
Kazakh Law Amendments related to local content

"GRATA" Law Firm would like to provide you with an overview regarding the adoption of the Law of the Republic of Kazakhstan № 223-IV "On amendments and additions to some legislative acts of the Republic of Kazakhstan concerning the Kazakhstan content" dated December 29, 2009, within a framework of the Law of the Republic of Kazakhstan № 2828 "On Subsoil and Subsoil Use" dated January 27, 1996 (the "Subsoil Law"). We hope that this review may be useful to your company.

On the 29th December, 2009, the Law of the Republic of Kazakhstan № 223-IV "On amendments and additions to some legislative acts of the Republic of Kazakhstan concerning the Kazakhstan content" (the "Law") was adopted. It was published on the 12th of January, 2010, in "Kazakhstanskaya Pravda" newspaper № 5 (26066), and came into effect from the 22nd January 2010¹.

Changes and additions to the existing legislation of the Republic of Kazakhstan were developed for the purposes of:

- unifying the conceptual apparatus of laws on Subsoil, Subsoil Use and Public Procurement on issues affecting the Kazakhstan (local) content;
- strengthening state control over the activities of mining companies in their acquisition of goods, works and services of Kazakh origin;
- automating the calculations of Kazakhstan content in the procurement of subsoil users;
- introducing a register of goods and services produced by Kazakh producers. In order to unify the conceptual apparatus of the Subsoil Law with other legislation affecting the Kazakhstan content, new concepts were introduced and changed in the existing Art. 1 of the Subsoil Law, defining its basic concepts.

Under the new changes, a product of Kazakh origin is a commodity that has been issued a certificate of origin **for domestic circulation**, confirming its origin in the territory of Kazakhstan.

¹ Except for some provisions, indicated in this overview (further in the text)

Further, a new concept was introduced - "**Kazakhstan content in work, service**". The definition of this phrase explains that Kazakhstan content is determined from set of percentages of the Kazakhstan content:

- in the cost of goods used in carrying out work;
- in the price of the contract and (or) the payments to workers - citizens of Kazakhstan;
- in the salary fund of the contractor under contracts for work and services;
after deduction of:
- costs of goods used in carrying out the work, and the price of the subcontract.

Therefore, it follows from this definition that the price of the subcontract and the cost of goods used in carrying out the work are deducted from the resulting set defining the Kazakhstan content in the work and services.

Please note that the definition of the **uniform methodology for calculating the Kazakhstan content in the procurement of goods, work and services by enterprises** was introduced in the Subsoil Law. The approval by the Government of the Republic of Kazakhstan of a procedure **for the calculation of the Kazakhstan content in the procurement of goods, works and services** is to be applied under this methodology.

The formula for calculating **the Kazakhstan content in the contract for the supply of work (services)** is provided in the uniform methodology of calculation of Kazakhstan content².

Whereas the Subsoil Law expressly provides that the calculation of the Kazakhstan content should be in accordance with a common methodology, subsoil users should not be guided by the principle of calculation of the Kazakhstan content contained in the definition of "the Kazakhstan content in the work, service" above. The purpose of the definition of the Kazakhstan content in the work and service section introduced by the legislature remains ambiguous.

The definition of **the Kazakh producer of works, services** meaning residents of the Republic of Kazakhstan **was introduced** by the Subsoil Law. Further, for the purposes of Kazakhstan content, residents of the Republic of Kazakhstan are recognised to be Kazakhstani citizens and (or) legal entities established under the laws of the Republic of Kazakhstan, with their headquarters on its territory, as well as their branches with their headquarters in the Republic of Kazakhstan, using **not less than 95% citizens of the Republic of Kazakhstan in the total number of employees**.

Thus, when procuring work and services, subsoil users will need to request information on the mandatory percentage of Kazakh personnel in the workforce of the potential supplier of work and services.

Given this definition of residency, legal entities performing work or providing services involving subsoil use will be forced to reduce the number of foreign workers they employ. According to a uniform methodology for calculating the Kazakhstan content in contracts for the supply of work (services), the percentage of Kazakhstan content in subcontracts is also taken into account. Thus, the permissible threshold percentage of Kazakh personnel applies to contractors as well as to subcontractors when determining their status as Kazakh contractors.

These amendments were introduced due to the need to reduce Kazakh unemployment, as well as to fill the demand for goods of Kazakh origin, as well as work and services from Kazakhstani contractors.

²The uniform methodology for calculating the Kazakhstan content in the procurement of goods, work and services was approved by the Decree No 367 of the Government of the Republic of Kazakhstan dated 20.03.2009.

In light of these advances, we recommend that subsoil users obtain from the contractor all relevant and reliable information regarding the percentage of Kazakhstan content in the work done, items to be procured, and the percentage in the work, goods received from subcontractors.

With regard to contractors and subcontractors, in order to preserve foreign experts and still comply with the mandatory percentage that classifies the contractor as a Kazakh producer, we recommend considering entering into licensing agreements, carrying out restructuring and adopting other measures as necessary. The Subsoil Law, in addition to defining goods of Kazakhstan origin, is supplemented by the definition of ***Kazakhstan content in the product***, which is the percentage of value of local materials used and the costs to the producer of goods used for processing goods in the territory of the Republic of Kazakhstan in the final cost of the goods. The indicator of the Kazakhstan content in the product is used in the calculation of the Kazakhstan content in contracts for the supply of goods, as well as in contracts for the performance of works (services).

The changes and additions to the existing laws of the Republic of Kazakhstan are aimed at strengthening state control over the execution of the obligations of subsoil users in their acquisition of goods, work and services of Kazakhstan origin. In particular, the new sub-item 15) of Art. 8.1 of the Subsoil Law expands the remit of the authorized body for the study and use of the subsoil (the Committee of Geology and Subsoil of the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan) - to include monitoring and controlling compliance with the terms of subsoil contracts. Previously, this was a function of the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan.

The Law has introduced amendments to the existing Law on Subsoil, which provide for the inclusion of obligations on the Kazakhstan content into the terms of subsoil use contracts. Administrative responsibility is provided for non-compliance with these requirements. Due to the fact that the Code of Administrative Offenses contains no provisions expressly providing for penalties for violations of compliance with the minimum percentage of Kazakhstan content, the general rule providing for violation of conditions of subsoil use contracts will be applied (Part 1 of article. 275 of the Administrative Code). According to Part 1 of Art.275 of the Administrative Code, a legal entity (subsoil user) may be fined 80 to 100 MCI³ if it is a small or medium enterprise or from 120 to 150 if it is a large enterprise. Further, in accordance with the requirements of the Law, the terms of subsoil use contracts must contain the size of the penalties (administrative fines) for non-fulfilment by the subsoil user of commitments undertaken with regards to the Kazakhstan content in goods, work and services, and staffing. In this regard, the Subsoil Law does not provide the amount of penalties (administrative fines) for these violations. Therefore, for violations of the Kazakhstan content rules, administrative liability as well as civil law liability may be imposed on the subsoil user.

The Act provides for the shift of subsoil users to the electronic procurement of goods, work and services. This will ensure the transparency of the procurement process, which can also be carried out in accordance with Kazakhstan laws on public procurement.

The addition of the new sub-item 17 of the Subsoil Law to the competence of the Government of Kazakhstan (approval of a uniform methodology of calculating the Kazakhstan content in the procurement of goods, work and services by enterprises), - reconciles the fact of a previously approved single method for calculating the Kazakhstan content. Previously, the development and adoption of the method of calculation referred to the Committee of Industry and Scientific and Technological Development of the Ministry of Industry and Trade of the Republic of Kazakhstan.

³ MCI – the monthly calculation index. At present it is 1413 KZT.

Article 63-1 of the Subsoil Law, which determines the procedures for the acquisition of goods, work and services for subsoil use operations, has been altered by the new Law. An important innovation is the provision of item 7, Art. 63-1 of the Subsoil Law,⁴ in accordance with which, the costs that are considered by the competent authority when monitoring the execution of contractual obligations by the subsoil user do not include the following:

- 1) the cost of purchasing goods, work and services, used in carrying out subsoil use operations, on the results of a tender, held outside the territory of the Republic of Kazakhstan;
- 2) the cost of purchasing goods, work and services purchased in violation of the procedures⁵ of the Government of the Republic of Kazakhstan.

According to sub-item 5) of item 2, Article 1 of the Law, the competence of the authorized body in the field of state regulation of trade and industrial policy has been partially restricted, in particular, the following functions are excluded from its competence:

- 1) forming and maintaining a register of goods, work and services used in carrying out subsoil use operations, and their manufacturers, as well as the development of criteria for their evaluation and inclusion into the register;
- 2) the development and approval following coordination with the competent authority of the method of calculating Kazakhstan content in relation to goods, work and services used during subsoil use operations or related activities associated with the contract;
- 3) taking part in monitoring compliance with the subsoil users' contractual obligations when they purchase goods, work and services of Kazakhstan origin;
- 4) approving the form that subsoil users employ to report purchased goods, work and services and the annual program for purchasing goods, work and services for the coming year;
- 5) requesting information on current and previous procurements of goods, work and services from subsoil users and (or) persons authorized by subsoil users to purchase goods, work and services for mining operations.

Furthermore, the Law has supplemented item 2, Article. 41-5 of the Law on Subsoil by requiring that a bid for the right of subsoil use for exploration, among other things, should include commitments for the application of funds for project, research and development work required to perform work under the contract, in the territory of the Republic Kazakhstan. This requirement is reflected in new sub-item 7-1), item 1, Art. 41-7 of the Subsoil Law.

The List of responsibilities of a subsoil user, enshrined in Article 63 of the Subsoil Law, has been supplemented by the following two responsibilities:

- 20) to provide the competent authority with the information about any changes and (or) additions⁶ to the annual program for purchasing goods, work and services within five working days of making the change or addition;
- 21) register the goods, works and services used during subsoil use operations, except for subsoil users, where more than fifty percent of the shares (equity share in charter capital) are directly or indirectly owned by the national managing holding company.

Due to the fact that the Law does not set a special time for these changes in Article 63 of the Subsoil Law to enter into force, these responsibilities become mandatory for subsoil users from the moment the Law came into force. The legislature has not defined a special time limit for registration in the register of goods, work and services. Nonetheless, subsoil users, who are covered by this obligation,

⁴ This item comes into force from 01 October 2010

⁵ Procedure for the purchase of goods, work and services for carrying out subsoil use operations, approved by the Decree of the Government of the Republic of Kazakhstan dated 28.11.2007, No. 1139

⁶ Please note that an obligation to notify the competent authority of the agreed annual work programs by providing copies of the relevant protocols is imposed on the authorized body for the study and use of mineral resources and is laid down in item 6 of Art. 64 of the Law on Subsoil

are strongly advised to register as soon as possible to avoid an application of administrative liability for any violation of the subsoil use operations and terms and conditions of subsoil use contracts.

It is generally anticipated that the amendments will lead to as the following issues:

- An increase in demand for goods, work and services of Kazakhstan origin, that are necessary to carry out subsoil use operations⁷;
- An increase in demand for Kazakhstan's specialists⁸;
- Automation of the calculation of the Kazakhstan content in the procurement of subsoil users;
- Development of a unified state approach to the Kazakhstan content in all strategic sectors of the economy of the Republic of Kazakhstan;
- The provision of accurate information about the current proposals on the Kazakhstani market for goods, work and services, comparing this parameter with the demand, and as a consequence, modernization and the creation of new competitive industries.

Hopefully, the information provided will be interesting and useful for you. If you have any questions or need additional information, we will be glad to help.

*** **

GRATA Subsurface Use Law Team
Natural Resources Department

Victoriya Katanayeva
Partner, Head of Subsurface Use Team
VKatanayeva@gratanet.com

Almat Daumov
Partner, Director of Almaty Office
ADaumov@gratanet.com

Nurbol Kissembayev
Partner, Director of Aktau Office
NKissembayev@gratanet.com

Samat Daumov,
Senior Lawyer, Director of Astana Office
SDaumov@gratanet.com

Ildar Jumiyam
Senior Lawyer, Director of Atyrau Office
IJumiyam@gratanet.com

⁷ Articles 63, 63-1, 63-2 of the Subsoil Law

⁸ Item 2, Art. 8-3 of the Subsoil Law, sub-item 10-1), item 1, Art.63.