

- PD-ABR-065
- 100188

- 8

**CAR OIL AND GAS LEGAL,
REGULATORY, AND INSTITUTIONAL REFORM
REPUBLIC OF KAZAKHSTAN - FINAL REPORT**

**NIS Institutional Based Services Under the
Energy Efficiency and Market Reform Project
Contract No CCN-Q-00-93-00152-0
Delivery Order No 17**

**Central Asian Republics
Regional Energy Sector Initiative**

Final Report

Prepared for

U S Agency for International Development
Bureau for Europe and NIS
Office of Environment, Energy and Urban Development
Energy and Infrastructure Division

Prepared by

Hagler Bailly
1530 Wilson Boulevard
Suite 400
Arlington, VA 22209-2406
(703) 351-0300

September 1998

CONTENTS

Executive Summary

Chapter 1 Introduction

Chapter 2 Subtask A Legal and Regulatory Reform

Major Results - Offshore Oil and Gas Rules and Regulations	2-1
Major Results - Oil Pipeline Tariff Methodology	2-5
Required Deliverables	2-8
Next Steps	2-8

Chapter 3 Subtask B Institutional Development

Major Results - Oil and Gas Regulatory Authority	3-1
Major Results - Aral Sea Consortium	3-3
Required Deliverables	3-5
Next Steps	3-6

Chapter 4 Subtask C Seminars/Workshops/Study Tours/Training

Major Results	4-2
Required Deliverables	4-2
Next Steps	4-2

Chapter 5 ChapterSubtask D Advisory Services/Coordination and Management of Subtasks A-C

Major Results - Oil and Gas Export Transportation Routes	5-1
Major Results - Specific Requests	5-2
Required Deliverables	5-3
Next Steps	5-3

Chapter 6 Lessons Learned

Appendix A Draft Law "On Regulation of Oil and Gas"

Referenced Reports

Appendix 1	Final Report - Offshore Oil and Gas Rules and Regulations
Appendix 2	Final Report - Oil Pipeline Tariff Methodology

Appendix 3	Concept Paper - Model Oil and Gas Regulatory Agency
Appendix 4	Final Report - Prospectus for an Aral Sea Consortium
Appendix 5	Final Report - Central Asian Countries Training Plan
Appendix 6	Final Report - Training Provided
Appendix 7	Long Term Advisor Report - J Michael Biddison
Appendix 8	Long Term Advisor Report - Claude W Eggleton
Appendix 9	Reference Materials & Equipment Identification and Procurement- Kazakhstan

EXECUTIVE SUMMARY

Kazakhstan, rich in natural resources, has been limited in developing its oil and gas due to the physical, economic, financial, legal, and regulatory restrictions it inherited from the former Soviet Union. Its ability to export oil and gas to world markets remains virtually controlled, six years after declaring independence, by Russia. Kazakhstan has made significant progress, beyond that achieved by Russia, in addressing the needs of a market economy and, as a result, it may be overall in a better position to attract investors in its energy resources - due to its ability to negotiate production sharing agreements, adopt an internationally acceptable oil pipeline tariff methodology, standardize tax issues, etc. During the course of this contract, USAID has assisted in a number of efforts to dramatically advance Kazakhstan's goal of transitioning to a market oriented oil and gas sector. The Prospectus for an Aral Sea Consortium and the International Aral Sea Consortium Agreement, when negotiated and signed, could lead to the exploration and development of the Aral Sea, the anticipated adoption of international offshore oil and gas rules and regulations will allow for the safe development of oil and gas in environmentally sensitive areas, the planned creation of an export pipeline working group demonstrates a clear recognition of the obstacles that prevent access to world markets, the request for technical assistance in the evaluation of the Kazakhstan/China Pipeline demonstrates the need to economically justify the project, the adoption and utilization of an international oil pipeline tariff methodology and public hearing process provides financial confidence to producers and shippers, etc. Concentrated efforts still remain in broadening the tariff methodology to gas pipelines and gas distribution systems, the creation of an independent oil and gas regulatory authority, rewriting a complete set of result oriented rules and regulations, the establishment of multiple export pipeline routes, creating a competitive environment for oil and gas shipments to world markets, etc.

CHAPTER 1

INTRODUCTION

INTRODUCTION

The USAID/Central Asia Republic (CAR) mission objective is “an effective policy framework in place to achieve private investment in an environmentally sound, regionally efficient, market oriented energy sector ” The desired intermediate result is to create a ‘ legal and regulatory environment conducive to private investment in energy ” Within this framework, Hagler Bailly has been providing technical assistance (TA) to the Governments of Kazakhstan (GOK), Turkmenistan, and Uzbekistan under Delivery Order 17 (DO 17) since February 1997 DO 17 is specific to the CAR Oil and Gas Sector Reform Program

The effort under DO 17 includes similar activities in Kazakhstan, Turkmenistan, and Uzbekistan Both regionally and in each country work has proceeded under the following subtasks

- Subtask A Legal and Regulatory Reform
- Subtask B Institutional Development
- Subtask C Seminars/Workshops/Study Tours/Training
- Subtask D Advisory Services/Coordination and Management of Subtasks A-C

Frequent changes of governmental structures and leadership in government has been more the rule than the exception, since the Republic of Kazakhstan (ROK) realized its independence Therefore, it is key that USAID recognize that the mission objectives and intermediate results are flexible and adaptable for changes in the GOK, especially in relation to oil and gas initiatives Therefore, all strategies embraced broad approaches rather than detailed plans It was the responsibility of Hagler Bailly to function within this environment and to adapt approaches which were realistic and attainable

A foundation for Kazakhstan economic growth and stability is the export of its significant mineral resources, including oil and gas In 1997, Kazakhstan produced about 521,000 barrels per day of oil, ranking 29th in the world and second only to Russia in the former Soviet Union

In maximizing all current means of export (pipeline rail and ship), Kazakhstan's ability to move oil to world markets remains a fraction of its potential. The lack of significant export transportation routes, coupled with the current low prices of oil in the market, makes it even more important for Kazakhstan to adopt international standards and practices, as is applied through USAID TA, to enhance its ability to attract investment in oil and gas for the long term.

CHAPTER 2

SUBTASK A: LEGAL AND REGULATORY REFORM

SUBTASK A LEGAL AND REGULATORY REFORM

The primary focus of this task was to provide TA on existing and proposed laws, decrees, and regulations relating to oil and gas development to ensure that they are internally consistent and in keeping with acceptable international standards. Efforts in this subtask were the development of offshore rules and regulations and to facilitate the adoption of an internationally acceptable oil pipeline tariff methodology.

Major Results - Offshore Oil and Gas Rules and Regulations

The purpose of this project was to assist the GOK and its state offshore oil company, Kazakhstancaspiishelf (KCS) in drafting a set of rules and regulations to govern the conduct of petroleum operations in the Caspian and Aral Seas, the adjoining coastal areas, and in and along other internal water bodies of the ROK. Up until the dissolving of the Caspian Sea Consortium (CSC) in 1997, the agreement for that consortium and its Exploration Research Study, primarily seismic in scope of work, was used as a substitute for a regulatory program. The GOK did not believe that the "Uniform Rules for Onshore Petroleum Operations," drafted and adopted in 1996 were applicable offshore. In addition, the onshore rules were adopted prior to the general availability and familiarity with the large number of international standards which are approved through the International Standard Organization. The standards are objective and performance based in their content and are the cornerstone of the "Environmental Management and Health Safety Plans," which have been adopted by the international oil companies involved in current and future petroleum operations in Kazakhstan.

The GOK is very anxious to attract foreign investors in the development of its vast oil and gas reserves. Geologic and seismic information to date indicates that the Caspian Sea is to be a prime area for oil and gas exploration and development. Although KCS gained a wealth of knowledge on the approach to oil exploration through its participation in the CSC, foreign capital and technologies are an imperative ingredient to maximizing the recovery of hydrocarbon reserves in Kazakhstan, where the current economic situation is fragile. In addition, the Caspian and Aral Sea regions are environmentally sensitive areas and, in the case of the North Caspian Sea, where large deposits of recoverable oil is possible, the GOK

has delineated "Ecologically Sensitive Areas and Specially Protected Natural Resource Areas" by law and edict. Environmental regulations for offshore situations such as the spillage of oil are essential to creating a compatible balance between resource specific environmental protection and the orderly, cost effective production of oil and gas. Offshore oil and gas exploration and development cannot realistically proceed without a viable regulatory framework which provides a level playing field for all operators.

In late 1996, Hagler Bailly was contracted to provide assistance to the GOK and KCS in the development of offshore oil and gas regulations. In January 1997, a working group was established by presidential decree and directed to draft sets of rules and recommendations on five specific offshore activities. This working group was represented by three foreign members of the Kazakhstan Petroleum Association (KPA), KCS, KazakhOil, the Ministry of Ecology and Bioresources (later changed to the Ministry of Ecology and Natural Resources or MENR), the State Emergency Committee, and the Ministry of Oil and Gas Industry (later changed to the Ministry of Energy, Industry, and Trade or MEIT). In early 1998, the oil and gas regulatory functions relative to these regulations, with some exceptions, were transferred to the MENR. The three KPA members appointed to the working group were Mobil, Royal Dutch Shell, and Agip. Tulpar-Munai also participated substantially in the health and safety regulatory portion of working group considerations.

The working group met ten times during 1997 to consider regulatory drafts prepared by Hagler Bailly consultants. August and October were the only months where meetings did not take place. No meetings were held in 1998, because the main documents for health and safety, technical construction, and environmental protection were completed by the end of December 1997. The September and November meetings encompassed an entire week, since the number of issues to be discussed were numerous.

Concurrent with the drafting of regulations, Hagler Bailly consultants spent considerable time researching applicable laws and regulations which were in effect and would affect the content of the rules being drafted. The GOK had inherited over 200 sets of GOST standards, regulations, and manuals which had the force of regulation from the former Soviet Union. Selected regulations were translated from Russian to English so that a match between existing requirements and ones being drafted could be made. In addition, the GOK had adopted a number of rules for natural resource protection and health and safety since 1993, which had some effect on the offshore regime.

The activities of the working group between January and May 1997, focused primarily on developing an outline for each of the five documents which was essentially a Table of Contents. The usual style in Western cultures is to develop the Table of Contents after, rather than before regulations are written, but the Kazakhstan preference is the reverse. The KPA members also expressed a desire for "no surprise subjects to be included" which they did not know about at the outset. This process, however, did serve one purpose and that was to

establish lines of communication among working group members who were accustomed to different regulatory persuasions. This may have facilitated discussion later in the year because by July, a lot of the major issues had been discussed.

A setback occurred after completion of the first draft of the environmental protection instructions in July 1997. In August 1997, the GOK passed the Law "On the Protection of the Environment" and the Law, "On Specially Protected Areas" which required substantial revision of this document. These laws also delineated responsibility splits between state and oblast governments which made our previous drafts statutorially inaccurate. Working group members either were not aware of the imminent passage of these laws or did not perceive the effect they would have on working group deliberations.

Activities during 1998 through the preparation of this report included finalizing the fourth document on "Damage Assessments for Environmental Violations and Payments for Physical Environmental Impacts" (seismic, acoustical, etc). KCS rewrote the first three documents into ROK standard regulatory formats which is substantially different in form, but not in context, than the drafts prepared by Hagler Bailly consultants. These drafts have been commented upon by both the GOK and the KPA members. During the past several months, the consultants have prepared several revisions based on comments and accompanied each set of responses with explanatory papers as to why or why not the comments resulted in document revisions.

As a result of work group discussions, Hagler Bailly was requested to develop several small issue papers or statements where working group members could not reach closure on an important issue. These included a discussion of operator responsibility versus liability, the definition of a coastline versus coastal area, and the difference between a contractor and an operator.

Below is the current status of each regulatory document considered by the working group along with a summary of the contents of the document.

- 1) Instructions for the Observance of Standards of Environmental Protection During the Design and Implementation of Petroleum Operations in Offshore, Coastline and Internal Water Bodies of the Republic of Kazakhstan

This document represents the core set of regulations and norms for the protection of the offshore environment during all petroleum operations. It provides a limiting definition to establish delineation between offshore and onshore and contains a specific definition of a coastal zone. It established the procedures for monitoring environmental media from both ambient and nature use permit aspects, requires the operator to have an approved waste management program, and a spill contingency plan for offshore operations. It sets forth the procedures for the required

Environmental Impact Assessment, which must be approved prior to the beginning of petroleum operations. Support facilities such as tank farms, supply depots and vessel loading stations are also covered because these activities are linkages between onshore and offshore. A process is provided for both the operator and the ministry responsible for the regulatory activity or enforcement action to hold hearings and informal conferences. Ten state ministries and committees and two regional entities are involved in the implementation of these rules however the majority of responsibility is assigned to three state entities and the two regional groups. In summary, this set of regulations represents a comprehensive environmental protection program.

This set of regulations was approved by the working group in November 1997 revised into GOK format in February 1998, and has since been sent to working group members for final revision. The final revised regulations were sent to various ministries and oblast administrations for final comment in July 1998. Hagler Bailly consultants are currently reviewing the latest set of comments from the ministries. KPA has indicated in writing that the latest draft sent to the ministries is acceptable to industry and should be approved.

2) Uniform Technical Rules for the Construction of Facilities While Conducting Petroleum Operations on Offshore and Internal Water Bodies in the Republic of Kazakhstan

This set of rules guides the conduct of the operator in drilling, constructing, operating, and abandoning any offshore oil, gas, or injection well during petroleum operations. It describes the duties of the operator and the ministry relative to project and design approval and is a counterpart to the "Uniform Rules for Onshore Petroleum Operations" established under presidential edict. The regulations are objective-based and, unlike previous Soviet-style regulations, do not set out a step-by-step approach to technical well completions and depends upon the operator to submit a project plan for approval. This set of regulations was approved by the working group in December 1997 and revised into Kazakhstani format in February 1998. It has since followed the same review process as described for the environmental protection instructions and has received written notice from KPA that the document is acceptable in the present draft form.

3) Safety Regulations for Conducting Oil Operations in Offshore and Internal Water Bodies in the Republic of Kazakhstan

This set of rules includes comprehensive requirements for conducting all operations on offshore facilities in a manner which protects the health and safety of workers at all times. It requires the operator to have a "Health and Safety Management Plan,"

approved by the Competent Body prior to beginning petroleum operations. The regulations cover such matters as protection against hydrogen sulfide gas release, explosion and fire protection, and establishes procedures for evacuation of personnel from an offshore platform. This regulatory package was first approved by the working group in December 1997 and has followed the same route through the review process as the environmental protection and technical construction rules. The Kazakhstani citizens are very safety conscious and the Ministry of Labor has a lot of regulations which apply to onshore operations. The intent of this regulatory package is to supercede existing regulations where they are in conflict. The KPA has expressed written notice that these rules are acceptable and should be adopted in the current draft form.

4) Methodical Recommendations to Define the Level of Damage Caused to Marine and Internal Reservoirs Resulting from Physical Environmental Impact and Violation of Nature Use Normatives

The original charge to the working group was to prepare two documents, one for a compilation of documents used for calculation of damage assessments from violations such as oil spills, air emissions, or unauthorized discharges, the other for payments to the ROK for loss of fish life and supporting biota from permitted activities such as seismic explosion and vessels transporting material to platforms. Hagler Bailly prepared a damage document in October 1997, which went to the working group and comments were received. In January 1998, the payment portion was submitted as a separate set of recommendations. In February, the working group decided to merge the two documents into one because of the redundancy that was necessary to support the two documents. Hagler Bailly redrafted the documents into one, changed the title, and submitted it in July 1998. No further action has been taken by the working group on this document and none is anticipated before October 1998. The other three sets of rules are essential to have approved before offshore petroleum operations begin. This package attempts to modify the way monetary penalties and damage reimbursements are calculated.

Major Results - Oil Pipeline Tariff Methodology

Development of international export markets for Central Asia's abundant oil and gas resources is critical to the economic development and political independence of Kazakhstan. A viable pipeline infrastructure which provides transportation services at economic rates, yet achieves a sufficient revenue stream to provide for maintenance, expansion, and capital attraction is vital to the export market development of oil and gas.

On July 12, 1996 USAID received a letter from the Ministry of Oil and Gas Industry (MOGI) requesting technical assistance in the development of an internationally acceptable oil

pipeline tariff methodology for the GOK Pursuant to USAID s agreement to fund the activity under DO 17, a steering committee comprised of representatives of KazTransOil (the newly formed national pipeline), KazakhOil, Ministry of Economy and Trade, Anti-Monopoly Committee (AMC), the Ministry of Energy and Natural Resources, State Agency for Control of Strategic Resources, KPA, and Hagler Bailly was formed The steering committee was co-chaired by Kaergeldy Kabylden, Vice President of KazTransOil and by Michael Biddison, Principal and Regional Manager of Central Asia, Hagler Bailly The initial meeting took place on April 21-22, 1997 with a total of six meetings in 1997

The creation of the steering committee was a great success It provided a forum for coordination, direction, and most importantly, education among the various government agencies and ministries, industry representatives (both local and international), and Hagler Bailly From the inception of this project until the methodology was approved, the membership of the steering committee and the agencies themselves underwent extensive change reflecting changes in the GOK New members were able to participate and share knowledge, and the forum provided the opportunity for the consultants and other parties to educate key communicators in the GOK The main source of continuity and institutional memory throughout the entire process was Hagler Bailly

The outgrowth of the steering committee process was a series of products, each building on the other, which led to overall successes In addition to the key educational values of the initial meetings, an important early product was a computerized valuation and tariff model of the KazTransOil system There should be little debate regarding the importance of developing and using accurate cost data in a tariff methodology In North America, where the cost-recovery methodology has been in existence for as long as there has been a pipeline industry, the rules and regulations defining allowable costs and their use in calculating tariffs have been developed and refined over decades Tariff related costs in formerly centrally controlled economies are extremely difficult to assess This applies for both the valuation of the original investment used in construction and the assessment of annual operations and maintenance (O&M) costs

The success of the tariff rate demonstration report then led to the preparation of a procedural guide for the implementation of the international tariff methodology At the October 29, 1997 steering committee meeting, a resolution, the actual tariff methodology, and recommendations from the steering committee were presented and discussed Additional comments were later incorporated and the final recommended methodology was delivered to the GOK in November 1997, as passed by the steering committee

On May 22, 1998, in a nationally televised public hearing (possibly one of the first in the former Soviet Union), testimony was heard from Michael Biddison, KazakhOil, KazTransOil, and the AMC All positively supported the proposed methodology Hagler Bailly had provided a procedural guide for holding a public hearing, which was extensively

followed. The public hearing was chaired by Yerzhan Utembaev, Chairman of the Agency for Strategic Planning and Reforms (ASPR). The importance of the recommended methodology and its crucial impact on oil operations in Kazakhstan called for personal briefings of President Nursultan Nazarbayev on the day preceding the public hearing by Mr. Utembaev. The minutes of the public hearing were jointly signed by those that attended.

On June 5, 1998 the AMC executive board met and formally approved the recommended methodology for the preparation of oil pipeline tariff rates. On July 1, 1998 rates were established based upon this methodology. In adopting a cost based rate of return methodology, the export surcharge was eliminated improving the economic viability of exported oil. Additionally, interest has been aroused to establish similar tariff methodology approaches for other natural monopoly industries, such as gas pipelines and gas distribution utilities.

The adoption of the recommended tariff methodology encompasses a number of key elements, including

- The steering committee approach of the open discussion and debate of the development of tariff methodology and tariffs among interested parties was accepted.
- A return on assets should be the basis for generating revenue and retained earnings for investors as opposed to a markup of expenses which does not include dividends to investors.
- Debt and equity financing is considered, used and useful assets are regularized, and fundamental definitions and rate formulas are integral.
- The use of international depreciation calculations are incorporated.
- Tariff rates should be based upon current assets and expenses, rather than speculative ones.
- Rates of return should have a fundamental foundation of reasonable rate levels.
- Rates of return should be based upon stable risk plus market risk that currently exists.
- Rate design should be based upon international principles, including gradualism.
- Regulatory authorities must examine all aspects of a rate increase and balance the interests of all parties including the natural monopoly and shippers.

- Regulatory proceedings should have public notice, be held in public forums with the opportunity for all parties to attend, should provide the opportunity to receive testimony from all parties, and maintain a public record
- Decisions of regulatory proceedings should be published

Required Deliverables

Deliverables submitted for Subtask A includes

- Status Report
- Current Oil and Gas Investment Environment
- Final Report - Offshore Oil and Gas Rules and Regulations (Referenced Appendix 1)
- Final Report - Oil Pipeline Tariff Methodology (Referenced Appendix 2)

Next Steps

USAID should support the working group effort to ensure that the four offshore rules and regulations are adopted by the GOK, as passed out of the working group. Several government entities are involved in the review of the documents, however the MEIT and MENR are the approval authorities. USAID should continue to facilitate the working group in establishing application forms and data information records that are required by the four documents. Additionally, the GOK has requested that the working group review and draft rules and regulations on plugging operations, temporary abandonment, and temporary shut-ins of oil and gas wells, both onshore and offshore.

The shift of emphasis has diverted in two directions with regard to the oil pipeline tariff methodology. USAID should continue to be a close advisor to KazTransOil on tariff issues, providing TA in determining costs of administration, operations, and maintenance, efficient management and supervision of operations, strategic planning of rehabilitation and new construction projects, etc. At the same time USAID should provide TA to the AMC to ensure transparency in tariff rate filings, public hearing procedures are adopted, rules and regulations based on jurisdiction are properly developed, expertise in determining fair and reasonable rates of return to investors, uniform non-payments and disconnection policies, and other regulatory issues.

14

CHAPTER 3

SUBTASK B: INSTITUTIONAL DEVELOPMENT

SUBTASK B INSTITUTIONAL DEVELOPMENT

This subtask was to provide TA for handling foreign oil and gas investments by improving the existing process and capabilities of organizational/institutional structures. Areas of TA concentration included a proposal for an independent Oil and Gas Regulatory Authority (OGRA) and the submittal of a draft Prospectus for an Aral Sea Consortium.

Major Results — Oil and Gas Regulatory Authority

Since the adoption of the Presidential Edict "On Petroleum" in June 1995, there has been great concern about the proper regulation of the oil and gas industry. In the edict, a "Competent Body" is referred to in several articles having jurisdiction over the industry, however in reality there are many GOK bodies that have been appointed as the "Competent Body" with specific regulatory functions. In other words, what may be the Competent Body in Article 30 may differ from the Competent Body in Article 39, or what may have been the Competent Body in 1996 is no longer considered to be the Competent Body in 1998. Additionally, the GOK has various levels of regulatory jurisdiction, which is not further defined, but supposedly those authorities could be farmed out to other government bodies for purposes of licensing, permitting, inspections, etc.

Presently, the oil and gas industry does not have an independent Oil and Gas Regulatory Authority (OGRA) providing oversight of its activities. In fact, nearly every state and several provincial governments have jurisdictional authority. As an example, up to five different state government agencies and, depending upon the oblast, several local committees monitor and enforce oil and gas safety regulations. Many investors agree that it is worthwhile to resolve oblast concerns first before approaching the state authorities for licences and contracts, due to the oblast governments ability to politically influence decisions. Sighting these issues, as pointed out by the oil and gas community of investors and certain state government counterpart officials, Hagler Bailly introduced a draft Law "On the Regulation of Oil and Gas," tailored to the issues and concerns of Kazakhstan. Serious discussion of this concept was initiated on June 15, 1998 at a committee meeting of Gas Transportation and Distribution Issues, whereby Michael Biddison proposed the consideration of such a draft law and forwarded a written proposal to all of the members of the committee. In a follow-up meeting with Vice-Minister of Energy Abetaev, Hagler Bailly was told that a draft law creating an independent OGRA was a good idea, however the GOK is not ready to consider such a proposal at this time.

Within the GOK, most state and provincial entities would not support the creation of an independent OGRA, simply because they will lose regulatory authority over an industry with traditionally monies to pay for licenses, permits and other fees and fines. Supporters of an OGRA would be at the executive branch levels, such as the ASPR and the renamed Committee for Regulation of Natural Monopolies and Protection of Competition (AMC), but only if politically and economically properly designed, so that it could be justified. It is also believed that KazakhOil and KazTransOil would support the concept of OGRA, since they are subject to the regulatory outcomes of multi-level government decision making.

The OGRA would assume many of the reporting requirements from the MEIT, the regulation of oil and gas pipelines from the AMC, environmental enforcement from the MENR, inspection functions from the State Emergency Committee (SEC) and several oblast committees, licensing from the State Inspection Committee (SIC), and other regulatory authorities from a variety of government entities.

As drafted into the proposed law by Hagler Bailly, Article 7.1 states that "The OGRA will be fully funded by registration and user fees, permit and information service fees, fines based on enforcement operations costs, and other charges as set forth in the oil and gas regulations. Permits, information service fees, fines, and other related charges are required to reflect the actual cost incurred by the OGRA in performing these functions and should not be the primary source of revenue for the OGRA. Registration and user fees are the primary source of funding for the OGRA and shall consist of a surcharge included in all transportation and distribution rates. These fees may be amended, effective upon 60 days notice by public hearing, and after publication in both the local and national news media. These fees shall reflect their associated costs and shall be applicable to all registered persons with oil and gas activities in the ROK. All such user fees, service fees, fines, and related charges collected shall be dedicated to funding the OGRA and deposited in a separate account, managed by the Ministry of Finance. The OGRA shall undergo the same budgetary process as any other state ministry."

There are several political issues in the regulatory landscape that would have to be addressed and favorably resolved in order to create an independent OGRA. Besides the issue of "independence" in decision making, which is certainly an important concern, the relationship between the OGRA and the AMC will have to be resolved, and the GOK would have to agree that the OGRA would have jurisdictional authority of the oil and gas industry. Other key players in this process would include certain oblast governments, MEIT, MENR, SEC, SIC, ASPR, KazakhOil, and KazTransOil.

It is widely known that independence in decision making is critical for attracting world class investment in the oil and gas sector. In fact, an independent OGRA will not set a precedence in Kazakhstan. In the past year, an independent Board for the Bank of Kazakhstan has been

established under similar circumstances and the GOK is currently evaluating the need for an independent State Regulatory Commission to regulate the electric power sector

Clearly the implementation of an independent OGRA benefits the interests of the ROK and the investors in industry activities. It ensures fair and reasonable decision making giving confidence to long term investors in exploration and development. A stable predictable regulatory environment in the oil and gas sector should translate directly into greater production of resources, more revenues to the state and local budgets, creation of new jobs attraction of start-up businesses and services and an overall healthier economy for the country

At this time there are over 35 foreign oil and gas companies with representative offices located in Kazakhstan. Several of these companies have begun operations and are literally plagued by the quagmire of GOK multi-agency regulation of the industry. As a group and individually, the representative companies of the KA support the concept of an independent OGRA as proposed by Hagler Bailly

The support within the GOK for the creation of an independent OGRA has been pursued at every opportunity. As each step was taken to develop an oil pipeline tariff methodology, support was also linked to the creation of an OGRA. Draft laws and lengthy discussions have been held with key elements of the AMC, ASPR, MET, and other GOK entities. As these entities have been reorganized and new leadership is appointed Hagler Bailly continued to conduct lengthy discussions, provided copies of materials, and responded to inquiries and questions

Major Results - Aral Sea Consortium

In mid-1996, Hagler Bailly was contracted to provide assistance to the GOK and KCS in the development of a prospectus and draft agreement for a proposed Aral Sea Consortium (ASC). The purpose of the project was to assist the GOK in creating favorable conditions for attracting foreign investors in the development of oil and gas resources of the Aral Sea basin. This task was complicated by the fact that the territory of the Aral Sea is shared by both Kazakhstan and Uzbekistan with approximately half of the water area in each country. KCS and the GOK, realizing that participation of Uzbekneftegas (the Uzbekistan state oil and gas company) as a full participant in the ASC oil and gas exploration effort is desirable from many standpoints, resulted in a request for USAID to assist in drafting an intergovernmental agreement aimed to create a foundation for the joint oil and gas activities in the region. Another one of the advantages of the joint exploration of the region relates to the Aral Sea environmental and socio-economic situations, since the total ecosystem and human health aspects should be studied and evaluated as a unit

By 1996, KCS and the GOK had already gained a wealth of experience in working with international oil and gas companies through the Caspian Sea Consortium (CSC) which was created in late-1993 to perform a comprehensive exploration research study of the Kazakhstan portion of the Caspian Sea. The CSC experience was very valuable to KCS for both the technical and administrative aspects of the business and it allowed KCS to identify certain problems that are inherent to any first time venture. It was the desire of KCS to minimize the recurrence of those difficulties in the organization and framework of the ASC.

The following activities were conducted and results obtained:

- A thorough study of the CSC documents was conducted. Its advantages and problems were revealed through numerous discussions with KCS and foreign participants in the CSC. Meetings were held with KCS executives and representatives of the CSC foreign participants to obtain a comprehensive picture of the things that worked as well as deficiencies.
- Comparative analysis between consortia and other types of ventures in the international practice was prepared and country - specific recommendations for Kazakhstan were presented as to how each type of organization agreement worked.
- The draft Prospectus for an ASC was developed using the CSC Agreement as a model. It took into account the international experience and the lessons learned from the CSC activities and resulted in substantial revisions to some sections.
- Negotiations and discussion of the draft Prospectus for an ASC with KCS and the GOK allowed for further improvements, particularly, the opportunity to involve Uzbekistan into the Aral Sea project. KCS recognized the need to involve Uzbekistan and took the initiative to bring Uzbekneftegas into the discussions.
- A presentation of the ASC project was made on October 24, 1997, at the IV International Geological Seminar On Geological Framework and Oil and Gas Bearing Prospectivity of the Aral Sea. A number of foreign oil and gas companies attended the seminar organized by KCS, which was pursuing this opportunity to attract the attention of foreign investors to the Aral Sea region. Hagler Bailly consultants participated in the seminar and saw a presentation on the summary of work completed.
- Simultaneously with finalizing the draft Intergovernmental ASC Agreement, the legal basis for the joint development of the Aral Sea region by Kazakhstan and Uzbekistan was proposed.

- During the summer of 1997, several drafts were prepared on the Intergovernmental ASC Agreement in consultations with KCS attorneys and took into consideration the political, historical, geographical, geological, economical and other conditions in the region. The attempt was made to create an agreement that would allow for the most open, transparent, and efficient terms of cooperation between the two countries for the mutual benefit in future incomes and prospects for upgrading the environmental situation of the Aral Sea region.
- At the end of July 1997, the draft Intergovernmental ASC Agreement was officially submitted to the Government of Uzbekistan (GOU) by the GOK, which was followed by the discussion of the project at the governmental and company levels in August 1997.
- Commissions for development of the Intergovernmental ASC Agreement were formed from both sides and further improvement of the document was based on the comments made by Kazakhstani and Uzbekistani experts. Six workgroups were developed to review different parts of proposed ASC activities and administrative structure.
- The final draft Intergovernmental ASC Agreement was prepared on the basis of further discussions and negotiations and submitted to KCS in September 1997. Since that time both governments have negotiated the final provisions of the Agreement, but have yet to sign and adopt it.

Overall, the results of this task included development of the draft Prospectus for an ASC and the draft Intergovernmental ASC Agreement between Kazakhstan and Uzbekistan. These draft agreements facilitated the governmental initiatives related to the Aral Sea region rehabilitation program and provided it with the reasonable and justified model of cooperation with foreign investors to the mutual benefit of the parties. This task also provided the foundation for the negotiations between the GOK and GOU, which appears to be a magnificent result, if one takes into account the roots of the ecological disaster and weak expectations to resolve this ecological problem in a traditional way by limitation of water consumption from the rivers feeding the Aral Sea. For many respects, the GOU's participation may be focal to the success of the Aral Sea oil and gas project.

Required Deliverables

Deliverables submitted for Subtask B includes

- Draft Law "On Regulation of Oil and Gas" (Appendix A)
- Implementation Plan for Central Asia

- Materials and Equipment Identification and Procurement-Kazakhstan (Referenced Appendix 9)
- Concept Paper - Model Oil and Gas Regulatory Agency (Referenced Appendix 3)
- Final Report - Prospectus for an Aral Sea Consortium (Referenced Appendix 5)

Next Steps

USAID should concentrate on providing TA to the AMC with regard to the establishment of an independent OGRA. Even though the AMC reports directly to President Nazarbaev, it now enjoys more freedoms in decision making than it has in the recent past. A concept that Hagler Bailly has proposed to AMC Chairman Radastovetz, which may be acceptable, is to assist the AMC in formulating specific regulatory departments for each of the important sectors, such as oil and gas, electric power, telecommunications, transportation, water and wastewater, etc. Each of these departments would have full regulatory jurisdiction over their specific sector, with president-appointed commissioners making regulatory decisions. Regulatory features, such as tariff setting, customer service, data and information collections, etc., would be performed by each individual department, or wherever efficiency dictates, under the umbrella of the AMC.

The Prospectus for an AMC and the Intergovernmental AMC Agreement have been submitted to the GOK and negotiated with the GOU. Neither the GOK nor the GOU have requested further TA. USAID is prepared to provide TA to either or both governments in this regard, when requested.

CHAPTER 4

SUBTASK C: SEMINARS/WORKSHOPS/STUDY TOURS/TRAINING

SUBTASK C SEMINARS/WORKSHOPS/STUDY TOURS/TRAINING

The primary objective of this task was to assist in the development of the skills necessary for Kazakhstan to actively, competently, and successfully participate in the global oil and gas industry. Such industry today is a complex marketplace, bringing together buyers and sellers, each with tremendous wealth, power, and knowledge. Many international oil and gas firms have decades of experience in the marketplace, while comparatively, Kazakhstan has virtually none. Such disparate administrative, business, and technical skills can lead to poor business transactions - both from an international oil and gas firm's perspective as well as that of the country. For implementation of this task, courses were designed which would begin to reduce this disparity.

The following seminars/workshops/training courses were provided in Almaty:

- International Petroleum Agreements
- International Petroleum Economics
- Oil and Gas Project Financing

Approximately 50 mid-level managers of the GOK ministries, agencies, committees, and state companies, having direct or indirect interests in the oil and gas industry, participated in the USAID courses. Initially, five courses were planned to be conducted, based upon interviews and research conducted with Kazakhstan government counterparts and oil and gas firm's with activities and investments in the country. Unfortunately, the planned training courses on Basic Oil and Gas Accounting and Independent Administrative Agency Law were not conducted in Kazakhstan, due to the lack of attendees resulting from structural government reorganizations, the movement of the GOK to Astana, and strategic and fiscal planning required from these changes. After recognizing the lack of GOK enthusiasm for the remaining two courses, USAID decided to not conduct any more courses for the remaining term of DO 17 (April 1 - September 30, 1998).

Major Results

The course on International Petroleum Agreements was conducted on August 11-12 1997 by Thad Grundy. It provided an introduction to the principal international agreements used between host governments or their state enterprises and private companies which are interested in exploration and production of oil and gas. The course addressed concession and licensing agreements, production sharing agreements, risk-service contracts and participation agreements. It also addressed issuing development rights, principal terms, and negotiations, risk assessment and risk reduction of agreements. Course materials include examples of international agreements and contracts with provisions used in other countries or developed by various trade associations.

Bhamy Shenoy taught a course on International Petroleum Economics on October 27-28, 1997, which covered the time value of money, calculation of return on investment and various criteria for prioritizing investment opportunities. Illustrative examples of capital investment projects include exploration, development, production, enhanced petroleum recovery, refineries, recovery of natural gas liquids, and pipeline investments. There were also discussions on liberalization, privatization, and globalization policies of governments and how these policies interact with market forces.

Oil and Gas Project Financing defined major financial concepts, shareholder value, cash flow, net present value, and other universal financial terms. The course focused on capital investment decision making, project cash flow analysis, methods of determining project returns, project risk analysis, financial statements of international oil and gas companies, and issues in privatization. The course covered some principles and key concepts of project finance and investment decision making, such as typical balance sheet and income statements, equity capitalization, and evaluation of project investment opportunities.

Required Deliverables

Deliverables submitted for Subtask C includes

- Final Report - Training Implementation Plan CAR (Referenced Appendix 5)
- Final Report - Kazakhstan Post Training Report (Referenced Appendix 6)

Next Steps

Much work remains to bring the administrative business skills of Kazakhstani officials up to parity with those exercised by international oil and gas firms. Many international oil and gas companies and donor agencies have conducted seminars/workshops/study tours/training of

Kazakhstan oil and gas officials but much more needs to be done. It is recommended that the Basic Oil and Gas Accounting and the Independent Administrative Agency Law courses should still be conducted, designed according to the specific concerns of the government. Significant interest has been expressed in training on Strategic Planning the objective of which would be to train mid-managers on solving in-country issues based on such variables as world oil and gas supply and demand, long term crude oil price forecasts, export transmission requirements, creating local and regional market demand, etc.

As has been suggested by government counterparts, consideration should be given to conducting training in oil and gas production areas of the country or resort type settings. Although increasing the costs of providing the courses, it is easier to ensure full attendance for the duration of the course, as opposed to conducting training within Almaty or Astana.

CHAPTER 5

SUBTASK D: ADVISORY SERVICES/COORDINATION AND MANAGEMENT OF SUBTASKS A-C

SUBTASK D ADVISORY SERVICES/COORDINATION AND MANAGEMENT OF SUBTASKS A-C

Hagler Bailly provided experienced oil and gas professionals to coordinate and manage activities under Subtasks A-C. Additionally, an effort was made to provide TA on oil and gas export transportation routes to the GOK. Several meetings were conducted with GOK officials and U.S. Ambassador A. Elizabeth Jones sent a letter requesting that USAID provide oil and gas TA to an inter-departmental working group appointed to address export pipeline issues. Hagler Bailly also responded to specific requests of the GOK for TA on a limited basis, depending upon resource availability and qualifications to provide such assistance. In furtherance of this subtask, TA was provided to KazTransOil, the MEIT, and the AMC.

Major Results - Oil and Gas Export Transportation Routes

Development of sufficient export transportation routes for the Central Asian region's abundant oil and gas resources is critical to the economic development and political independence of Kazakhstan. Although, substantial work has been done with regard to analyzing the various export transportation route options at a macro level, little has been done to enumerate and analyze the potential specific impediments that are common and shared across political boundaries.

Potential export pipeline routes for Kazakhstan oil and gas resources include the following: 1) Caspian Pipeline Consortium (Tengiz to Novorossiysk), 2) and 3) East/West Pipeline (Kazakhstan to Supsa or Ceyhan), 4) Kazakhstan/China Pipeline, 5) Atyrau/Samara Upgrade, 6) Kazakhstan/Iran Pipeline, and 7) Kazakhstan/Pakistan Pipeline.

On January 29, 1998, Prime Minister Balgambaev signed GOK Edict 22P, establishing an Inter-Departmental Commission on Developing the Fuel-Energy Sector. A working group on Internal and Export Oil and Gas Pipeline Projects was created and chaired by Chairman Utembaev of the Agency for Strategic Planning and Reforms. Other GOK entities appointed

to the working group include the Ministry of Energy Industry and Trade, Ministry of Foreign Affairs, KazakhOil, KazTransOil, State Investment Committee Ministry of Ecology and Natural Resources, Ministry of Finance, and Ministry of Justice U S Ambassador A Elizabeth Jones sent a letter to Chairman Utembaev, requesting that USAID oil and gas consultants provide TA to the working group, however the working group has yet to formally meet and discuss the issues related to export transportation routes

In December 1997, Ambassador Jones submitted a proposal to KazakhOil to create an export pipeline working group for the GOK In response, the GOK expressed an initiative to conduct a conference on this matter, with the expected results from the discussion to be the formulation of export pipeline option priorities Hagler Bailly, Harvard Institute for International Development (HIID), and USAID/CAR worked closely with KazakhOil and KazTransOil in facilitating the "GOK Conference on Alternative Export Pipelines " The conference was held in Almaty on March 31 - April 1, 1998 with over 250 attendees As a result of the conference "An Export Strategy for Kazakhstan to 2005" was submitted to the GOK, including materials presented by USAID consultants Specifically, Hagler Bailly contributed to the conference in facilitation, translation, and interpretation, presentation of a paper on generic transportation issues across the region, and post conference TA evaluation of export transportation routes As requested, Hagler Bailly also prepared an independent evaluation of the USAID-sponsored "Post Conference Report," submitted to the GOK by USAID-funded consultants, and developed a draft work plan on the role and activities of the proposed GOK working group for the GOK

Major Results - Specific Requests

Hagler Bailly responded to specific requests for TA by the GOK on a number of occasions Many requests were for data and information that required research in relation to legal, regulatory, political, technical, financial, and economic issues Oftentimes, submittal of data and information had to be tailored and presented according to particular circumstances in Kazakhstan

With regard to KazTransOil, Hagler Bailly continued to provide TA on all of the elements of the oil pipeline tariff methodology Each element of the methodology was questioned, leading to an evaluation and comparison of KazTransOil to international investor owned pipeline operations For example, details in accounting practices, organizational and infrastructure development, strategic planning and forecasting, cash flow analyses, reorganization and privatization, and project evaluation was sought on a short term basis Additionally, computer modeling was performed to assist KazTransOil in their negotiations with the Chinese National Petroleum Corporation on the Kazakhstan/China Pipeline route This TA included modeling costs and tariffs of the proposed pipeline with different variations of throughput and pipeline sizes Hagler Bailly also responded to requests regarding

negotiation strategies environmental analyses feasibility studies treatment of rights of ways, and other issues

Extensive TA was provided to the AMC, in all of its evolutions of government structural changes, on the fundamental elements of regulatory jurisdiction TA not only included both oil and gas pipeline tariff methodologies and tariff rate applications, but also procedures on public hearings, debt and equity financing of monopoly operations, provisions of customer service, etc A major focus was on drafting "instructions," or basically rules and regulations for natural monopolies, such as standard filing requirements for the AMC Hagler Bailly assisted in the development of cost of service models to be used in supporting rate applications and on several other technical documents that would impact regulation of the oil and gas sector Hagler Bailly also assisted in drafts of the Law "On Natural Monopolies," which was adopted on June 25, 1998 by the GOK

TA was provided to the MEIT on the regulation of wholesale and retail gas purchases, gas pipelines, and gas distribution companies Hagler Bailly was appointed to an MEIT gas working group, which provided an avenue to make a presentations at a working group meeting, review and comment on draft gas rules and regulations, and propose a draft Law "On the Regulation of Oil and Gas "

Required Deliverables

Deliverables submitted for Subtask D includes

- Long Term Resident Advisor Report - J Michael Biddison (Referenced Appendix 7)
- Long Term Resident Advisor Report - Claude W Eggleton (Referenced Appendix 8)
- Short Term Expert Trip Reports

Next Steps

USAID should continue to urge the GOK to focus on oil and gas export pipelines through a high level GOK working group structure Hagler Bailly should be appointed as facilitators of the working group and the KPA should be given the opportunity to appoint three representative members to participate The working group should concentrate on pipeline transmission issues that will directly translate to greater investment in Kazakhstan's oil and gas sector, such as prioritizing rehabilitation and construction of the KazTransOil system, negotiating with foreign governments on particular obstacles to investment in export transportation routes, developing models on generic issues that will need to be resolved, including handling rights of ways, tariff methodologies, tax concerns, proper and transparent

rules and regulations operating procedures, etc , forecasting volumes to be shipped local government authorities, etc

USAID should continue specific TA to the GOK on an as-needed basis, if resources are available and mission objectives and intermediate results can be obtained within the oil and gas sector Response to requests for short term TA has demonstrated confidence by the government counterparts in the international expertise of Hagler Bailly, and builds strong relationships as advisors to the GOK

CHAPTER 6

LESSONS LEARNED

LESSONS LEARNED

The experiences of DO 17 has provided the following lessons, which should be applied when pursuing further activities in oil and gas reform in Kazakhstan

- The GOK and investors seek USAID TA when they can clearly identify the areas where international experience and expertise are required. USAID-funded consultants should readily maintain a certain degree of flexibility to quickly respond to the changing environment and needs.
- On the basis of the experience gained through implementation of DO 17, it is clear that more opportunities for training could be provided. However, this training should not focus on an academic course; it should be tailored to the specific needs of the GOK specialists, since the need in training is normally revealed when providing TA on specific projects.
- USAID needs to demonstrate more flexibility in its approach to institute changes and reforms in Kazakhstan. The Western approach and logic does not always slide easily into a system which has a different cultural, political, and economic experience. Both sides of the effort stay on a learning curve, which sometimes meets, but oftentimes does not. USAID should maintain patience and be willing to search for alternative methods to achieve desired results that add value, when obstacles to reaching objectives present themselves.
- USAID contractors must communicate closely and work directly with the highest levels of counterpart governments in order to achieve results. The types of high visibility projects that Hagler Bailly has been associated with are all very technical in one sense, but just as, or probably even more important, are that these projects have very political connotations, as well. Creation of independent regulatory commissions, approving international tariff methodologies, adopting new laws on oil and gas, drafting oil and gas rules and regulations, to name just a few projects, cannot be accomplished by working with middle management or even upper level management of ministries, agencies, committees, and state companies. These projects must be pursued at the highest levels of government and at the executive office levels, to properly negotiate and resolve the technical and political landscape with the leaders of the country.

- USAID contractors must be entrusted as international advisors to government counterparts, working on their behalf, and bringing the concepts of the world to them. Hagler Bailly has a wealth of international management advisors that have spent their entire careers working at the highest levels of the private and public sectors. Counterpart governments recognize this and welcome the experience and education that Hagler Bailly is able to offer on various projects. Relationships and confidences grow with cooperation in jointly achieving results in legal, regulatory, and institutional reform. Hagler Bailly should represent themselves to government counterparts as international management advisors, funded by USAID, so that strategic objectives can be obtained.
- USAID contractors should “redline” draft documents, when requested for comments on documents generated by government counterparts. Oftentimes, Hagler Bailly was requested to review proposed draft documents (laws, rules, procedures, etc.) by counterpart governments when they are being considered for adoption. Similar to the consideration of changes to draft legislation in the U.S., it is most efficient to “redline” the proposed changes directly in the document, showing all of the additions and deletions, so that the counterpart governments can easily analyze and review new proposals in the proper context. In general, providing separate written comments on the draft document is generally not efficient or effective, since long detailed explanations of concepts cannot compete with specific red-lined language proposals.
- The USAID contractor must take the lead role as a facilitator of specific tasks when involved in a working group setting with government counterparts. Experience demonstrates that the best manner to get discussion of the issues in a working group is to assume the role of facilitator and initiate pertinent draft written proposals, therefore focusing the issues and strategic results on paper. The proposals should be drafted in the government accepted format and style, address all of the specific issues and concerns of the government, and be somewhat flexible and negotiable so that the working group decision will be favorably inclined. Additionally, it is important to prepare specialized background papers and make detailed presentations which emphasize the importance and benefits to the favored position to the working group. Up-front rules need to be developed and agreed upon at the initial meeting of any working group, which include a clear understanding of the goals, a meeting schedule, members and alternative members appointed, working draft documents must be simultaneously presented in Russian and English, strong and committed leadership must be decided, timely submittal of working draft materials must be ensured, education of various concepts and issues is a key component, individual members of the working group represent their entire organization, deadlines for the development and adoption of work products by the working group should be set, etc.

APPENDIX A

DRAFT LAW "ON REGULATION OF OIL AND GAS"

INITIAL WORKING DRAFT - FOR DISCUSSION PURPOSES ONLY

**LAW OF THE REPUBLIC OF KAZAKHSTAN
ON
REGULATION OF OIL AND GAS**

I GENERAL PROVISIONS

- 1 1 This Law is intended to promote the efficient development transmission and consumption of oil and gas in the Republic of Kazakhstan on the basis of the following principles of a market economy and a democratic society 1) ensure the health and safety of the general public and the industry, 2) protect the natural environment from contamination by any oil and gas activity 3) conserve oil and gas resources by preventing waste and maximizing recovery from the reservoirs, 4) transparency in the release of public information concerning oil and gas commercial exploration and development, 5) provide fair and reasonable rates for the services of oil and gas transmission and gas distribution systems which have monopoly characteristics and 6) create an independent government oil and gas regulatory body in the Republic of Kazakhstan to oversee and monitor the activities of the industry
- 1 2 The Oil and Gas Regulatory Agency (hereinafter referred to as OGRA) shall be established as an independent body of the Government of the Republic of Kazakhstan with regulatory and enforcement powers over persons carrying out activities in the oil and gas industry within the territorial boundaries of the Republic of Kazakhstan The OGRA is granted exclusive jurisdiction, authority, and power over all persons and property, public and private involved in exploration, drilling, production, gathering, processing, storage, transportation, and distribution of oil and gas
- 1 3 The activities and authorities of the OGRA shall be governed by the Constitution of the Republic of Kazakhstan, legislative and normative acts of the Republic of Kazakhstan, Decrees of the President, and this Law The OGRA shall have all such legal capacities as are necessary for the exercise of its power and the performance of its duties and functions
- 1 4 Any ministry, commission, or agency of the Government of the Republic of Kazakhstan or any subordinate regional or provincial government entity which previously had jurisdiction and authority over the activities in the oil and gas industry shall transfer all such rights and powers to the OGRA, as addressed by this Law, within thirty days after this Law is enacted
- 1 5 The OGRA is a legal entity and possesses a seal with the Republic of Kazakhstan State Emblem and its name in the languages of Kazakhstan and Russian
- 1 6 Words and phrases used in this Law shall have the following meaning

NOTE DEFINITIONS ARE TO BE DETERMINED IN LATER DRAFTS

II OIL AND GAS REGULATORY AGENCY MEMBERS

- 2 1 The OGRA shall consist of three members, with equal status and voting rights, appointed by the President of the Republic of Kazakhstan Each member shall be appointed based upon a majority recommendation of the Upper House of the Parliament of the Republic of Kazakhstan

- 2 2 A member of the OGRA may be re-appointed to a term of service, but shall not serve for more than two full terms. Members are to serve staggered six year terms in order to ensure continuity and uninterrupted operation of the OGRA. Therefore the terms of office for the initial three members would expire at the end of the second, fourth, and sixth year, respectively.
- 2 3 Each member appointed to the OGRA must demonstrate at least ten years of combined professional training, education, and experience in the oil & gas industry. A member must be qualified to properly assess all oil and gas economic and technical issues and concerns, make fair, reasonable, objective, and independent decisions, and discharge his duties and responsibilities as prescribed by this Law. Each member of the OGRA shall be a citizen of good standing of the Republic of Kazakhstan or have resident work visa status in the Republic of Kazakhstan.
- 2 4 The chairman of the OGRA shall be selected by the President of the Republic of Kazakhstan from among the members of the OGRA. The chairman is responsible for calling and presiding over meetings, administration, day-to-day management, and operations of the OGRA.
- 2 5 In the determination of all decisions, each member of the OGRA shall have one equal vote, and two votes majority shall determine the course of action of the OGRA.
- 2 6 Members of the OGRA can only be removed from office by decision of the President of the Republic of Kazakhstan in recitation of one or more of the following reasons:
- 2 6 1 Conditions of health, which seriously impairs work performance, as determined by an independent medical doctor,
 - 2 6 2 Conviction of malfeasance in office or another criminal act defined in the Criminal Code under the laws of the Republic of Kazakhstan,
 - 2 6 3 Serious or systematic violation of OGRA administrative rules or the inability to perform the professional duties required of a member,
 - 2 6 4 Loss of citizenship or residential status in the Republic of Kazakhstan, or
 - 2 6 5 Voluntary request in writing for resignation or retirement by a member.
- 2 7 The chairman of the OGRA shall enjoy all privileges and a salary equivalent to minister of the Republic of Kazakhstan. The other two members of the OGRA shall enjoy all privileges and a salary equivalent to vice minister. The staff of the OGRA shall enjoy all privileges and salaries equivalent to staff of ministries and state agencies.
- 2 8 Each member shall serve full time on the OGRA. Members and staff of the OGRA shall have no interest, financial or otherwise, direct or indirect, in any oil & gas activity subject to the jurisdiction of the OGRA or engage in any activity which would impair their ability to act in an impartial manner.
- 2 9 Other requirements and conditions of government service, legal status, social protection, and regulation of relations which are defined in the Decree of the President of the Republic of Kazakhstan having the power of law "On Governmental Service", shall be applied to the members and staff of the OGRA.

III OIL AND GAS REGULATORY AGENCY RESPONSIBILITIES

- 3 1 The OGRA shall develop adopt, publish, and enforce oil and gas rules and regulations in accordance with legislative and normative acts of the Republic of Kazakhstan Decrees of the President, and this Law Specifically the OGRA is authorized to make its own rules and regulations with regard to 1) applications for registration 2) applications for and issuance of permits 3) collection of and maintenance of oil and gas records and data 4) conservation and management of oil and gas resources, 5) field inspection methods and policies 6) monitoring technical operations and procedures, 6) proper health and safety standards 7) environmental protection 8) operations and tariffs of oil and gas transmission and gas distribution systems 9) shipper and customer service standards, 10) public hearing and appeals process and 11) OGRA decision-making procedures and conduct
- 3 2 The OGRA shall have the authority and the duty to administer and regulate oil and gas activities upon the territory of the Republic of Kazakhstan, including inland waterways and seas
- 3 3 The OGRA shall establish procedures for the collection and storage of data records and information regarding all oil and gas activities conducted within the Republic of Kazakhstan
- 3 3 1 All persons engaged in activities in the oil and gas industry within the territory of the Republic of Kazakhstan shall provide to the OGRA all geochemical geophysical geological technical, and economic data, maps, samples and required reports in accordance with rules and regulations
- 3 3 2 Non-confidential data will be retained and stored for a period to be specified by the OGRA in the rules and regulations OGRA will make such non-confidential information available to the general public, including preparation of routine reports and studies to summarize the submitted data of geographic areas, geological formations and trends and time periods
- 3 3 3 Members and permanent staff of the OGRA shall maintain in secrecy all confidential information, as defined by the OGRA, that comes into their possession or to their attention during the performance of their duties Redistribution of such confidential information, except as required by law, by the members and staff of the OGRA shall constitute a violation of this statute and may be punishable under both the criminal and civil penalties of the Republic of Kazakhstan
- 3 4 The OGRA shall prepare maintain, and make available to the general public maps and information denoting the location of all permitted oil & gas activities specifically all wells pipelines, and processing and storage facilities located within the territory of the Republic of Kazakhstan
- 3 5 The OGRA will ensure that environmental rules and regulations are enforced with regard to any oil and gas activities within the territory of the Republic of Kazakhstan
- 3 5 1 The OGRA shall enforce all environmental protection laws legislated by the Republic of Kazakhstan, and all pollution control rules and regulations promulgated by itself or any other state agencies as they relate to oil & gas activities
- 3 5 2 The OGRA shall regulate the injection of any substance in to any subsurface formation, whether for the purpose of testing, disposal, or production enhancement
- 3 6 The OGRA shall have the authority and the duty to designate concentrated areas of oil or gas production as a Field, and to issue Field-Wide Rules in order to conserve natural resources and maximize their recovery

- 3 7 Any member or staff of OGRA shall have the authority and the duty to inspect any area or facility where oil & gas activities are being conducted to insure that operations are in accordance with this Law and all other laws of the Republic of Kazakhstan Any member or staff of OGRA shall have complete access to all exploration, drilling, production treating processing storage transportation, and distribution facilities, all data and information files, and other information related to oil & gas activities of all registered persons
- 3 8 The OGRA shall resolve conflicts and disputes of a technical nature between interested parties through an adjudicatory process However, every attempt should be made to resolve such issues through consensus agreements between the OGRA and the individual parties prior to formal resolution attempts through the adjudicatory process
- 3 9 The OGRA, having due regard for Good Oil Field Practice, may issue specific directions for compliance with oil and gas rules and regulations in such a manner as would reflect the actions of a prudent operator
- 3 10 The OGRA shall provide assistance to any person registered to conduct oil and gas activities in obtaining all necessary licenses, permits, and authorizations required by relevant state government ministries and agencies and any other subordinate regional and provincial governments to conduct oil & gas activities

IV OIL AND GAS REGISTRATION AND PERMITS

- 4 1 No person shall conduct oil and gas activities in or upon the territory of the Republic of Kazakhstan without obtaining registration with the OGRA, and then only in accordance with the rules and regulations promulgated by the OGRA
- 4 2 To conduct oil & gas activities on a certain area of land, inland waterway, or sea, a registered person must 1) have the proper licenses required to undertake oil and gas activities 2) have a valid contract or agreement with the mineral interest owner or state entity with jurisdiction 3) obtain required permits from OGRA for specific oil and gas operations, and 4) be in legal and regulatory compliance with the OGRA, and all other governmental jurisdictions of the Republic of Kazakhstan Registration is required prior to making any application to the OGRA for permits to conduct specific oil and gas operations, or in any way avail itself to services of the OGRA
- 4 3 The OGRA shall issue permits for a registered person to conduct specific oil and gas operations as defined by the oil and gas rules and regulations, for the following categories 1) geophysical data acquisition, 2) drilling of a well, 3) initial completion of a well for production or injection purposes, 4) re-completion of a well for production or injection purposes, 5) temporary abandonment of a well, 6) permanent abandonment of a well, 7) disposal of any produced fluid 8) disposal of any fluid introduced into a well that is recoverable 9) construction of any pipeline other than infield gathering lines, 10) erection of any facility for the storage of produced fluids, 11) erection of any facility for the processing of produced fluids, and 12) such other activities as specified by oil and gas regulations

V TRANSMISSION AND DISTRIBUTION COMPANIES

- 5 1 If the OGRA determines that an oil transmission, gas transmission, or gas distribution company constitutes a natural monopoly activity, requiring control and administration of pricing and tariffs to protect the public interest as a common carrier, the OGRA will undertake the necessary economic regulation of that company

- 5 2 The OGRA shall insure that any registered person involved in oil & gas activities has access to the use of common carrier oil and gas transmission pipelines or is not unduly discriminated against with regard to access by its owners
- 5 3 The OGRA shall establish fair and equitable tariff rates for utilization of common carrier natural monopoly oil and gas transmission pipelines based on a cost-of-service methodology or such other methodology that meets international practices and standards
- 5 4 Tariffs for oil pipeline transmission, gas pipeline transmission, and gas pipeline distribution services shall be established by OGRA to 1) protect shippers and customers against monopolistic prices and discriminatory activity, 2) provide registered persons that own and operate pipelines with an opportunity to recover their costs of service including prudently incurred operating, maintenance, administration principal, and interests costs and a return on investment comparable to that in other economic sectors subject to similar risks and 3) encourage efficiency in internal operations and management practices
- 5 5 The OGRA shall have the power and the right to require all gas pipeline distribution companies and registered persons involved in gas commodity marketing and brokering to file forecasts of expected sales of gas for each year on September 1, as well as supply plans and contracts to meet the forecasted needs, along with contingency plans to meet requirements should the actual demand vary from the forecasted requirements The OGRA must approve these plans by October 1 of each year
- 5 6 The OGRA shall require all gas pipeline distribution companies to unbundle the delivery cost from the commodity cost of gas Gas pipeline distribution companies shall file a commodity cost of gas for the next quarter, reflecting as closely as possible the current rates that the gas pipeline distribution company paid in procuring the gas supply The gas commodity will not be a source of profit for the gas pipeline distribution company - only the cost of procurement and the cost of gas itself can be passed through to its customers OGRA shall review the quarterly filing and approve the commodity rate for the next quarter according to established rules and regulations
- 5 7 The OGRA does not require gas pipeline transmission and gas pipeline distribution companies to purchase and resell gas commodities for its customers Owners and operators of gas pipeline transmission and gas pipeline distribution systems may choose to only provide transportation and customer services Registered persons that broker and market gas commodities to customers are subject to the OGRA rules and regulations for that activity
- 5 8 The OGRA will at its own discretion or pursuant to a schedule published by OGRA perform management audits of oil and gas pipeline transmission companies and gas pipeline distribution companies In the case of gas pipeline distribution companies, gas commodity procurement audits shall be conducted to ensure efficient service and fair and reasonable gas costs for customers Financial and management audits of oil and gas pipeline transmission and gas pipeline distribution companies shall be performed at least once every two years, but may be performed more often at the discretion of the OGRA according to established rules and regulations

VI TRANSPARENCY AND FAIRNESS

- 6 1 It is the intent of this Law that the OGRA shall be an independent administrative and regulatory agency, free from short-term political pressures, and able to function objectively and fairly in its decision making responsibilities Independence, in this context, means that the OGRA functions as an autonomous non-political state body that does not report directly to any executive,

legislative or judicial branch of the Government of Kazakhstan. The OGRA is accountable to the Government of Kazakhstan in the following manner: 1) it must undergo the same budgetary approval process as any other ministry or state agency; 2) OGRA members must meet certain minimum qualifications, are appointed to limited terms of six years, and can be prematurely removed from office under certain conditions; and 3) all decisions of OGRA can be appealed on the basis of legal jurisdiction to the Supreme Court of the Republic of Kazakhstan.

6.2 All hearings and meetings of the members of the OGRA shall be public. Decisions of the members of the OGRA shall be published at the time the decisions are made. All decisions of the members of the OGRA, made at public hearings and meetings, shall be determined through published orders, which will include a recitation of the key facts, assumptions, opinions, and reasoning in justification of such decision. OGRA shall establish specific rules and regulations with regard to the conduct of public hearings and meetings.

6.3 All decisions of the OGRA of an important nature, such as tariffs and customer service issues, shall be determined, announced, and justified at open public hearings by a majority vote of the members, only after testimony and comments by the public and all interested parties have been considered. Decisions of a routine nature, such as issuance of permits and authorization to conduct certain activities, will not require an open public hearing, unless challenged by any party upon good reason. Open public hearings shall allow the right to all interested parties to present prepared statements, introduce testimony from expert witnesses, cross-examine expert witnesses from adversarial positions, and submit printed matter as part of the permanent record.

6.3.1 Public hearings and meetings of a routine or recurring nature of members of the OGRA shall be held at regularly scheduled times once every seven days to be announced by publication in relevant newspapers and trade journals with the hearing agenda.

6.3.2 Special public hearings and meetings for specific purposes of members of the OGRA shall be held only after an advance 10-day notice to the public by publication, and by process of service notice to declared parties of interest.

6.3.3 A record of the proceedings at all public hearings and meetings of members of the OGRA shall be available to anyone for examination at the OGRA during normal hours of business.

6.4 Members of the OGRA are prohibited from communicating with any person who attempts to wield undue influence or persuasion over any OGRA action. Such members are to be punished under such administrative rules and regulations as adopted by the OGRA and such criminal and civil penalties as prescribed by law. Any person who attempts to exert undue influence on any member of OGRA shall be prosecuted and shall have applied to them such legal criminal and civil penalties as prescribed by law.

6.5 The OGRA shall publish an Annual Report on March 31 of each year, describing its activities and operations for the prior calendar year. This report shall be presented to the President of the Republic of Kazakhstan and copies of the report shall be available to the public.

VII OIL AND GAS REGULATORY AGENCY FUNDING

7.1 The OGRA will be fully funded by registration and user fees, permit and information services fees, fines based on enforcement operations costs, and other charges as set forth in the oil and gas regulations. Permits, information services fees, fines, and other related charges are required to reflect the actual cost incurred by the OGRA in performing these functions and should not be the primary source of revenue for the OGRA. Registration and user fees are the primary source

of funding for the OGRA and shall consist of a surcharge included in all transportation and distribution rates. These fees may be amended, effective upon 60 days notice by public hearing and after publication in both the local and national news media. These fees shall reflect their associated costs and shall be applicable to all registered persons with oil and gas activities in the Republic of Kazakhstan. All such user fees, service fees, fines, and related charges collected shall be dedicated to funding the OGRA and deposited in a separate account managed by the Ministry of Finance. The OGRA shall undergo the same budgetary process as any other state ministry.

7 1 1 Funding for the initial two years of operation of the OGRA shall be through the general revenue fund of the Republic of Kazakhstan.

7 1 2 The OGRA shall prepare and publish a financial report by March 31 of each year which shall include an accounting of all registration and user fees, permits and information services fees, fines, and other related charges paid to the OGRA account and all expenses incurred during the prior calendar year. The financial report shall also identify any loans taken during the year, and any other funds made available to or used by the OGRA. The OGRA shall make the financial report available to the public.

VIII JUDICIAL REVIEW

8 1 Any person may appeal an OGRA decision for judicial review, but the appeal is limited to the OGRA's legal constraints, and whether it made decisions outside its boundary of authority and discretion. The judicial review appeal may only be considered after all administrative remedies have been taken, such as consultation with the technical staff, administrative adjudication within the OGRA, and appeal for rehearing directly to the OGRA. Only after these steps have been fully exhausted may a person petition the Supreme Court of the Republic of Kazakhstan for judicial review of such action.

8 1 1 In deference to the independence and expertise of the OGRA, judicial review will be limited to questions of law, and whether the OGRA acted in a manner inconsistent with the legal authority granted to it.

8 1 2 Judicial review of the oil and gas rules and regulations promulgated by the OGRA is limited and subject to revocation only upon a finding by the Supreme Court of the Republic of Kazakhstan that such rules and regulations are arbitrary, capricious, or exceed the OGRA's legal authority.

8 1 3 The sole remedy available to the Supreme Court of the Republic of Kazakhstan is to remand for reconsideration to the OGRA the decision under appeal with guidance under which reconsideration shall be made. The Supreme Court of the Republic of Kazakhstan shall not have any influence in relation to an OGRA decision, other than remanding an OGRA decision made outside its legal limitations.

IX INTERNATIONAL ARBITRATION

9 1 Any dispute arising between the OGRA and a registered person that qualifies as a foreign national or international company, concerning the interpretation or performance of the terms of any registration, permit, or the application of the oil and gas rules and regulations, that cannot be settled between the parties through all the administrative remedies available through the OGRA, or legal remedy through the Supreme Court of the Republic of Kazakhstan, may be submitted to arbitration by either party. In any such arbitration proceeding, the Government of Kazakhstan shall be represented by the OGRA or such other legal representative as shall be so designated.

9 1 1 The Government of Kazakhstan hereby consents and by making an application for registration, all persons agree to submission of such disputes to the International Centre for Settlement of Investment Disputes pursuant to the Convention of Settlement of Investment Disputes between states and nationals of other states or

9 1 2 By such other mode of international arbitration as may be provided for in individual contracts or agreements involving the Republic of Kazakhstan