

# Part I: Information on Kazakhstan

## Introduction

The Republic of Kazakhstan, which after Russia is the second largest former Soviet republic in terms of landmass, became an independent and democratic political entity in 1991. Kazakhstan is rich in natural resources and, consequently, its economic development has been and remains highly dependent upon the extraction and export of oil, gas and minerals. Kazakhstan is a leading producer of both ferrous and non-ferrous metals, grains, fuel and oil products. The country is also a significant exporter of wool, meat, machinery and various chemicals. Kazakhstan has recently enjoyed relatively high levels of foreign direct investment, particularly in the oil and gas sector, compared to most developing nations.

Since 1991, economic and structural reforms have helped Kazakhstan to develop an independent market economy. Economic reforms and government-sponsored privatisation in the mid-1990s helped shift assets into the private sector, which contributed to economic growth in the early 2000s. Real GDP grew at an annual rate of 9.8% in 2002, 9.3% in 2003, 9.4% in 2004, 9.7% in 2005 and 10.6% in 2006. Year-on-year consumer price inflation in Kazakhstan has gradually increased from 6.0% in 2001 to 8.6% in 2006. In 2002, Kazakhstan became the first country in the Commonwealth of Independent States ("CIS") to receive an investment grade rating from Moody's Investors Service. In 2004, this investment grade rating was upgraded to Ba/NP, while Standard & Poor's upgraded long-term local and foreign Kazakhstan currency ratings to BBB/BBB-, and raised the Kazakhstan short-term foreign currency rating to A-3. On 8 October 2007, Standard & Poor's announced that it had lowered Kazakhstan's long-term foreign currency sovereign ratings to BBB-. Economic reform in Kazakhstan is an ongoing process and continues today. Kazakhstan is currently in the process of developing a new legal framework that includes revised tax, securities, bankruptcy, joint-stock company, currency control and auditing laws.

## Geography and Demography

Kazakhstan is located in Central Asia and is bordered by Russia to the north and north-west, China to the east, Kyrgyzstan, Uzbekistan and Turkmenistan to the south and the Caspian Sea to the west. It is the ninth largest country in the world, covering 2.7 million square kilometres, approximately the same size as western Europe. In December 1997, the capital and most state bodies moved from Almaty, located in southeast Kazakhstan, to Astana, located in central Kazakhstan. Almaty remains Kazakhstan's principal business and financial centre and is the country's largest city.

The country has a population of approximately 15.3 million and is one of the most sparsely populated countries in the world, with an average population density of approximately 5.6 people per square kilometre. Kazakhstan's population is ethnically diverse with more than 120 different ethnic groups. Ethnic Kazakhs account for approximately 55% of the population, followed by Russians (30%) and Ukrainians (4%). The relative size of the Kazakh ethnic group has increased since the country's independence, primarily due to non-Kazakh emigration, higher ethnic Kazakh birth rates and the return of many ethnic Kazakhs from other countries.

Kazakh is the official language of Kazakhstan and is spoken by approximately half of the population. Russian is spoken by more than three-quarters of the population and is officially recognised for use in state matters and local government. Kazakhstan's adult literacy rate is approximately 99%.

## Constitution and Government

### Constitution

Since 1991, Kazakhstan has been one of the most politically stable countries in the CIS. The country's current constitution (the "Constitution") was adopted in August 1995 and amended in October 1998 and May 2007. The Constitution provides for a tripartite structure of government with executive, legislative and judicial branches.

### *Executive Branch*

The executive branch of the government is responsible for implementing laws, decrees and international agreements, preparing and implementing the budget, establishing fiscal policy, carrying out social policy and defending the rights and freedoms of citizens.

Under the Constitution, the President is the head of State and Kazakhstan's highest ranking official. The President has the primary responsibility for Kazakhstan's domestic and foreign policy, is commander-in-chief of the armed forces and has the power to issue decrees and resolutions that are binding on the entire State. Only the President can initiate constitutional amendments, call referenda and appoint administrative heads of regions, including the heads of the capital, Astana, and the city of Almaty. In certain circumstances, the President has the power to dissolve Parliament.

The President enjoys other significant powers of appointment and dismissal, including the power to appoint and dismiss the Prime Minister, the Cabinet members and the Governor of Kazakhstan's central bank.

The Constitution, as recently amended, provides that the President is elected to office by popular vote for a term of five years and Mr. Nazarbayev, the current President, may under the Constitution, serve an unlimited number of terms of office. In December 1991, Mr. Nazarbayev, who had been the First Secretary of the Communist Party of Kazakhstan, was elected as the first President of Kazakhstan. A referendum in April 1995 extended the term of his presidency until 2000, and he was re-elected in January 1999 and December 2005. His current term of office is seven years, which expires in 2012.

The Government, which includes the Prime Minister as its executive head, one or more Deputy Prime Ministers and other ministers and officials, is the body that heads the executive branch of government. Members of the Government are appointed by the President, based on the Prime Minister's recommendations, for a term of five years. The Government is automatically dissolved after each presidential election to allow the President to form a new administration. Neither the Prime Minister nor the members of the Government are members of Parliament.

### *Legislative Branch*

Kazakhstan has had four different parliamentary structures since 1991. The current structure includes a bicameral Parliament, which consists of an upper chamber (the "Senate") of 47 Senators and a lower chamber (the "Majilis") of 107 deputies. The President appoints 15 Senators and representative bodies of the regional and municipal authorities appoint the remainder. Nine of the 107 deputies of the Majilis are selected by the People's Assembly of Kazakhstan, a cultural advisory body to the President whose members are selected by the President. The remaining 98 deputies of the Majilis are selected by the President from the party list of the parties that win the election. Senators serve six-year terms and deputies of the Majilis serve five-year terms. Senator elections were last held in 2005 and will next be held in 2008. Elections of the Majilis were last held in August 2007 and will next be held in 2012. All deputies of the current Majilis are members of the National Democratic Party Nur Otan, of which President Nazarbayev is the chairperson. The Organisation for Security and Cooperation in Europe has criticised Kazakhstan's three past elections for falling below international standards because of the President's party's dominance of the political scene and the weakness of the opposition.

### *Judicial Branch*

Judicial authority is vested in the Supreme Court, the Constitutional Council and regional and district level courts. The Supreme Court is the highest judicial body for all civil and criminal matters. The chairperson and the judges of the Supreme Court are elected by the Senate from candidates nominated by the President based on recommendations of the Supreme Judicial Council. The Supreme Judicial Council is comprised of members appointed by the President and includes the chairperson of the Constitutional Council, the Attorney General and the Minister of Justice.

## Kazakhstan's Position in the International Community

Kazakhstan has established diplomatic relations with over 120 countries and is a full member of the United Nations, the International Monetary Fund ("IMF"), the World Bank, the United Nations Educational, Scientific and Cultural Organisation, the International Atomic Energy Agency, the European Bank for Reconstruction and Development, the Asian Development Bank, the International Development Association, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the International Organisation of Securities Commissions and the Islamic Development Bank. In addition, Kazakhstan has observer status with the World Trade Organisation. Kazakhstan agreed an economic stabilisation programme with the IMF and has received standby and extended fund facilities from the IMF totalling to 538,300,000 Special Drawing Rights (approximately US\$850,000,000), all of which have been repaid. Kazakhstan is a party to the Partnership and Co-operation Agreement with the EU, which took effect in 1999. In 1994, Kazakhstan joined NATO's Partnership for Peace Programme.

## The Kazakhstan Economy

Kazakhstan's economy is highly dependent on the successful development of the oil industry. Kazakhstan's economy is expanding rapidly, posting real GDP growth in 2006 of 10.6% and over 9% for each of the past five years, fuelled by increased global demand for oil and high oil prices. In addition to the fast growing oil sector, other rapidly expanding sectors of the economy include construction, financial services and communications. Since 2002, economic growth in Kazakhstan has led to an increase in spending on imports. High oil prices created a surplus in the current account of the balance of payments and increased foreign exchange reserves, reducing inflationary pressure on the country's economy. In the post-Soviet era, Kazakhstan has received about 80 percent of the total foreign investment in Central Asia. Inflows of foreign direct investment have been in excess of US\$1bn per year since 1995, and have averaged nearly US\$2bn per year over the past ten years, giving it the highest per capita rate of foreign direct investment in the FSU over the period. However, Kazakhstan's economy, and particularly its banking sector, has encountered a period of instability in recent months. Inflation has increased beyond expectations and the credit ratings of a number of major banks in Kazakhstan have been downgraded.

A number of international companies in the resource sector currently operate in Kazakhstan, including ArcelorMittal, Areva, BP and Shell.

The table below sets out Kazakhstan's GDP, real GDP growth and inflation for the years 2002 to 2006.

	2002	2003	2004	2005	2006
GDP (US\$ bn) . . . . .	24.6	30.8	43.2	57.1	77.2
Real GDP growth (% change) . . . . .	9.8	9.3	9.4	9.7	10.6
Inflation (consumer price index % change) . . . . .	6.0	6.5	6.9	7.6	8.6

Source: Economist Intelligence Unit

The country's rapid economic growth has stimulated employment and raised living standards. Unemployment rates in Kazakhstan declined from 8.3% to 7.9% between February 2006 and February 2007 and salaries have increased in recent years.

## Mining regulatory regime in Kazakhstan

### General

In Kazakhstan, all subsurface reserves belong to the State. Exploration and production rights are granted by the State, which exercises its powers in this regard through the designated government agency, currently the Ministry of Energy and Mineral Resources ("MEMR"). Subsurface use rights are granted for a specific period, but may be extended before the expiration of the contract or licence. Subsurface use rights may be terminated by the State if the counter-party does not satisfy its contractual obligations, which generally includes compliance with long-term and annual work programme commitments, payment of royalties and taxes to the State and the satisfaction of mining, environmental, safety and health requirements.

Between August 1994 and August 1999, both a licence and a separate subsurface use contract were required for exploration and production of the hydrocarbons and mining sectors. Licences were regulated by a relevant government licensing body while contracts were regulated by a separate contracting government agency. In August 1999, the State abolished the two-tier process. Subsurface use rights are now established only by a subsurface use contract and no licence is required. Licences previously issued, however, remain valid. Currently, licences which remain valid and subsurface use contracts are both regulated by MEMR.

Although the State developed a model contract for subsurface use contracts, final contracts are negotiated between the contracting parties.

Kazakh law endeavours to provide a stable investing climate and has traditionally guaranteed the stability of the terms and conditions of subsurface use rights, even if subsequent legislation provides for less favourable terms and conditions. If a contract provides that the terms and conditions cannot be changed without the parties' consent, changes introduced by subsequent legislation are not applicable unless the parties either expressly agree or if new legislation expressly provides for retroactive effect. This protection from the effects of subsequent legislation is not available for certain matters, including those relating to defence, health, protection, environmental safety, national security and, since 1 January 2004, tax. New legislation, which became effective in November 2007, grants the Kazakh government the right to require amendments to, or to unilaterally terminate, subsurface use contracts of strategic importance if it is determined that the operations thereof have a material impact on the economic position of the Republic which creates a significant threat to national security. This law has retroactive effect.

### *Relevant legislation*

There have been three main phases of subsurface use regulation in Kazakhstan:

- the pre-August 1994 regime, from Kazakhstan's independence in 1991 to August 1994;
- the licensing regime from August 1994 to August 1999, which had two sub-phases: (i) August 1994 to January 1996; and (ii) January 1996 to August 1999; and
- the contract regime that began in August 1999.

The Group acquired subsurface use rights during the latest two of these phases. The relevant regulatory regime for each subsurface use right is the legal regime in place at the time when the licences were granted and/or the contracts were executed.

### *Pre-August 1994 regime*

After the collapse of the Soviet Union, matters concerning subsurface use rights were regulated by a subsurface code adopted after Kazakhstan's independence. Licensing was introduced in April 1994 by presidential decree and was implemented by the Licensing Regulations adopted in August 1994.

### *Licensing regime*

Under the licensing regime, a licence from the government, as the licensing body, was the pre-requisite for obtaining subsurface use rights and the basis for negotiation of a subsurface use contract with the relevant contracting government agency. Licences outlined in general terms the licensee's permitted subsurface use operations, including exploration and/or production rights. The subsurface use contract, which was also required for the granting of exploration and production rights, had to be consistent with the provisions of the corresponding licence.

### *August 1994 to January 1996 ("Licensing Regulations")*

Under the Licensing Regulations, both exploration and production licences had to identify the licensee, the purpose of the licensee's subsurface use, a description of the licence area, the term of the licence and a minimum work programme. Other provisions could include subsurface use payments, planned production volumes, production sharing mechanisms, rights to information gained during the course of subsurface use operations, health, safety and environmental

provisions, monitoring procedures, local content requirements, training obligations, provisions for extensions, terms for signing of subsurface use contracts and terms for the use of equipment and infrastructure.

### Term of the licence under the Licensing Regulations

The term of an exploration licence was up to five years, with the possibility of two extensions. The term of a production licence was up to 20 years, with the possibility of extensions for an unspecified duration and the term of a combined licence for exploration and production was up to 25 years, plus extensions.

### Suspension, termination or revocation of licences

The Licensing Regulations did not provide for specific provisions relating to the suspension or revocation of licences. Any breach of a licensee's provisions triggered a right of suspension or termination exercisable by the relevant governmental authority. However, in practice, this right was only exercised upon a material breach of the licence provisions. Termination was also required if the licence was issued based on false information provided by the licensee, the officials involved had an undisclosed agreement, or if the licensee conducted subsurface use operations not permitted under the licence, failed to make required payments, regularly violated environmental or safety rules, or entered into liquidation or bankruptcy. Finally, the licence was terminated if the licensee failed to commence subsurface operations within the deadlines established by the licence or voluntarily relinquished its subsurface use rights.

### *January 1996 to August 1999 ("Subsurface Law")*

The Subsurface Law of 26 January 1996 established into law the prior two-tier licensing and contract regime of the Licensing Regulations, and specifically recognised the validity of previously issued licences and contracts. The Subsurface Law for the first time introduced by legislation the concept of suspension, that allowed a grace period for a licensee to remedy the breach and avoid complete termination of its subsurface use rights. The corresponding contracts for licences issued prior to the Subsurface Law could also contractually contain suspension provisions. Amendments to the Subsurface Law made on 13 January 2007, repealed the provisions regarding suspension of subsurface use contracts. However these amendments do not impact the provisions of subsurface use contracts signed before 13 January 2007.

### Term of the licence under the Subsurface Law

Under the Subsurface Law, licences for exploration activities were granted for a period of up to six years. If the agreed work programme and other obligations were fulfilled the exploration term could generally be extended for up to two 2-year periods.

Licences for production were granted for a period of up to 25 years with no limit on the term of extension. Combined licences were granted for a period that included the exploration and production licence periods, including any extensions for exploration. The term of the licence for exploration or production could be extended if the licensee had applied for an extension at least 12 months prior to its expiration.

### Suspension, termination or revocation of licences

MEMR, as the licensing authority, is able to suspend a licence for a period of up to six months if a licensee conducts activities not permitted by the licence, violates the conditions of the licence, carries out activities not in accordance with the work programme stipulated by the contract or systematically or materially breaches applicable environmental protection and safety legislation.

If a licensee fails to rectify the circumstances, its licence can be suspended or revoked. Revocation could also result if the licensee did not conclude a contract within the required timeframe or if production levels are set below the geological potential of the relevant deposit.

The licence terminates upon expiration of the licence term, liquidation of the licensee or revocation of the licence by MEMR. MEMR is also able to terminate the licence if the conditions of the licence

are not fulfilled. Furthermore, if a particular combination of shareholders is required by the licence, a change in the shareholding structure without the consent of MEMR could be grounds to terminate the licence.

### *Post-August 1999 ("Contract Regime")*

As a result of amendments to the legislation on subsurface use in August 1999, the rights to exploration and production are now granted solely on the basis of a contract executed by the subsurface user and the government contracting agency, which is currently MEMR. The amendments to the Subsurface Law specifically provided that all previously issued licences remain valid. Existing licences are governed by the law in effect at the time the licences were issued and may still be extended in accordance with such prior law.

In addition, the amendments to the legislation generally require an open tender for subsurface use rights, but an entity that makes a commercial discovery and seeks related production rights may engage in direct negotiations.

### Term of the contract

The term for granting subsurface use under the Contract Regime continues to be 6 years for exploration, with two 2-year extensions, and 25 years for production. The only significant difference is that subsurface use rights may be granted for up to 45 years if the deposit under contract contains significant or unique reserves.

### *Other subsurface use terms*

#### Rehabilitation

All subsurface users carrying out subsurface use operations are required by law to set up a fund ("Rehabilitation Fund") to rehabilitate land damaged by subsurface use activity. The amount payable into the fund is established within the terms of the subsurface use contract. Subsurface users are generally required to make quarterly or annual payments to the Rehabilitation Fund. For mines related to metal ore production and coal mining, a subsurface user must set aside an amount (usually not exceeding 1% of annual sales revenue) which has been negotiated between the competent authority and the subsurface user.

### Assignment, transfer and amendments of subsurface use rights

Assignments, transfers, amendments and pledges of subsurface use rights may only be made with the prior consent of MEMR. Assignments and transfers include assignments of the rights in a subsurface use contract and alienation of shares (interests) in a subsurface use company, including a transfer of shares or rights as contributions to the charter capital of another legal entity, the sale of the property complex, sales of interests during bankruptcy proceedings or upon the privatisation of the subsurface user by the State.

Article 71 of the Subsurface Law, as amended on 1 December 2004 and 14 October 2005, provides the State with a pre-emptive right to acquire subsurface use rights in a subsurface use contract, an interest in a company holding subsurface use rights, as well as in any entity which may directly or indirectly determine or exert influence on decisions made by a subsurface user, if the main activity of such entity is related to subsurface use in Kazakhstan. This pre-emptive right permits the State to purchase any such subsurface use rights or equity interests being offered for transfer on terms no less favourable than those offered by other purchasers. The relevant government authority has the right to terminate a subsurface user contract if a transaction takes place in breach of this law. These provisions apply both to Kazakh and overseas entities. The exact scope of the law is uncertain and there is insufficient precedent to indicate how it may be applied in all situations. For example, it is unclear how this law applies to publicly traded companies.

### Relinquishment

Relinquishment obligations of subsurface use rights within the contract area are set out in the contract (and licence where applicable). Usually exploration contracts provide for the

relinquishment of the contract area on an annual basis, based upon certain percentages of the total contract area, but excluding the territory on which a commercial discovery has been made. By the end of the exploration term, all of the contract area must be returned, apart from the territory on which a commercial discovery is made.

### Balance reserves

If subsurface use rights are determined by reference to reserves, and the actual reserves prove to be lower than anticipated, the subsurface user is not automatically entitled to an adjustment of the terms and conditions of the subsurface use contract. If the reserves prove to be higher than anticipated, the contract usually provides for an obligation to amend the contract to specify additional obligations on the subsurface user.

### *Taxation of subsurface use rights*

#### *Taxation of subsurface users*

Subsurface users operate under special tax provisions set out in the subsurface use contracts. Generally, subsurface use contracts establish procedures for the calculation and payment of the following taxes: excess profit tax; special subsurface use payments (bonuses and royalties for tax royalty contracts); and generally applicable business taxes such as corporate income tax and value-added tax ("VAT"). The Kazakh Tax Code also provides for a special tax regime for production sharing agreements, which historically have only been used for petroleum contracts. Prior to their conclusion, all subsurface use contracts are subject to compulsory tax reviews. The purpose of these reviews is to confirm that the contractual tax regime is consistent with the tax law in force when the contract is signed. The reviews take into account the specific conditions of the subsurface contract.

The following is a description of the substantive provisions of the tax regime that applies to most of ENRC's current contracts and licences (where applicable).

#### *Tax regimes*

Since 1995, subsurface contracts for mining deposits have been taxed under a tax royalty regime (also known as the model 1 tax regime). The tax royalty regime envisages the payment by the subsurface user of all generally established taxes and other payments included in the Kazakh Tax Code.

#### *"Ring fencing" provisions*

Subsurface users operating under more than one subsurface use contract or licence, or having activities outside of the scope of their subsurface use contracts or licences, are required to maintain separate records of their tax liabilities with respect to each of the tax regimes established in each subsurface use contract as well as for activities outside the scope of any contract. Consolidation of the results of operations between subsurface use contracts or licences (where applicable) is not permitted for subsurface use taxation purposes.

#### *Tax payments of subsurface users*

The taxes and other special payments are as follows:

#### **Bonuses**

Subscription or signing bonuses are fixed lump sum payments made by subsurface users for the right to use the subsurface in question. Subscription bonuses are determined in subsurface use contracts or licences and are based on the estimated volume of mineral resources and the estimated economic value of the areas covered by the contract. Subscription bonuses are payable within 30 days after the signing of the subsurface use contract.

Commercial discovery bonuses are amounts paid to the government in respect of each commercial discovery of mineral resources in Kazakhstan paid at 0.1% of the assessment base. Commercial

discovery bonuses are based on the value of the recoverable reserves approved by the State Commission on Reserves.

For subsurface use contracts signed between January 1997 and July 1998, the tax regime may also include production bonuses. Production bonuses are lump sum fixed payments which must be paid when the subsurface user reaches certain production levels established in the subsurface use contract.

### Royalties

Royalties are calculated and paid separately for each type of mineral resource extracted. Royalties may be paid either in monetary form or in kind. Royalty payments are determined as a percentage of the volume of the extracted resources and may be based on either a flat rate or a sliding scale.

### Export duties

All goods, with a few exceptions, are exempt from customs duties when exported from Kazakhstan. Certain restrictions and licensing requirements may apply to the export of goods from Kazakhstan.

### Import duties

Most goods imported into Kazakhstan are subject to import customs duties, customs fees for the customs clearance and import VAT.

### Other taxes

Subsurface users are also subject to generally applicable taxes and obligatory payments in Kazakhstan such as corporate income tax, VAT, property tax and social tax.

### Tax rates

The general corporate income tax rate is 30%.

Dividends and interest payable to resident and non-resident legal entities are also subject to withholding tax at a rate of 15%, except where the rate is modified by a double-taxation treaty.

### Excess profits tax

Excess profit tax is assessed after taking a deduction for corporate income tax and is paid separately with respect to each subsurface use contract. For contracts signed between 1 January 1997 and 1 January 2005, the excess profit tax rate is dependent on the internal rate of return. The rate of tax rises progressively from 0% to 30% once the internal rate of return exceeds 20%. For contracts signed after that period, the rate of excess profit tax is determined by the ratio of income to deductions. If this ratio exceeds 20% the rate of tax rises progressively from 10% to 60%.