore oil and gas rules and regulations;
- ▶ Evaluation of over 550 former Soviet Union (FSU) rules, regulations, procedures and manuals that are scheduled to expire within the next year or need to be revised;
- ▶ Draft Prospectus for an Aral Sea Consortium;

- ▶ Conducting training sessions for GOK officials in Strategic Planning, International Petroleum Economics, Energy Regulatory Agency Administrative Law, Petroleum Investment Agreements, Oil and Gas Accounting, and Oil and Gas Project Finance.

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## CHAPTER 2

### IDEAL FRAMEWORK FOR ENHANCING OIL & GAS INVESTMENT

Kazakhstan's legal and regulatory framework for the oil and gas sector should be considered in relation to an "ideal", in order to identify problem issues and the proposed course of action by the GOK to resolve those issues. An ideal framework is proposed, taking into account the current legal, political, economic, and social situation.

#### 2.1 POLICIES

Oil and gas policies should be broad and general guidelines, the capstone for setting overall government objectives such as developing strategies for exploitation of oil and gas resources, priorities for oil and gas investments, allocation of state resources, and attraction of foreign investment. Such policies should be set at the highest level of government.

Kazakhstan's strategic plan for restructuring and privatization and enhancing the investment environment in the oil and gas sector was unveiled in March 1997. The long-term objectives of the strategic plan are to:

- ▶ Satisfy the internal demand for oil, gas and refined oil products through increased production and improved distribution; and
- ▶ Earn hard currency through the use of multiple and imaginative means of short-term transportation and the long-term establishment of continuous transportation systems which would allow Kazakhstan to supply significant volumes of oil and gas to international markets.

The former Ministry of Oil and Gas Industry had identified: 1) over 50 oil and gas fields that are planned for development; 2) construction or refurbishment of at least five to ten processing facilities and refineries; and 3) several additional oil and gas pipelines requiring construction. One of the key strategies of the Ministry was to include a carefully organized investment program in its strategic plan. The investment program outlined short, medium, and long-term projects which were carefully prioritized.

It is not clear whether Kazakhstan's investment program for its oil and gas sector takes regional supply and demand issues into account. Kazakhstan, along with the other Central Asian countries, should seek to optimize their investments on the basis of regional

opportunities. With regional cooperation, Kazakhstan and neighboring countries can avoid duplicate investments and reduce the need for self-sufficiency. Regional cooperation is needed for exports of oil and gas through common pipelines and for solving environmental problems.

## 2.2 LEGISLATION

Oil & gas legislation prescribes the framework of the government's authority in the sector and is concise and operative in a form that is: (1) acceptable to the Parliament, which will enact it, and the Government, which will implement it; and (2) adopts international oil and gas practices and standards.

As mentioned earlier, Kazakhstan has enacted a number of laws and decrees that have improved the legislative framework of the oil and gas sector for investors. The Presidential Edicts "Concerning Petroleum" and "Concerning the Subsurface and Its Use" establish the general rules for the conduct of oil and gas operations. They specify the aims and principles of the executive bodies, procedure for tendering, procedure for licensing and execution of exploration and production contracts, rules for protection of the subsurface, conditions for the safety of the population and personnel, and the rights and obligations of the subsoil users. The Subsurface Edict is more comprehensive than the Petroleum Edict. It is more general in nature and is intended to apply to all economic subsurface minerals. It has been established that the Petroleum Edict overrides the Subsurface Edict, in the event of conflict. However, the Subsurface Edict contains provisions for conveying the ownership rights for the exploitation of subsurface minerals from the State to individuals and companies and between individuals and companies. These provisions facilitate approaches to the privatization of oil and gas activities that are not present in the Petroleum Edict.

The existing legal framework for the oil and gas sector is generally acceptable. However, it should undergo legislative improvement to make the process more transparent and attractive for investors. Kazakhstan would also benefit by amending the Presidential Edict "Concerning Petroleum". This Edict should be made more comprehensive to specific oil and gas issues by incorporating features from the Subsurface and Licensing Edicts. An independent Oil and Gas Regulatory Agency (OGRA) should be appointed as the competent body and in theory be the single point of contact for regulatory issues concerning investors.

## 2.3 RULES AND REGULATIONS

Oil and gas rules and regulations should conform to international standards and practices, be adopted and enforced by an independent OGRA, and cover the mechanics for the management of operations in the oil and gas sector. Rules and regulations may be very specific in direction, but retain flexibility and transparency, taking an objective and result-oriented approach rather than the Soviet-style prescriptive mechanisms in place today. The OGRA should be empowered with a transparent methodology to allow for changing

circumstances and the ability to reissue rules and regulations without undue political or industry influence.

The OGRA should function as an autonomous, non-political, quasi-judicial, and technical body of Government in association with the oil and gas industry. The concept of an independent OGRA is important, since it provides consistency and stability to decisions and allows investors (and potential investors) reasonable assurances that their investments are insulated and will not be affected by short-term political considerations. The OGRA would function as a "one-stop" agency which would represent the GOK on all oil and gas regulatory issues in an impartial and transparent manner. The OGRA would be responsible for: conservation and management of natural resources; maintaining a repository of oil and gas field operations data and information; issuance of permits and licenses and collection of their corresponding fees; establishment of transportation tariff mechanisms and rates for oil and gas pipelines; resolution of disputes; approval of oil and gas contracts between the GOK and investors; and the promulgation and enforcement of rules and regulations prescribed under the framework of laws and legislation enacted by the GOK.

#### **2.4 NATIONAL OIL COMPANY KAZAKHOIL AND NATIONAL OIL PIPELINE COMPANY KAZAKHNEFTEPROVOD**

The role of National Oil Company (NOC) is to carry out exploitation of oil and gas resources on behalf of the State. The NOCs have evolved from the need to control, protect, and develop the indigenous capability to exploit an important national resource. In many countries, the NOC is assigned exclusive authority to exploit all domestic oil and gas reserves. They operate oil and gas fields on their own behalf as any oil company would. Where NOCs lack the necessary technology and risk capital, they have been authorized to enter into contracts with foreign oil companies. Today, production sharing is the most common form of contract. NOCs are responsible for managing the contracts with foreign oil companies. Both Indonesia, which pioneered this concept, and Malaysia have used this arrangement for over 25 years to successfully attract significant foreign investment in their oil and gas sector. As a result, the NOCs in these countries have developed into sophisticated and technically competent oil companies which are venturing out in the international arena.

Kazakhstan has taken a somewhat different approach in the development of its national oil and gas company and it is much further along in the process of restructuring and privatization as compared with other Central Asian Republics. Kazakhstan's regional oil and gas producing entities have been converted into joint stock companies (JSCs). A new national oil company, KazakhOil has been created along with a national oil pipeline company KazakhNefteProvod. KazakhOil manages the State's interests in the JSCs that conduct exploration, production, and refining operations. The privatization of individual JSCs is accomplished through Trust Management Contracts (TMC) leading to privatization,

concessions, and sale of JSC shares to investors. A signature bonus and specified work commitments are integral parts of the TMC. It is planned that the State would dispose of its JSC shares in KazakhOil on the stock exchange as the operations of the JSC improves. In some instances, KazakhOil has entered into a production sharing contract with an investor for a producing field (Karachaganak) and could do the same for new exploration areas (Caspian Sea). KazakhOil itself is a JSC and may eventually be partially or completely privatized. The oil transportation activities have been consolidated under National Oil Pipeline Company KazakhNefteProvod. Plans are to restructure and privatize the JSC, with an emphasis on attracting shippers as stockholders. The gas transportation entity, KazakhGas has been privatized through a management operations contract with Tractebel.

Kazakhstan should assure that JSCs which have not yet been privatized continue to streamline their operations. Those JSCs should proactively seek new technologies and investment to upgrade their operations and be competitive.

## **2.5 CONTRACTS, AGREEMENTS AND LICENSES**

Both the Petroleum and the Subsurface Presidential Edicts assign the responsibility for negotiating and signing of contracts to a special Government body (Competent Body in the Petroleum Edict and Authorized Body in the Subsurface Edict); however, no specific Government agency was specified in either Edict. Negotiators of contracts are required to include provisions that will resolve environmental protection, health, subsoil use and protection, and safe conduct and supervision of operations with relevant State agencies. The procedures for contracts are governed by two separate GOK Resolutions, "On the Procedure for the Registration of Contracts to Conduct Subsoil Operations" and "On the Procedure for the Conclusion of Contracts to Conduct Subsoil Operations" adopted on July 15 and September 6, 1996 respectively. The contracts are signed by the Competent Body pursuant to "Regulations on Competent Organs of the Government of the Republic of Kazakhstan. Dealing with the Conclusion and Execution Contract with Subsurface Users of the Underground Resources" dated May 27, 1996. The implementation of the contract is the responsibility of the Competent/Authorized Body. In the matter of local economic, ecological, and land issues, both of the Edicts assign implementation responsibilities to local representatives and executive bodies.

A contract for subsurface operations can be signed only after a license has been issued and the contract terms cannot be contrary to the terms of the license. Licenses are issued pursuant to the Presidential Edict "Concerning Licenses". Since as many as 27 Governmental bodies are known to be involved, the process for licensing and contracting has proved to be very burdensome. The GOK recognizes this problem and recently placed the licensing process in abeyance until a "Law on Licensing" could be revised.

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## CHAPTER 3

### RECOMMENDED CHANGES IN THE STRUCTURE OF THE OIL AND GAS SECTOR

The recommended changes for the oil and gas sector of Kazakhstan are based upon the current status of laws, rules and regulations, process, structure and institutions, and ideal framework for enhancing oil and gas investment. It should be noted that these recommendations are based solely on the study of Kazakhstan's laws and regulations, published information, and informal discussions with GOK officials. Kazakhstan has achieved significant progress in legal reforms to date and is the most progressive among the Central Asian Republics in creating a viable privatized oil and gas sector. The changes proposed are primarily intended to simplify the investor-GOK interface, bring rules and regulations to international standards, and create an improved mechanism of adopting, revising, and enforcing regulations through an independent OGRA. The recommendations describe how USAID's specific technical assistance and training activities will help support the proposed changes.

#### 3.1 POLICIES

*Kazakhstan should emphasize investments which take advantage of the regional supply and demand imbalance and support policies that maximize oil and gas exports to potential markets. Construction and refurbishment of oil and gas pipelines with adequate capacity are needed to attract foreign investment and spur exploration and development of oil and gas resources.*

The GOK should be a regional leader in the development of potential markets for Central Asian domestic oil and gas supplies. Investments should be oriented towards maximizing production and construction and refurbishment of oil and gas pipelines, to ensure reliable supplies to regional markets.

USAID has engaged in preliminary discussions with KazakhOil, KazakhNefteProvod, the Ministry of Energy and Natural Resources (MENR), the State Agency for Strategic Planning, and the State Agency for Control of Strategic Resources on policy issues that address restructuring and privatization, regulatory mechanisms, operations of State-owned companies, encouragement of strategic investment into oil and gas transportation systems, and management of revenues derived from oil and gas production. USAID has developed a training program for GOK officials which includes courses in Strategic Planning and International Petroleum Economics. These courses would serve to reinforce strategic thinking and planning on specific issues as well as those that effect the world oil and gas industry.

### 3.2 LEGISLATION

***Kazakhstan should amend the Presidential Decree “Concerning Petroleum” to make it more comprehensive by incorporating features from the Subsurface and the Licensing Decrees. The amended Decree should establish an independent OGRA to serve as a single point of contact for investors.***

USAID should assess and carefully consider the political-economic environment in addressing the need to amend the Presidential Decree “Concerning Petroleum”. Perhaps a working group of GOK officials, international oil and gas community representatives, and USAID advisors could be incorporated to address oil and gas specific concerns in: subsurface operations, licensing and contracting, insurance programs, and other areas of the present Decree that need clarification. Most importantly, the amended Decree should resolve the regulatory institutional structure by creating and appointing an independent OGRA. This amendment would serve to eliminate many of the regulatory uncertainties and structures that concern investors, giving them a single agency to resolve issues.

### 3.3 RULES AND REGULATIONS

***Kazakhstan should immediately create an independent OGRA, responsible for the promulgation and enforcement of rules and regulations. In addition, a review of the Former Soviet Union (FSU) rules, regulations, procedures, instructions, manuals, etc. should be made to determine what needs to be continued, revised, or replaced.***

Over the past several months, we have stressed the need to create an independent OGRA. Many GOK ministries, agencies, and committees have been contacted in this regard. However, placing regulatory authority and responsibility for an entire sector in a non-political body is a relatively foreign concept. Unfortunately, there would need to be several changes in current law to allow for a relatively independent agency to exist and function outside the realm of political influence and control. In addition, it is widely known that several Government bodies rely on partial funding from the oil and gas community, which they generate by issuing licenses and permits. Nevertheless, USAID through its contractors, continues to have influence with the GOK for the creation of independent regulatory agencies through draft proposals being considered in the “Law on Natural Monopolies” and amendments to the Presidential Decree “On Electric Power Engineering”. The GOK is beginning to understand the need for independent regulation of privately-held companies, based on its experience in the power sector privatization process and the failure to regulate through agreements and contract mechanisms. Hagler Bailly plans to conduct a training course on Energy Regulatory Agency Law to reinforce the concept of independence and heighten the need for systematic agency actions relating to information gathering, rule-making, licensing, and adjudicatory hearings.

In general, many of the FSU rules and regulations that were adopted by the GOK are prescriptive in nature, focusing more on specific techniques rather than end-results, and the concept of flexibility needed to adjust for technology or unnecessary costs to investors (and ultimately to Kazakhstan) is absent. The GOK has recognized that over 550 rules, regulations, procedures, instructions, manuals, etc., that directly address the oil and gas sector were taken from or modeled on FSU standards and there is a great need to review and determine which of these should be continued, revised, or replaced. USAID should coordinate resources with the GOK, other donors and the oil and gas community to review the need for individual FSU documents, prioritize the actions that are to be taken, and develop a plan to build a foundation of rules and regulations which meet the requirements of Kazakhstan and conform to international practices and standards. Some rules and regulations that need to be considered include:

- ▶ Regulations, procedures and obligations relating to exploration and production licenses.
- ▶ Rules for the protection of petroleum resources.
- ▶ Rules for the protection of the environment.
- ▶ Rules for public life and health protection.
- ▶ Rules for the identification and protection of Holy sites, and historical and cultural monuments.
- ▶ Rules for registration of contracts.
- ▶ Rules for revocation of licenses.
- ▶ Rules regarding bank guarantees or substitute.
- ▶ Rules concerning the timing and procedures for holding a tender.
- ▶ Rules concerning submission of bidding proposals.
- ▶ Rules regarding license validity periods, as well as the suspension, revocation, and termination thereof.
- ▶ Rules concerning submission of bidding proposals.

- ▶ Rules regarding the substance and approval process of voluntary and forced utilization.
- ▶ Rules regarding the location, construction, operation, use and the ultimate dismantling of structures placed in navigable waters.
- ▶ Rules regarding the discharge and burial of wastes from petroleum operations, including the setting of permissible levels of impurity.
- ▶ Rules concerning the measurement and weighing of petroleum, including the frequency and methods.
- ▶ Rules concerning the protection of natural resources, and the conduct of spill clean-up operations.
- ▶ Rules concerning the reclamation of land utilized for petroleum operations.
- ▶ Rules concerning the laying and operation of submarine pipelines and cables.
- ▶ Rules regarding the content, and submission requirements relating to an environmental protection plan.

The GOK has set a date for expiration of the FSU rules and regulations, but has yet to develop replacement directions.

The GOK has established a Steering Committee for the Establishment of Offshore Regulations consisting of representatives from MENR, KazakhOil, JSC Kazakhstan Caspi Shelf, Ministry of Ecology and Bioresources, Gosgortekhnadzor, Hagler Bailly and the Kazakhstan Petroleum Association. The Steering Committee has been meeting monthly to review and provide direction on the development of working drafts by Hagler Bailly. The Steering Committee intends to approve final drafts of the following proposed regulations by the end of 1997 and support the legislative process for adoption next year. Principal areas being covered by the developing regulations include.

- ▶ Instruction on Observance of Environmental Protection During Planning and Conduct of Oil Operations in Offshore, Coastline, and Internal Bodies of Water.
- ▶ Methodical Recommendations to Define Payment for Physical Environment Impact

Caused to Marine and Closed Water Resources (Acoustic, Vibration, Electromagnetic, etc.).

- ▶ The Scope of Documents Aiming to Define the Level of Damage Caused to the Marine and Internal Water Reservoirs Due to the Result of Violation of Nature Normatives During Oil Operations (in Addition to Damage Levels).
- ▶ Safety Rules for Construction of Facilities While Conducting Oil Operations in Offshore and Internal Bodies of Water.
- ▶ Technical Rules for Construction of Facilities While Conducting Oil Operations in Offshore and Internal Bodies of Water.

### **3.4 NATIONAL OIL COMPANY KAZAKHOIL AND NATIONAL OIL PIPELINE COMPANY KAZAKHNEFTEPROVOD**

*The GOK should formally develop a Program of Restructuring and Privatization of both KazakhOil and KazakhNefteProvod.*

USAID has offered assistance to both KazakhOil and KazakhNefteProvod in the development and implementation of individual Programs for Restructuring and Privatization. These Programs could address selected elements, including but not limited to: strategic planning; goals and objectives; valuation of assets; reduction of debt; cost of asset refurbishment; risk/return assessments; shareholding structure; level of Government intervention; reduction of subsidies and social costs; financial and economic impact issues; etc. KazakhOil and KazakhNefteProvod should analyze their various business functions and undertake a program of divestment and privatization of entities that are not central to their core activities.

### **3.5 PIPELINE TARIFF METHODOLOGY**

*KazakhNefteProvod should adopt an objective and transparent cost-of-service rate-of-return oil pipeline tariff methodology and revise its tariff rates accordingly.*

USAID has been assisting the GOK in developing an objective and transparent cost-of-service rate-of-return oil pipeline tariff methodology. A Steering Committee was formed by the GOK, which meets monthly and includes representatives of KazakhNefteProvod,

KazakhOil, MENR, State Agency for Control of Strategic Resources, Ministry of Economy and Trade, the Kazakhstan Petroleum Association and Hagler Bailly. Hagler Bailly advisors have taken the lead in the project by: conducting research on the pipeline configuration and its accounting, cost, and revenue structure; creating a computer model of the tariff methodology; analyzing current tariff rates and their relationship to costs of operations; and recommending a methodology and tariff rates that are adaptable to GOK accounting and business practices and are fair and reasonable to both investors and shippers. The Steering Committee has requested that USAID provide the proposed tariff methodology and recommended tariff rates to KazakNefteProvod by September 25, 1997. USAID should assist KazakhNefteProvod in the procedure for GOK adoption of the tariff methodology and further refine the recommendations as needed or requested. The implementation of the new tariff rates is planned for January 1, 1998.

### **3.6 CONTRACTS, AGREEMENTS AND LICENSES**

*The GOK should adopt a standard transparent procedure for entering into contracts and agreements with private investors in the oil and gas sector. Operating licenses and permits should be issued by the independent OGRA.*

The GOK should negotiate and approve oil and gas contracts and agreements with private investors that reflects international practices and standards. A simple standard transparent procedure for entering into contracts and agreements in Kazakhstan should be developed and implemented.

The independent OGRA should have the right to approve oil and gas contracts and agreements in relation to regulatory issues. In addition, the OGRA should be the only GOK body responsible for issuing operating licenses and permits in the oil and gas sector. Operating licenses and permits should grant permission to conduct specific activities and not be issued until after a contract or agreement has been approved.

### **3.7 REGIONAL COOPERATION WITHIN THE CENTRAL ASIAN REPUBLICS**

*Kazakhstan should create a legal and regulatory climate for oil and gas development, which complements the Central Asian region.*

In order to be competitive in the attraction of investment to its oil and gas sector, Kazakhstan must be cognizant of the ongoing legal and regulatory reform activities in the region. Currently, USAID is in the process of negotiating Memorandums of Understanding with other independent in the region to provide similar technical assistance. In this context, USAID consultants and Hagler Bailly strive to design similar oil and gas rules and

regulations which complement the Central Asian Republic regional investment environment, but tailor these projects to the concerns of each individual country.