

# IMPLEMENTING SUBSOIL USE CONTRACTS: CONTRACTOR'S OBLIGATIONS AND CONTROL OVER THEIR FULFILLMENT

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**After execution of a Subsoil Use Contract and its entering into legal force, the parties to the Contract: a Contractor (being also a Subsoil User) and the Competent Agency of the Republic of Kazakhstan begin its implementation. It means nothing but that the parties fulfill their obligations and exercise their rights ensuing from the Contract.<sup>1</sup> Our practice shows that Contractors are not always clearly aware of the scope of those rights and obligations as well as of those of the state agencies, which they will need (or have) to interact with in connection with the executed Contracts. Not aiming at the completeness of information, I would like to dwell on some key issues, from my viewpoint, which are significant for the Contractors on the stage of implementation of the Subsoil Use Contracts.**

**Contractor's Obligations under Subsoil Use Contract and Grounds thereof.** Starting the implementation of Contracts, Contractors should keep in mind that by no means the Contracts fix all their rights and obligations (considering the chosen subject, this article deals only with obligations) and that some of the obligations are stated in the Contract in the most general way. It means that along with the obligations of the Contractor expressly stated in the Contract, other obligations of the Contractor exist in relation to the Contract. Therefore, on the whole, one should speak about obligations of the Contractor ensuing from the Contract for the subsoil use. To facilitate a clearer understanding of such obligations, they may be classified by the grounds of their origin and subdivided into obligations arising from:

1. the content of the Contract;
2. the special subsoil use legislation;
3. general provisions of the current legislation<sup>2</sup>; and
4. civil torts and public offences.

**Contractor's Obligations Ensuing from the Contract.** To illustrate the Contractor's obligations following from the Contract, we will use the structure and the content of a Model Contract for the subsoil use operations<sup>3</sup> which has certain specifics:

- The Contractor's obligations are listed not only in special clause 7.2 of the Model Contract, which determines general obligations of the Contractor but are scattered in many other Articles of the Contract (just as these obligations are not exhausted by special Articles dealing with obligations of the Contractor in specific Contracts);
- Certain rights of the Competent Agency correlate with obligations of the Contractor, some of which, though not stated expressly as such in the Contract, are undoubtedly obligations of the Contractor;
- The Contract spells out most obligations of the Contractor in the most general way, and formulates them either as rules referring to some other special legislation, or the need of application of such legislation is evident without any references.

**Contractor's Obligations Ensuing from Special Subsoil Use Legislation.** As already stated, the Contractors have a whole set of

<sup>1</sup> Non-performance or improper performance of obligations under the Contract may result in the liability of the parties right up to the termination of the Contract; however, the issues of liability and types thereof are not considered here.

<sup>2</sup> For the purposes of this article, subdivisions 2) and 3) of the classification may also include the relevant international treaties and agreements, which have a special legal status ensuing from Article 4 of the Constitution of Kazakhstan.

<sup>3</sup> Approved by Decree No. 108 of the Government of the RK dated January 27, 1997. The analysis of concluded Subsoil Use Contracts shows that the structure and the content of most of them are very close to the Model Contract; others have certain deviations, and only some of the Contracts state the Contractors' obligations in detail. These distinctions, however, cannot not, on the whole, alter the general situation as regards the sources of the Contractor's obligations under the Contracts.

special obligations and procedures not expressly included into the Contracts, but ensuing from the special subsoil use legislation. First of all, these are the basic Law On Subsoil<sup>4</sup> and Law On Petroleum<sup>5</sup>; however, even these Laws in most respect spell out the obligations of the Contractor too generally or make references to other legislative acts. In order to clearly understand the Contractor's obligations, one should, at least, be aware of the requirements of the other special legislation. A good demonstration of such reference rules of the Contract is the environment protection rules. In order to understand actual obligations of the Contractor in this respect, one should be based not only on the text of the Contract and the Subsoil Law and Petroleum Law, but very clearly visualize the entire block of Kazakhstani ecological legislation in which hundreds of legislative acts relate to the subsoil use to some extent. Sometimes other laws (for example, the Law of the Republic of Kazakhstan On the Environmental Protection<sup>6</sup>) represent the other (with respect to basic laws) special legislation, but more often these are various Rules and Regulations adopted by Decrees of the Government of the Republic of Kazakhstan.<sup>7</sup> A special act (by no means the only act), which is highly indicative in this respect, is the Uniform Rules for the Environment Protection (SREP) in the development of solid minerals, oil, gas, and underground water in the Republic of Kazakhstan. These Rules establish basic provisions and requirements to all stages of the development and commercial operation of fields and deposits, calculation and assessment of the reserves, design and establishment at the fields of rational systems of development, construction and operation of wells of all categories, managing the processes of development, and protection of the subsoil and of the environment. This very document (by the way, very bulky) determines the legal regime of such key document for the Contractor as Project of the Development of the Field (and all types thereof), as well as the procedure for the issuing agency's supervision over its implementation. Meanwhile, the Subsoil Law and Petroleum Law even do not mention the Project of the Development of Fields and numerous related obligations of the Contractor.

The special legislation also includes other regulatory acts (including various Instructions, and the like). For example, the Ministry of Energy, Industry and Trade of the RK and the Ministry of Natural Resources and Environment Protection of the RK have approved by their joint Order dated July 9, 1999 the Instructions for the Observance of Ecological Safety Rules When Projecting Oil

Operations in the Defined Water Area and Coastal Zones of the Seas and Inland Basins of the Republic of Kazakhstan<sup>8</sup>.

Moreover, the Contractor's obligations may vary depending on the type of the Contract (Exploration, or Exploration and Production, etc.), on the type of minerals (oil, gold, uranium, etc.), on the geographical location of the contract territory (land or sea), etc. Clarification of the most obligations must also be based on the analysis of the relevant special subsoil legislation.

**Contractor's Obligations Ensuing from General Provisions of the Current Legislation.** Some of the Contractor's obligation, though not mentioned either in the Contract or in the special subsoil legislation, will apply to the Contractor by virtue of general provisions of the current legislation. In other words, any companies operating in Kazakhstan may have certain obligations (provided the actual grounds exist), irrespective of the corporate structure of the company, type of ownership, foreign participation and the general type of activity (for example, the obligation to license foreign work force, the obligation to license various types of work and activities when conducting the subsoil use operations, including designing, constructing and operating industrial explosion and fire hazardous and mining businesses, main oil and gas pipelines, oil and gas drilling operations, etc.)

**Contractor's Obligations Ensuing from Civil Torts and Public Offences.** A special group of obligations arising out of implementation of the Contract is civil obligations arising out of harm infliction (tort obligations) and obligations arising as a result of violation of the rules of public law. As distinct from all other groups of obligations ensuing from the Contract, they arise as a result of various legal offences of the Contractor and his employees, and per se mean imposing on them of civil, administrative and criminal responsibility of material and non-material nature. For example, the new Administrative Code of the RK<sup>9</sup> contains special Charter 19 (Articles 240 – 306) Administrative Offences in the Area of Environment Protection, and Use of Natural Resources which includes a number of rules related to the subsoil use whose violation will entail administrative liability, including the obligation to pay fines.

Since in this case the Contractor's obligations are transformed into the liability, then it would be more appropriate to refer them to the issues of liability for violation of contractual obligations. However, it should be kept in mind that they fall within the system of the Contractor's obligations ensuing from the Contract.

<sup>4</sup> The Edict of the President of the Republic of Kazakhstan Having the Force of Law On the Subsoil and Subsoil Use dated January 27, 1996, as amended (the Subsoil Law);

<sup>5</sup> The Edict of the President of the Republic of Kazakhstan Having the Force of Law On Petroleum dated June 28, 1995, as amended (the Petroleum Law);

<sup>6</sup> The Law of the Republic of Kazakhstan On the Environment Protection dated July 15, 1997, as amended;

<sup>7</sup> Approved by Decree No. 1019 of the Government of the RK dated July 21, 1999 (the Rules). Please note that as regards the content the Rules practically coincide with other important act – the Uniform Rules for the Development of Oil and Gas Fields of the RK, approved by Decree No. 745 of the Government of the RK dated June 18, 1996.

<sup>8</sup> These Instructions, though not perfect from the viewpoint of legal technique, may, in many respects, serve as a good methodological manual for Subsoil Users.

<sup>9</sup> The Code of the RK On Administrative Offences was adopted on January 30, 2001.

**IS IT WORTHWHILE TO DUPLICATE  
 THE LEGISLATION IN THE CONTRACT?**

Please note that sometimes one and the same obligations of the Contractor may relate to several of the above groups. For example, provisions of the current legislation may be duplicated in the Contract, which is often the case. Therefore, it is important to decide in practice which obligations of the Contractor must be expressly fixed in the Contract, whether the rules of the current legislation should be duplicated in the Contracts or just the reference should be made in it that the rules of the "other current legislation of the Republic of Kazakhstan" are applicable to the Contract, or it should not be mentioned at all in the text of the Contract.

It is evident that merely contractual rules should be stipulated in the Contract. As to duplicating of the rules of the current legislation in the Contracts, then, from the formal legal point of view, it means nothing else but a mechanical copying of legislation in the Contract. However, from practical viewpoint it is possibly feasible for better understanding of their obligations by the parties and, which is more important for the Contractor, for better understanding of these obligations by the courts (arbitration), including international, in case of any potential dispute between the parties to the Contract. However, one should understand that transfer of the legislative rules to the Contract does not mean the actual change of their legal regime because Kazakhstani legislation contains a number of grandfathering rules, and, above all, the rules of Article 383 of the Civil Code of the RK which state as follows:

- 1. A Contract must comply with the rules, which are compulsory for the parties and which are established by legislation (imperative rules), being in effect as of the moment of its conclusion.**
- 2. If after the conclusion of a contract, the legislation establishes for the parties binding rules which are different from those being in effect at the moment of the conclusion of the contract, the terms and conditions of the concluded contract shall retain their force, except for the cases where the legislation establishes that its effect shall cover the relations which arose from the earlier agreements.**

A similar rule exists in the Subsoil Law, pursuant to which amendments to the legislation worsening the position of the Subsoil User shall not apply to the Contracts issued and concluded prior to such amendments (Article 71).

The above means that inclusion or non-inclusion into the Contract of the Contractor's specific obligations stipulated by the legislation will not affect the need of their implementation both at the moment of the Contract's execution and during the effectiveness of the Contract even in case of any changes in the legislation.

Therefore, each time a Contractor may independently decide which of the rules of the legislation should be duplicated in the Contract, and which should not<sup>10</sup>. It is more important to be well aware of these obligations. In this respect (in addition to the above), from the practical standpoint, it makes sense to proceed from the fact that Contractor's obligations may be notionally divided into several stages according to the stages of the Contract's effectiveness, including as follows:

- from the day of the Contract execution until the beginning of the subsoil use in some form;
- at the stage of exploration work;
- at the stage of development and commercial operation of a field;
- at the stage of field operation; and
- at the stage of termination of the Contractor's obligations under the Contract, including, if the field has been operated, its conservation (in each particular case subject to the type of the Contract: Exploration, and/or Production of the mineral).

At each of the stages the Contractor has specific obligations, the content of which, as stated above, is defined both in the specific Contracts, and (in more detail) in other legislation.

**WHO HAS THE RIGHT TO CONTROL THE FULFILLMENT BY THE CONTRACTOR  
 OF THE TERMS AND CONDITIONS OF ITS CONTRACT?**

The Subsoil Law contains special Article 70, which regulates the control over observance by a Subsoil User of the terms and conditions of the Contract.

This Article is rather laconic in that it states only consequences of violating the deadlines for the commencement of exploration or production, and also conducting of exploration on an insufficient level. The Competent Agency (Authorized State Agency) is named as a controlling agency.

Without discussing the legally incorrect rule of this Article concerning the possibility of canceling the Contract by anyone, except by the Parties thereto (which are the Contractor and the Competent Agency, and not some non-defined authorized state agency), one should admit that existence in the key law of the Article of such title and content might give rise to some illusion of the Contractor as to the subjects that control him and the scope of control over the fulfillment of obligations under the Contract. Actually, a number of state agencies, on quite legal grounds, have the right to control the fulfillment of obligations ensuing from the Contract, and, if any relevant violations exist, to notify the Competent Agency of the violations (which, in its turn, may raise issues concerning the liability of the Contractor, suspension and even termination of the Contract).

Alongside with the Competent Agency (at present, the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan), the most

<sup>10</sup> Until recently the issue has been discussed how mandatory the rules of the Model Contract are, and whether or not they should be completely duplicated in specific Contracts. There are no doubts that from the legal standpoint and legal nature of this Contract, the Model Contract is not mandatory and its structure and content may considerably be changed upon the mutual agreement of the parties (which ensues from its legal definition contained in Article 1.13 of the Subsoil Law).

important controlling agencies are: the Ministry of Natural Resources and Environment Protection of the RK (supervises over ecology and subsoil protection); Agency of the RK for Emergency Situations (mining and technical supervision); and various state agencies, which carry out control over designs and rules during construction; over water and land resources; State Sanitary and Epidemiological Service; State Agency for Standardization, Metrology and Certification; local authorities; bodies of the Prosecutor's Office; tax authorities, etc.

As it is known from the mass media publications, lately the controlling functions over the Subsoil Use Contracts are also carried out by the Parliament of the RK and the Governmental Commission,

which, being headed by Danial Akhmetov, Vice-Premier, and with the participation of representatives of the Ministry of Finance, Ministry of Economy, Ministry of State Revenues, Ministry of Energy, Ministry of Justice of the Republic of Kazakhstan, reviews subsoil use contracts. The Commission has already reviewed about 20 contracts of major oil producers. The main object of the review is the compliance of the subsoil users with the contractual and license terms and conditions".

In its relationships with all numerous controlling agencies, the Contractor should, of course, know its obligations, and, which is of no less importance, his rights.

*translation by the author*

" Contractual obligations: Achilles' Heel of Investors. Oil & Gas of Kazakhstan – 2000. No. 5–6, pages 28–29



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