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Interview of Yerbolat Yerkebulanov in the “Drilling Solutions” No. 3 (October 2015)

1. Could you please tell us about yourself and your experience in the subsoil use?

I came into the subsoil use sector in February 2006, when accepted a job offer from the company, which had two hydrocarbons exploration contracts and a branch in Aktobe. My functions as a single lawyer included general legal support on all corporate issues (conclusion of civil contracts, keeping minutes of shareholders general meetings, labour, tax issues, etc.). Currently I work as a counsel in GRATA Law Firm since November 2010. GRATA structure involves subdivision by practices. Thus, my practice focus is subsoil use, regulated procurement and contract law.

2. What challenges do you face and how do you cope with them?

Having joined GRATA, I was demanded to meet work standards accepted inside international law firms. That was the main challenge. International law has been developing for many years, while in Kazakhstan the legislation was established from scratch after the collapse of the Soviet Union. Here is one example. Once we had a multijurisdictional project for the sale and purchase of a corporation, which had branches and subsidiaries in several countries. We represented Kazakhstan. The common correspondence involved about a dozen of various companies. Just for the fun, I reviewed the profiles of all the participants. It appeared that three companies were of the age between 182 and 100 years, another half of the companies was 99 to 50 years old. The youngest law firms (a little more than 20 years) were one Chinese law firm and GRATA. Can you imagine what standards can be achieved in a several decades of constant improving the quality? Besides, such standards also require from you to:

- 1) condense the text as much as possible (“brevity is the soul of wit”);
- 2) use simple terms (“It is a simple task to make things complex but a complex task to make them simple”);
- 3) work quickly (“you have the whole night/weekend ahead”);
- 4) focus on the big picture paying attention even to minor risks (the quality which is difficult to develop during first years without direct supervision from more experienced colleagues);
- 5) and many others.

Although before joining GRATA I had 9-years experience as a corporate lawyer, the first year of work was the most difficult. It got easier as it went on. Generally, I would advise all law graduates to try working at a law firm which uses international standards. It will be difficult, but will provide for the good development in a legal practice terms.

3. Are you currently engaged in or supervise any subsoil use projects?

Yes, we do have a lot of requests from the subsoil users. On a regular basis we receive requests for due diligence, for clarification of controversial issues, which are not clearly covered by law or subsoil use contracts. However, owing a duty of confidentiality, I cannot provide details on this question.

4. Do you think Kazakhstan needs the rules for procurement of goods and services by subsoil users?

Sure, it does. You can see that due to the binding nature of the procurement rules for subsoil users Kazakhstan companies

started to earn much more. Do you remember how it was before? Previously, subsoil users could purchase using the approach such as purchase from anyone you want.

It seems to be a normal approach, but it leaves a gap for the situations, when any investor seems to invest in the subsoil use operations under financial contractual obligations, on the one hand, but on the other hand he purchases almost all goods, works and services (the “GWS”) from “own” companies (from “own” country).

Please note that in this case the government can hardly rebuke for anything, because formally it is shown that subsoil users spent as much as prescribed by the work program. As to the fact that the purchased GWS could cost 5-10 times more than the same in Kazakhstan, this is about the right of a subsoil user as the money owner. As a result, in these cases most of the capital does not stay in Kazakhstan, even if there are competitive local companies offering GWS of no worse quality than the foreign ones.

It is why the introduction of the commitment to comply with procurement rules upon prior notice thereof on the common website (reestr.nadloc.kz or tender.sk.kz for Samruk-Kazyna companies) totally turned the tide and enabled Kazakhstani companies to be aware of upcoming procurements, participate and therefore receive orders, pay salary to Kazakhstani citizens.

Let us look at it another way. In terms of procurements there are three groups of subsoil users. Procurement procedures of the first group consisting of Tengizchevroil LLP, Karachaganak Petroleum Operating B.V. and North Caspian Operating Company B.V. (so called “Three Whales”) are not transparent. According to public information, in 2013 the said companies procured GWS for about \$8.6 bln. In comparison: the quasi-state hydrocarbon subsoil users (about 20 Samruk-Kazyna companies) purchased GWS in 2013 for \$4.2 bln, while the other hydrocarbon subsoil users spent \$5.3 bln.

If the government managed to move forward in this matter, as discussed from 2010, then Kazakhstani businesses could directly participate in GWS procurements of “Three Whales” that would dramatically increase the cash flow of funds remaining in Kazakhstan. However, these companies refer to the contract stability provisions, what enables them to perform procurements under canned schemes. These companies could be offered to perform transparent procurements at least in respect of some limited range of GWS. As far as knew, the government systematically works with these companies and, perhaps, in the future the situation will change for the better.

5. Have you ever initiated or proposed any changes to or cancellation of the GWS procurement rules?

Yes, I made some editorial comments. Among recent proposals, there was one made at the Minex Central Asia Forum in Astana (March 2015) regarding the obligatory notification in the register about the upcoming procurement of a particular product in a particular commodity exchange, for instance, 1 week prior. The reason was that representatives of NaDLoC JCS (National Agency on Development of Local Content JSC) reported at that event that according to the results of 2014 it turned out that 27% of goods were procured by hard minerals subsoil users through commodity exchanges. However, public authorities are considering the exclusion of such procurement way from the rules. The reason is that there are too many commodity exchanges, which deprives a wide range of suppliers of the real access to such procurements.

6. Whether the rules are of advisory nature, or does the government strictly monitor compliance therewith?

Actually, few people know that the rules of procurement by subsoil users (the first edition) were first approved in summer 2002. However, subsoil users started to be guided by the rules only after the introduction of penalty provision in the Subsoil Law (Article 77.6), under which expenses related to the GWS purchase, made in violation of the procurement rules, shall be excluded from the expenses taken into account by the competent authority as performance of contractual obligations by the subsoil user.

What does it mean? For instance, my financial obligations under the contract amount to \$10 mln. Let’s deduct other financial liabilities of \$1 mln, such as: training (1%), liquidation fund (1%), insurance, economic and social development of the region,

research and development expenses, taxes, indirect expenses, etc. An amount that remains for purchasing GWS is \$9 mln, comprising, for instance, \$7 mln under the procurement rules, and \$2 mln beyond the procurement rules. The competent authority will exclude 2 mln US dollars and consider that I have fulfilled 80% of contractual obligations, not 100%. Thus, I will have to invest another \$2 mln to meet the work program requirements. In addition, there is a risk of penalties (up to 30% of the outstanding liabilities), if so prescribed in the contract. Thus, it would be more profitable for me to follow the procurement rules.

7. Is there any authority to apply, in case of non-compliance with the GWS procurement rules?

If a potential supplier believes that a subsoil user has violated the procurement rules, such a supplier can file a complaint with the competent authority (Ministry for Investment and Development (hard minerals subsoil users) and the Ministry of Energy (hydrocarbon, coal and uranium subsoil users)), with a copy to the organizations, authorised by the Ministries to address the issues related to the procurement rules, represented, accordingly, by NaDLoC JCS (www.nadloc.kz) or the Contract Agency (www.contractagency.kz).

In addition, you always have an option to apply to the courts.

8. What future do you see for the state regulation of subsoil use area by applying such rules?

I think in the next few years the procurement rules will continue to be relevant to subsoil users*. In the following few months the new rules are expected to be enacted as approved by the competent authority**. (Previously, the authority to approve the rules was given to the Government of the Republic of Kazakhstan).

* Kazakhstan joined WTO and local content obligations in subsoil users' procurement are preserved by 1 January 2021.

** The New Procurement Rules approved by the Order dated 30 January 2015 No. 96 entered into force from 13 October 2010.

The original in Russian can be viewed [here](#)

Industries

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Locations

KAZAKHSTAN

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