State-Owned Oil Enterprise Case Studies: KazMunayGaz

Working Paper

Saule Ospanova

I. Context and Background

The JSC NC KazMunaiGaz (KMG) deals with all key energy issues in Kazakhstan, including production, refining, transportation, sales, and relations with foreign investors. Moreover, the company de facto sets up export quotas for domestic and foreign producers of hydrocarbons. At present, the conglomerate is the most powerful financial-industrial group in Kazakhstan, which is unsurprising, taking into account the importance of the energy sector for the domestic economy.
The KMG was founded in 2004 through the merger of two exploration and production companies, JSC Uzenmunaigas and JSC Embamunaigas. In 2005 KMG EP was partially privatized. The SOE’s parent company, NG KMG, is an integrated oil and gas company wholly owned by the government of Kazakhstan. The KMG's founding party is the Government of the Republic of Kazakhstan represented by the State Property and Privatization Committee of the Ministry of Finance of the Republic of Kazakhstan.

Kazakhstan ranks 12th worldwide among the holders of proven oil and gas condensate reserves, 22th - in terms of natural gas reserves, and 17th - for oil and gas production.

According to the Resource Governance Index by the Natural Resource Governance Institute (NRGI), Kazakhstan scores 56 out of 100 points and ranks 25th among 89 countries that were assessed. Kazakhstan gets the second-best ranking among Eurasian countries but still shows weak resource governance scores compared to the global average. According to the index, Kazakhstan shows good results in taxation, state-owned enterprises, sovereign wealth funds, government effectiveness, regulatory quality, rule of law, political stability and absence of violence, and open data subcomponents. It has lower scores on the licensing, national budgeting, voice and accountability, and control of corruption subcomponents.

JSC NC "KazMunayGas" accounts for 28% of the total crude oil and gas condensate production volume in Kazakhstan and 16% of natural and associated gas, provides for 65% of oil transportation through trunk oil pipelines, 77% of oil transportation with tankers from the port of Aktau, and 95% of natural gas transportation through trunk gas pipelines, processes 82% of the Kazakh crude oil with the retail oil product market share of 17%.

JSC NC "KazMunayGas" is among the biggest employers with the number of employees of over 84,000. Oil revenue accounts for approximately 40 percent of total government revenue. Exchange rate volatility driven by fluctuations in oil prices, pressing development needs, and limited implementation and absorptive capacities are among Kazakhstan’s key policy challenges. But over the past several years important reforms have been undertaken through the adoption of international standards for the productive, financial and public sectors and to diversify the economy away from oil and minerals.

By the early 2000s, the oil and gas industry was the major driver of the country’s economy accounting for about 62 percent of export earnings and close to 40 percent of the government’s budget revenue.

Consequently the government made two key policy decisions: (i) to create the National Fund of Kazakhstan; and (ii) to created a strong SOE.
Since the KMG's initial portfolio of assets contained mature fields, the government granted it a series of commercial privileges by law, aimed at providing it with a clear competitive advantage. These included: the right of first refusal on any onshore oil and gas rights, interests or assets offered for sale in Kazakhstan; preferential access rights to KMG oil and gas transportation assets; and access to unlicensed acreage in Kazakhstan without the need for the government to run a competitive tender process. In addition, all PSAs post-2004 had to include at least 50 percent participation of KMG EP, carried through exploration. A modern corporate governance structure was set up, to afford the KMG the management flexibility needed to fulfill its mission. The company did not have large noncommercial obligations, nor was it required to undertake non-core commercial activities beyond those acquired at the time of its creation.
As long as Kazakhstan's investment conditions remained attractive to private investors, protectionist policies may have been one of the most effective ways for the government to help the company achieve the size and economies of scale necessary to become a fully fledged oil and gas corporation.

KMG has had a range of special privileges as a result of mid-2000 legislative changes:

1. Right of first refusal on any onshore oil and gas right, interest or asset offered for sale in Kazakhstan;
2. preferential access rights to KMG oil and gas transportation assets;
3. right to ask KMG to enter into direct negotiations with the government for any unlicensed oil and gas acreage in Kazakhstan;
4. 50% minimum carried participation in upstream projects.

These policies gave KMG EP a clear competitive advantage. Special privileges are not the only component of the government's ownership strategy. The government wanted it to have a modern corporate governance structure to give its management the flexibility needed to execute its non-organic growth strategy (that is, growth by acquisition as opposed to growth through the drill bit).

<u>Core mandate and mission</u>

KMG states its mission as to build on its position as a leading oil and gas company in Kazakhstan by increasing its production and replacing its reserves both through acquisitions in the short-to-medium term, and through exploration in the longer term. The overarching vision is to have a highly-efficient SOE meeting highest safety and corporate governance standards[1].

The Petroleum Law of 1995 and the Law on Subsoil and Subsoil Use 1996 were the main laws governing the petroleum sector. The majority of agreements in the 1990s was under concessionary contracts and had taken place in Tengiz (the highest producer and third-largest reserve holder) and other fields (Aktobe, Emba, Kumkol, and Uzen) that had much smaller reserves but collectively accounted for 50 percent of production. After its creation in 2002, KMG was mandated to act on behalf of the state in PSAs and relevant agreements, and was provided increasing authority over the years.

According to the Annual report 2017, mission of the KMG EP is "to effectively produce hydrocarbons to maximise shareholder value, while providing long-term economic and social benefits to the regions where it operates and helping to realise the potential of every Company employee".

[1] www.kmg.kz

KMG EP is planning to repurchase common shares and GDRs held by minority shareholders and to withdraw these securities from the stock exchanges, followed by closer integration and strategic alignment with its parent company, NC KMG. In fact, that is the number one company objective for 2018-2019.

Stated company values include:

- Work safety and highest EHS standards
- Employee development: training, education and conducive work environment
- Highest standards of corporate governance
- Ensuring business responsibility

Institutional position within the state system

Policy and regulatory functions in the hydrocarbon sector are carried out by the Ministry of Energy RK[2]. KMG EP and its holding, NC KMG, are purely commercial entities. The ministry also acts on behalf of the state, or mandates a competent body in contracts and agreements for exploration and/or production with subsoil companies. NC KMG's shareholders are the Samruk-Kazyna Sovereign Wealth Fund (90%) and the National Bank of the Republic of Kazakhstan (10% + 1 share).

Although regulatory functions belong to the state, in practice, it is the government-company nexus governing the hydrocarbons industry. The roster of top management cadres is interchangeable, set in constant rotation, with an exception of geology and exploration subdivisions, where there is more human resources stability and good technical expertise is required.

It is worth noting that practically any significant changes in the company's policy, restructuring or leadership over its history can be linked to shifts in inter-elite power dynamics and their contestation over decision-making and resources[3]. Inter-elite interaction in Kazakhstan heavily influences the country's economic and political discourse, including the domestic energy complex. However, this subject deserves a separate note.

Organizational structure of the company

The KMG group is comprised of 201 organizations, including the corporate centre JSC NC "KazMunayGas". The founder of KMG is the Government of the Republic of Kazakhstan represented by the Committee for State Property and Privatization of the Ministry of Finance. KMG Board of Directors (BOD) determines the priority directions of the Company's business activity, approves the development strategy, taking into account economic, environmental and social impacts, and monitors the implementation of its strategy.

Currently, one of the most significant drivers behind KMG transformation process is the Government's approval of a large-scale privatization program in December 2015. The aim of the program is to support market reforms in Kazakhstan and increase efficiency of enterprises by transferring government-controlled companies into the private sector. The government share in the economy is expected to be decreased down to 15% by 2021. KMG is an active participant of the privatization program. About 73 KMG subsidiaries will be privatized by 2020. Specifically, around 45 companies will

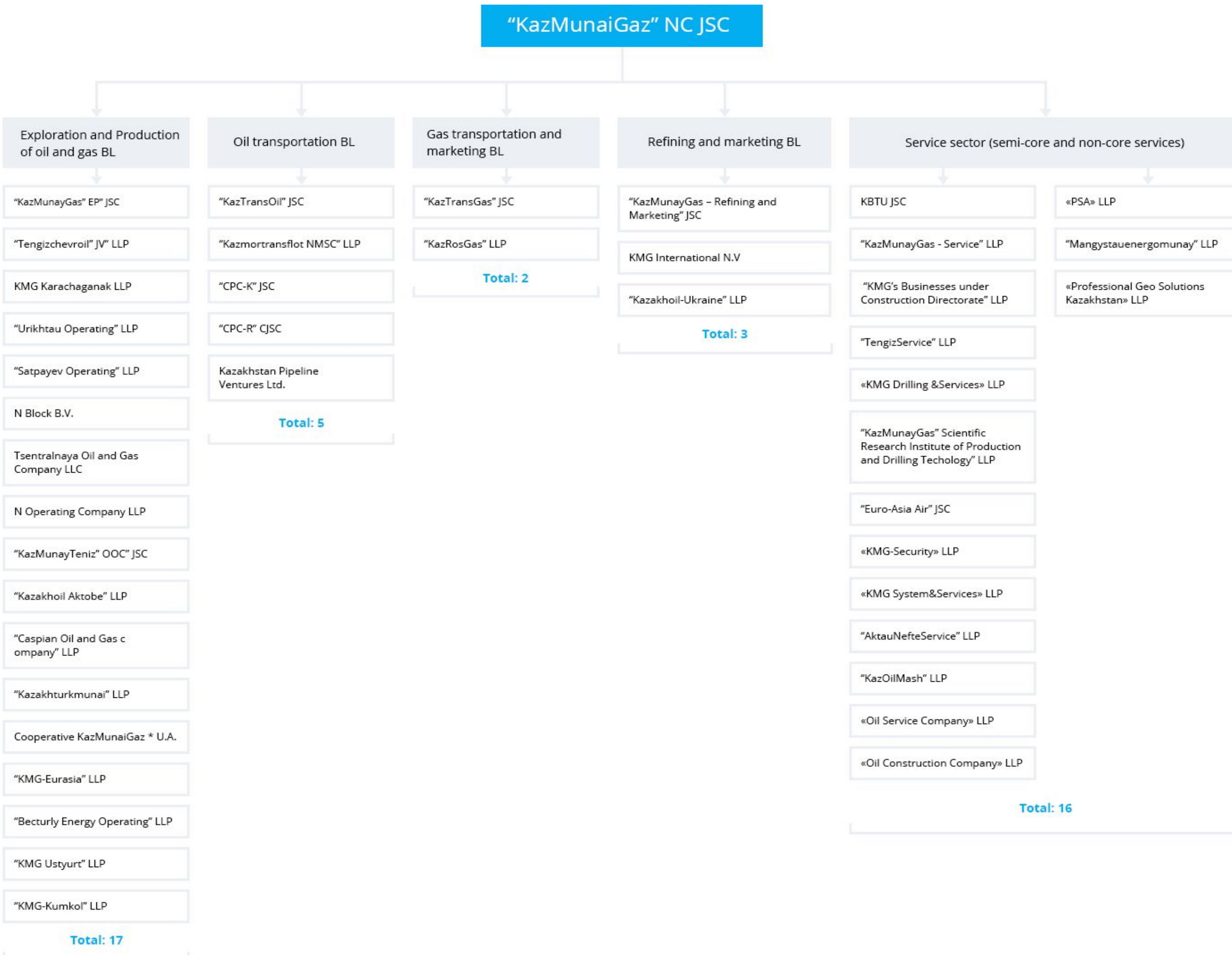
---

[2] Resolution No. 994 September 19, 2014 on the regulatory role of the Ministry of Energy; plus other Resolutions No. 390/2002, 1072/2010, 567/2014

[3] Elite contestation over the country natural resources and specifically oil and gas are explored more in depth by the following sources https://file.ejatlas.org/docs/kashagan-oil-field/Kashaganbis.pdf S Yenikeyeff's articles et al

be transferred to the private sector, another 28 companies will be consolidated or liquidated in order to optimize the group structure. Reintegration and delisting KMG EP were part of this multi-step process.

KMG Organizational Chart[4]:



On the operations front KMG is a joint venture established in 2002 between two former state-owned enterprises, KazakhOil NC CJSC and Oil and Gas Transportation NC CJSC (the national transportation company). KMG is a fully state-owned operator responsible for services for exploration, development, production, processing, transportation, and marketing of oil and gas in Kazakhstan. During the past decade, a series of legislations were enforced and have provided the SOE with additional mandates.

---

[4] www.kmg.kz

The Petroleum Law of 2005 authorized KMG to act as a regulator for monitoring and controlling of compliance of subsoil companies in accordance to their subsoil use contracts. Additionally, the Petroleum Law provided KMG with further mandates namely: taking part in strategy formation for the use petroleum resources, representing the state in contracts and agreements, organizing tenders for subsoil operations, and exploring and producing of oil and gas. One of the major mandates given to the SOE was via the amendment to the industrial development law in 2004, the PSA Law of 2005 that required all production sharing agreements (PSAs) to include KMG with a minimum of 50 percent equity in oil and gas projects.

II. Accountability – to the state and to the public

According to the KMG's Strategy until 2025, KMG will focus on the following three top-priority development areas, in order to ensure sustainable growth and taking into account the external and internal environment factors:
1. Enhancing the company's short-term and mid-term financial standing though capital restrictions and improvement in the operational efficiency.
2. Making KMG's target business model with the privatization programme factored in.
3. Strengthening KMG's role as a key player of Kazakhstan's petroleum industry (long-term effect of great importance to sustainable development).

Consistent with the key priorities, the Company's principal goals are:

- increasing the production volumes and the reserves level;
- securing recovery of investment;
- creating value and strengthening financial soundness.

According to KMG reports, achievement of goals within this framework of priorities will enhance the overall business efficiency and improve KMG's operating and financial performance.

KMG EP does not have large noncommercial obligations and is not required to undertake non-core commercial activities beyond those acquired at the time of its creation. The government was pleased with KMG EP's results and has not explicitly indicated its intention to lift the special privileges granted to it. However effective this strategy has proved in helping KMG EP rapidly build an asset portfolio and economies of scale, it has not quite helped the SOE to achieve competency in the management of petroleum exploration activities. The assets acquired by the SOE are maturing, but as long as the government's protectionist policy remains in place, there may be no real incentive for the SOE to diversify its portfolio internationally or to assume exploration risk. The issue is even more complicated, if political corruption, lack of accountability and interwoven roster of cadres between political and energy sectors are taken into account.

There are rules governing fiscal transfers between the company and the state (RGI Database 2018). According to Article 7 of the Charter of the Joint Stock Company National Company KazMunayGas approved by resolution of the body (resolution of the Board of Management of JSC "Samruk-Kazyna, of "22" 2016, minutes No.13/16), "The Shareholders of KMG is Joint Stock Company Sovereign Wealth Fund Samruk-Kazyna and the Republican governmental agency National Bank of the Republic of Kazakhstan". Furthermore, according to Article 7, KMG Shareholders are entitled to collect dividends. Articles 9 specifies the rules for paying the dividends. The official Dividend Policy of Samruk Kazyna approved by KazMunayGas of 29 March of 2011 also specifies the rules for paying the dividends to the shareholders. According to the Corporate Governance Code of Samruk-Kazyna, "a clear and transparent mechanism for determining the amount and payment of dividends must be defined for the purpose of effective distribution of profits in the Organization. "Dividends are not the only revenue that the state receives from the SOE. The National Fund also receives revenue from subsoil users, including corporate income tax, excess profits tax, bonuses, tax on production of useful minerals and so on. However, rules governing these payments are provided for in the Tax Code (Article 147.1) and Subsoil Use Law (RGI Database 2018).

KMG discloses information on payments/dividends paid to Samruk-Kazyna and the National Bank of Kazakhstan--the company shareholders. In turn, Samruk-Kazyna publicly discloses information on dividends received from KazMunayGas. The National Bank indicates only the aggregate dividends received. The National Fund in their annual report specifies the portion of the Republic of Kazakhstan under the production sharing that is received mainly through KazMunayGas. Overall, KMG publishes annual reports, including its balance sheets, cash flow statement and income statement.

Non-commercial role:
The sustainability report only mentions the amount spent on sponsorship and charity, indicating that "contractual payments for the development of the social infrastructure of the regions based on the operational information, accounted for more than 10.5 bln Tenge." This suggests there may be other non-contracted payments. For example, the 2015 Annual Reports for KMG and KMG E&P mention social payments relating to other projects. Neither report gives full details of payments. The 2015 KMG Annual Report gives details on "socially important projects" but does not give the amount spent on each, saying only that its "own funds" were used. In addition, details on non-operational activities by the SOE are not found in the EITI main report. This problem with identifying social and other non-contracted payments is ongoing due to lack of disaggregated detailed reporting from KMG in the past. However, there is an expectation that more detailed reports will be forthcoming, if pressure from civil society and EITI coalition continues (RGI 2018).

Local content:
During the Soviet era, petroleum-related knowledge and human capital used to be maintained and managed at the central level. Upon independence, Kazakhstan had to develop its own capabilities. As a first step, the country relied on international oil companies (IOCs) to develop employment and local capabilities by including obligations to this effect in the contractual agreements with these companies. In addition, IOCs were required to carry out social development programs especially in the vicinity of operations. Over this period, local content requirements were regarded as corporate social responsibility (CSR) activities and were often defined by the companies themselves. They were lenient and not clearly defined by authorities.

Corporate governance

The 2016 – 2017 Corporate Governance Action Plan of KMG aims at continuing the implementation of processes, standards, and principles of corporate governance in the following areas:

- Risk management and internal control;
- Sustainable development, including development of KPIs for management;
- Remuneration and professional training of entry-level employees;
- The effectiveness of the Board of Directors;
- Relations with shareholders;
- Information disclosure.

The BOD is comprised of eight people, half of them are independent directors (update RGI--recent changes). The Board has four committees on nomination and remuneration, strategy and innovation, finance, and audit. The topics submitted for the agenda of the BOD are discussed within preliminary BOD committee meetings. BOD decisions, adopted during internal meetings, are recorded with complete details by the Corporate Secretariat; this entity acting as a liaison between the governance bodies and structural units delivers the orders issued by BOD to the Management Board and internal audit, and keeps the Board informed on the implementation timeline.

The Code of Ethics sets unified behavioral standards for all KMG workers, irrespective of their position. The Code sets standards on interaction with colleagues, governmental authorities, shareholders, subsidiaries, business partners, communities and media. The Code was approved by KMG BOD in 2010. Compliance with the Code is compulsory for all employees. KMG's Board of Directors reviews the provisions of this Code every two years, examining the extent to which they are implemented in practice and, if necessary, making adjustments. The Code is based on the principles of justice, respect for human rights, intolerance to corruption, prevention of conflict of interests, and leading by example (KMG Sustainability Report 2017).
KMG also has an Ombudsman, anonymous hotline and email, where employees or any external party can report corporate misconduct or violation of any norms. The right to appeal and confidentiality are guaranteed, based on the stated principles in the KMG documents.

The new Corporate Risk Management System has become an integral part of corporate governance, setting KPI thresholds for evaluation. The relationship of the risk management process and operational activities includes : 1) recognizing the importance of the CRMS development as a key element of the corporate governance system; 2) the corporate governance based on setting of threshold levels of KPIs taking into account KMG's assessed risks; 3) in the process of threshold KPI setting, the company will

- seek to calculate a threshold KPI value on the basis of residual value in the area of operational/non-operational risks exclusively comprised of external factors which are unmanageable and beyond the KMG's control;
- manage operational/non-operational risks in accordance with internal risk factors.

KMG identified own sustainability issues relevant to their work:

- The Group's impact as an oil & gas operator to the society and the environment.
- Management's requirements for information and market analysis.
- Conclusions from dialogues with co-interested groups.
- International initiatives and guidelines for sustainable development, especially GRI and good practice in the oil & gas industry.
- Disclosure requirements from stock exchanges, analysts, rating agencies, institutional investors and other interested parties.

All of the components outlined above are indeed positive developments in making the KMG corporate culture healthier. The debate around delisting of KMG EP presents an interesting case of how political decisions and national interests impacted this process and made it possible. It is a good illustration of KMG's corporate governance culture and interactions between the state and the company.

Delisting of KMG EP

As of end 2017, NC KMG retained a majority stake of 58%2 in KMG EP. Its free float was 34%. The remaining 8% were treasury shares. NC KMG held the majority of seats on the KMG EP's Board of Directors. At the same time, the rights of minority shareholders were protected both by legislation and by the requirements of the exchanges on which KMG EP was traded, as well as the corporate governance system and the Relationship Agreement implemented in conjunction with the Company's IPO in 2006.
The Company is currently completing a number of actions that will result in NC KMG and KMG EP owning a total of 56,210,435 common shares and 82,165,972 GDRs, corresponding to around 99.5% of all common shares in issue (including common shares in the form of GDRs). Certain amendments have been made to the Company Charter, under which existing provisions protecting the rights of minority shareholders no longer apply.

The Relationship Agreement with NC KMG ceased to have effect after the termination of trading and the cancellation of the listing of GDRs and common shares on the London Stock Exchange (LSE) and Kazakhstan Stock Exchange (KASE) in the first half of May 2018. In December 2017, the Company announced its intention to repurchase its GDRs at a price of US$ 14.00 per unit and delist them from LSE, as well as repurchase all of its outstanding common shares at a price of US$ 84 per share, in accordance with the 1:6 GDR conversion ratio, and subsequently delist them from KASE. This announcement has been the key factor influencing the price of both securities since December 2017.

Minority shareholders included China Investment Corporation (PRC sovereign wealth fund), and funds overseen by Western managers--e.g. BlackRock. One of the arguments for the minority share buyout and delisting of KMG EP had been improvement of the NC KMG financial flexibility via full access to EP's cash flow and reserves--if it will be used to reduce the high debt burden of the group. KMG EP has virtually no debt and represents a significant portion of the group's earnings, while the group had $16 bln unadjusted gross debt in 2017. Presumably, NC KMG financial profile will improve once it will enjoy greater control over KMG EP resulting in group's better resilience to oil price shocks. There is also an expectation that the NC KMG own proposed IPO will be closer.

Over the past 12 years of KMG EP existence as a public company, its minority shareholders (predominantly international) had an uneasy relationship with the parent company. Two earlier attempts to buyout GDR holders had failed over price considerations. This conflict had been the center of debate over corporate governance and shareholder rights in Kazakhstan. On December 8 2017 KMG EP launched $1.95 billion tender offer for its GDRs and shares, valued at $5.6 bln. On May 11 2018, the KMG EP announced delisting at London SE. As a result, the relationship agreement has terminated and the new version of the company Charter, approved by the shareholders at Extraordinary Group Meeting 2 on March 12 2018, became effective.

The following are the main amendments to the Charter, which comply with the requirements of the laws of Kazakhstan and were approved on 12 March 2018:

a. To change the majority required to pass shareholder resolutions on certain matters specified in the Charter — including the delisting of the Company's securities and Charter amendments — from a qualified majority (75%) of the total number of voting shares in issue to a simple majority of votes exercised at the meeting;

b. To change the requirement for resolutions of the Board on certain matters specified in the Charter from a majority vote of the Directors (including a majority vote of the Independent Non-Executive Directors) present at the relevant meeting to a simple majority vote of Directors present at the meeting;

c. To remove the express right of the Independent Non-Executive Directors to engage professional consultants to advise them at the expense of the Company (without prejudice to any engagement entered into prior to EGM 2);

d. To change the requirement for the agenda of all Board meetings to be approved by the majority of the Independent Non-Executive Directors present at the relevant meeting to a simple majority vote of all the Directors present at the meeting;

e. To change the quorum required for a duly authorised meeting of the Board from two-thirds to one-half of all Directors;

f. To change the requirement that two-thirds of the INEDs be present for a Board meeting to be quorate.

Based on these changes to the Charter, it is clear what made the decision to delist possible and how opposition of minority shareholders was rendered moot.

Sources:

Transparency

Key operational and payment data had become available for KMG EP over the past decade after the 2006 IPO and going public. KMG produces annual consolidated reports and makes them available on their website. However, if further probing or detailed explanations are requested, especially regarding more complicated arrangements with the company affiliates and subsidiaries, the company tends to be elusive and decision-making opaque. In fact, aside from the restricted access conferences and meetings, it is highly unlikely to encounter company representatives in a wider public setting.
The company does disclose aggregate data on production volumes, sales volume, finance and operations, most of it in the annual reports (RGI 2018).

In December 2017, a new Code on Subsoil and Subsoil Use was approved. The Code introduced a more simplified process for allocation of licenses by providing the extractive companies with fairer bidding opportunities, including through online services; and more liberal technical and financial criteria. Additionally, the Code addressed the issue of hidden ownership by introducing a concept of control over a company, allowing the government and business partners to see who they work with. This is a step, however limited, in making the process more transparent.
Kazakhstan has initiated discussions around beneficial ownership (BO) disclosures in the country following the amendments to the EITI Standard in February 2016. Based on the Standard requirement, Kazakhstan's beneficial ownership roadmap was published in December 2016[5]. Although new to the discussion of the beneficial ownership disclosures, Kazakhstan has already taken steps in bringing about changes in the country's legislature through launching discussions around amending the Subsoil and Subsoil Use Code. Following the establishment of the Interministerial Working Group on beneficial ownership disclosures in 2017, members of the EITI National Stakeholders Council agreed to pilot BO disclosures in the next EITI Report.

KPI (key performance indicators) system setting: Introduction of a KPI on ‘reporting transparency’ (RT) for the management team was the first step on the way to improving the KMG corporate culture.

[5] Available on https://eiti.org/sites/default/files/documents/beneficial_ownership_roadmap_-_kazakhstan_english.pdf

Audit: Although not explicitly required[6], the company accepted this as a standard best practice early on and has been contracting an external auditor for its financial reporting.
KMG had a very difficult and complicated transition to the International Financial Reporting Standards starting back in 2002, just as the Group's structure was changing and becoming more and more complex. The Group has been contracting Ernst & Young for its financial reporting external audit services for more than a decade.

Procurement: Procurement is carried out in accordance with the Rules for Purchase of Goods, Works and Services by JSC Sovereign Wealth Fund Samruk-Kazyna and Entities whose fifty or more percent of voting shares are directly or indirectly owned or beneficially owned by the Samruk-Kazyna JSC, approved by the Samruk-Kazyna Board of Directors on May 26, 2012 (minutes No.80)[7]. This is a key regulation, which is still not fully harmonized with various cross-sectoral regulations, but the process is ongoing.

KMG communication strategy is comparatively standard in comparison with other SOEs and some IOCs. It went through a period of transformation after KMG EP went through 2006 IPO, when the requirement for public disclosure of company reporting for the stock exchange influenced the parent company to make more reporting public. However, much of that corporate reporting, although available on the company website, is not mainstreamed to public at large. There are hardly any public debates and consultations.

Legislative oversight: According to the Article 31 of the Law on Subsurface Use, KMG is required to provide reporting on contracts implementation to the president and the government (currently-Ministry of Energy), but not to the Parliament. Article 17 of the Charter of KazMunaiGas relates only to financial statements, not to operational or non-operational activity. Article 18 states that KMG needs to keep records concerning its activities, but that these can only be requested by Shareholders, not the parliament (RGI 2018).

EITI implications in Kazakhstan
The Government of Kazakhstan announced its commitment to the EITI in 2005 and was accepted as an EITI Candidate in September 2007. In 2010, the EITI reporting requirements were embedded in the Law on Subsoil and Subsoil use, making it mandatory for all companies to report in accordance with the EITI. In October 2013, EITI Board declared Kazakhstan compliant with the 2011 EITI Rules. According to the 2017 BP Statistical Review of World Energy, Kazakhstan's total proven oil reserves were equal to 30 billion barrels at the end of 2016 and average oil production was equal to approximately 1.7 million barrels per day.

[6] RGI Database: The Statement on the Committee on Internal Audit of KazMunayGas of 2011, No 1 does not specifically state that the SOE's financial statements have to be audited externally, although repeated mentions of an external auditor suggest that a policy is in place. For example, Article 7.20. states that Audit Committee shall "1) with regard to financial statements: a) discuss with the Company's management and external auditors the financial reporting issues, including relevancy and justification of the applied financial reporting principles [...] c) consider any significant disagreements between the external auditor and the Company's management on the Company's financial reporting [...] 3) On external audit: a) explore the issues related to appointment and change of the external auditor of the Company and prepare appropriate recommendations [...] d) preliminarily approve all essential terms and conditions of the agreement (contract) with the external auditor for conducting audit of the annual financial statements of the Company; e) discuss with the external auditor to what extent a proposed plan and a scope of an audit meet the needs of the Sole Shareholder and the Company's Board of Directors; f) reviews results of annual and interim audits together with the external auditor including the response of the Company with regards to audit results." It would seem to be an impossibility to fulfil these criteria without appointing an external auditor.
[7] http://zakup.kmg.kz/uploads/files/Pravila_zakupok_AO_Samruk-Kazyina.pdf

There is a strong sense of ownership within the ministry in charge of EITI implementation-Ministry of Investments and Development, and all stakeholders are contributing to the EITI process. Civil society remains engaged in the EITI, but the impact of their work and the strength of their voice is hampered by long standing conflicts between the various NGOs and civil society coalitions that have an interest in the EITI. Although EITI implementation in Kazakhstan has significantly enhanced transparency in the extractive sector, there appears to be limited impact of this transparency on greater accountability and reform. Although Kazakhstan is meeting the minimum expectations of the EITI in terms of publication and dissemination of EITI data, more could be done to make use of EITI data for analytical purposes, including ensuring that it delivers recommendations pertinent to addressing challenges and reform needs in the extractive sector. The latest 2017 validation report included specific recommendations pertaining to SOEs engagement: ● It is recommended that a more sustainable and transparent disclosure framework related to license and contract allocations is put in place, embedded in the relevant Ministries and SOEs that have rights to negotiate contracts. The transition to the new legal framework under the new Law on Subsoil would be a good opportunity to effectuate this change. ● It is recommended that the government takes steps to ensure that the new draft Subsoil code provides a sound foundation for comprehensive reporting and publication of beneficial ownership data. ● It is recommended that the National Stakeholders Council (NSC) undertakes a comprehensive assessment of the public accessibility of information related to state-owned enterprises, including quasi-fiscal spending, and agree a plan for engaging with and requesting disclosures from SOEs for the data that is currently not yet disclosed. A more regular outreach and dialogue with SOEs engaged in oil, gas and mining would be beneficial. ● In light of the substantial production pertaining to KazMunayGas, the NSC could consider joining the EITI's targeted effort on increasing transparency in commodity trading.

III. Company performance

KMG set out strategic priorities in its 2025 planning:

- Strengthening KMG position in Kazakhstan OG sector: KMG will focus on increasing reserves, consolidating assets in Exploration & Production sector, and effective management of joint ventures.
- Ensuring financial stability: KMG will optimize capital expenditures, increase operational efficiency and plan to prepare for IPO in 2018.
- Business portfolio restructuring: transferring downstream assets to the private sector. Optimization and gradual withdrawal from oil services and other non-core business assets planned to be completed by 2021.

Strategic goals for the upstream sector include increase of oil and condensate production by 56% and increase recoverable reserves by 22% by 2025 in comparison to 2014. In order to achieve these goals, the company is planning to further expand its participatory interest in the Tengiz, North- Caspian and Karachaganak projects, maintain high rate of exploration, strengthen its role in the field exploration and development projects, gaining operator/co-operator's rights under the existing and new projects, enhance oil recovery, develop its hard-to-recover reserves (heavy oil and bitumens, coalbed methane), and continue building strategic partnerships with the world's leading oil and gas companies.

Strategic goal in the oil transportation sector is to increase it by 30%, from 74 mln tonnes in 2014 to 96 in 2025. It will be done by improving the oil pipelines management system (process automation system, SCADA, equipment remote control, implementation of energy efficiency improvement programs), involving KMG's fleet (KMTF) as a sole operator in sea transportation on the Black Sea and Caspian Sea, and increasing capacity, as well as the continued implementation of the Kazakhstan-China oil pipeline expansion project.

SD: Since February 7, 2006 JSC NC "KazMunayGas" has been the member of the UN's Global Compact and has consistently supported the commitment to 10 principles of the Global Compact and 17 goals of sustainable development. Sustainable development in the modern world of business is becoming the main focus of organizations and communities. Combining economic, environmental and social issues, sustainable development becomes an integral part of strategic management for many organizations. With the approval of the Corporate Governance Code of SWF Samruk-Kazyna JSC (Fund), KMG considers the sustainable development as one of the strategic goals along with growth of the company's long-term value. Integration of sustainable development values into key business processes, operations and decision-making processes becomes the main priority.

In September 2016, Kazakhstan ratified Paris Agreement on Climate Change, and as a leading company in the oil and gas industry KMG also understands the importance of its contribution to the initiative of global sustainable development.

The JSC NC "KazMunayGas" has published a separate Sustainability report for the year 2016, which discloses the information on non-financial aspects of the company, reflecting its interest in providing transparent and open information. The report was prepared in an extended version and in accordance with GRI international sustainability reporting guidelines. The sustainability report also constitutes a message about KMG's progress in the framework of the UN Global compact. The information presented in the report is balanced, reflects challenges of the companies and challenges in international and regional context, and also the priority guidelines for further development.

One of the main stated goals is 100% associated gas utilization, (zero flaring) in the very near future. Therefore,they have also endorsed the World Bank's Initiative on "Zero Routine Flaring by 2030". This strategy also includes working with industry partners and governmental institutions to establish an effective policy and technological framework for reducing GHG (Greenhouse Gas) emissions. These actions already resulted in significant reductions of CO_2 emissions.
The company's sustainability plans for 2016 included a strong sustainability strategy, with a focus on building the corporate culture at all levels with all employees and achieving tangible results in terms of HSE, community development, human resources is essential to our business success. As national company, with over 80,000 employees and a top tax payer, it has an obligation to be consistent and develop for the long term, to deliver a significant portion of the country's energy needs to support economic growth. The goal is that KMG becomes a leader in what we do, not only financially and operationally, but with regards to sustainable development as this enhances long-term value and reliable business partnerships.

Upstream operational performance

KMG EP was founded as upstream and Kazakhstan-focused commercial company, with oil and gas reserves that were largely mature. In addition it has supplemented its asset base with ongoing domestic acquisitions. KMG EP is requested to contribute to national and regional projects, and discloses associated costs on its website. In the years immediately following the IPO in 2006, the raised funds along with the rights granted to KMG EP by NC KMG as part of the IPO, were used to purchase significant onshore producing assets--shares in Kazgermunai, Karazhanbasmunai and PetroKazakhstan. These assets allowed to diversify KMG EP resource base and cut its overall cost of production, while at the same time providing returns in the form of dividends.

The total volume of crude oil processing in Kazakhstan increased by 2.8% year on year in 2017 to 14.9 million tonnes. Kazakhstan's Ministry of Energy expects the volume of crude oil processing to increase to 15.8 million tonnes in 2018. Currently, the country imports some light oil products to satisfy domestic demand. According to the Ministry, with the modernisation of the refineries (the modernisation of the country's oil refineries in Atyrau and Pavlodar was completed in 2017, while the modernisation of the Shymkent refinery will be completed in 2018), from 2019, total refining capacity will increase to 17.5 million tonnes of crude oil per year. The production of light oil products will grow by 3.3 million tonnes per year, the Ministry estimates, thus fully meeting domestic demand for light oil products.
Most of the oil (about 85%) produced in Kazakhstan is exported. Its main foreign trading partners for crude oil are Europe — notably Italy, the Netherlands, France, Austria and Switzerland — and China.

In 2017, the Company's capital expenditure amounted to 111.1 billion tenge, or 4 billion tenge (3%) less than in 2016. This was primarily due to a decrease in capital expenditure on the construction and modernisation of production facilities, but partially offset by an increase in purchases of fixed assets and higher expenses related to production and exploration drilling. Capital expenditures include the cost of drilling new wells, the construction and modernisation of production facilities, the purchase of fixed and intangible assets and non-production capital expenditure.

Kazakhstan's fuel and energy sector hit record levels pretty much across the board in 2017 and the Government, through the Ministry of Energy, intends to take steps to maintain the current growth rate and step up industry development. It has overhauled tax policy in relation to subsoil use (the updated tax code came into force in January 2018) and it plans to introduce an electronic trading platform for the gas industry to improve the mechanism for pricing and distributing liquefied petroleum gas (LPG), including the step-by-step elimination of the state's wholesale price regulation. The necessary legislation is due to be drawn up by December 2018.

The company set four primary objectives:
1. Replenishing and increasing the resource base and maintaining production levels;
2. Ensuring the profitability of assets;
3. Developing new business competencies; and
4. Maintaining the company's values.

In 2011, there was a period of Zhanaozen labour unrest at the KMG's largest wholly owned asset, which led to labour disruption, reduced production and increased costs, primarily due to the additional benefits granted to restore social calm. NC KMG was fully supported by the Government RK in resolving these issues. The ripple effect of violent suppression of those riots had a lasting impact over the next few years. According the the KMG EP annual report 2017, few factors are cited to have contributed to the ultimate decision to delist:

- Addressing ongoing and growing social obligations that limit company's ability to control future costs;
- Operation in mature fields where production maintenance costs remain relatively high and increasing investment is constantly required to address the production decline;

- Inability to utilise large cash balance to increase shareholder value through new acquisitions or through the return of cash to shareholders via dividends due to various views of shareholders and their representation on the Board.

According to top management of KMG EP, the decision to delist was not easy, but very necessary, as it revolved primarily around the strategic objectives of KMG EP's majority shareholder, NC KMG.
Since its listing on the London Stock Exchange, KMG EP created a corporate governance system in line with international requirements, which was designed to achieve the complex task of maintaining the balance of interests of its various stakeholders: NC KMG, as the main shareholder and key player in Kazakhstan's oil and gas market, minority shareholders, company employees, the state, the regions in which the Company operates, and its foreign partners. Significant changes in market conditions, however, and changes in the strategy of the National Company were causing the interests of the various groups of shareholders to diverge. This was hindering KMG EP's development to the point of being counterproductive, so the priority was to find a mutually beneficial solution to the situation.
The 98% acceptance of the tender offer by minority shareholders indicates that the proposed solution — to buy out the minority stakes and delist KMG EP — was welcomed by almost everyone. Minority shareholders have been able to sell their shares at a fair price, while NC KMG has been able to bring KMG EP deeper into the fold. It expects to reap the benefits of this integration at group level.
From a financial perspective, participants in the Company's IPO who retained their positions and accepted the last tender offer have had a positive yield on their investment.

January 15, 2018, KMG and the Chinese National Oil and Gas Corporation held bilateral negotiations in the framework of the implementation of the agreement signed earlier by the heads of the two states. Following the meeting, an agreement was reached on a prospective increase in the export of Kazakh gas to China up to 10 billion cubic meters per year.

Samruk-Kazyna has reportedly proposed that the Anglo-Dutch major Shell acquire a minority stake in KMG, amounting between 10% and 20%. Due to the relative information scarcity surrounding the discussions, as none of the two negotiators has yet gone public with the details, the price of a possible agreement is for the moment not known. Samruk-Kazyna, whose total assets were estimated at $67bn as of 2016, already holds a 90% stake in KMG. 2015 was the year that ended with crude oil prices at their lowest level since 2009 (below $40 per barrel). That's when the National Bank of Kazakhstan became a 10% shareholder of KMG, following a $4bn injection, in order to support the fund in its effort to bail the energy group out. It was then believed that KMG's accumulated net debt/EBITDA, which normally shouldn't exceed 3.5, would lead to a breach of its Eurobond covenants. Samruk-Kazyna's decision to spend $4.7bn for half of KMG's stake in Kashagan helped the oil producer deconsolidate some $2.2bn of indebtedness stemming from the giant offshore oilfield project in the Northern Caspian and to reduce its debt-to-EBITDA ratio.

Throughout 2017-2018 KMG continued work towards lightening its debt burden through sales of non-core assets and stabilizing its performance--amidst slightly elevated oil prices on the road to an initial public offering (IPO), set to take place around 2019-2020. Even though the exact time of realization, as well as the size that Samruk-Kazyna will finally retain in KMG, are still undisclosed, the float is being practically enabled by the recent KMG EP delisting. Despite it not completely fitting into the category of the so-called 'blue chips', NC KMG is numbered among the most high-value prizes for investors under a major privatization program launched by government RK with the aim of trimming State's participation rate in 65 businesses down to 15% of GDP by 2020, in line with OECD precepts .

Relationship between the KMG EP minority shareholders and majority shareholder NC KMG had become especially difficult in 2015-2016, with disputes over the Purchase offer, share of dividends, and overall direction of the company. 2016 was another year during which KMG EP neither acquired significant oil and gas assets nor invest in an exploration programme. Independent directors issued a letter statement, where they were recommending that the Board should pay a special dividend to return surplus cash to shareholders, which was, of course, in the interest of KMG NC--in order to retain large cash balances in the company and making it available to their state shareholders in turn. The national budget required cash inflows at that point. (KMG AR 2017 + Bloomberg)

During 2016 the Government of the Republic of Kazakhstan increased the quota of KMG EP's oil supplies to domestic refineries to approximately 40% of its total production. The independent directors asserted there was no transparency over how the Government sets quotas to supply the domestic refineries and this lack of transparency over key regulatory decisions remained an area of concern for them throughout existence of KMG EP as a public company.

There are also some changes happening in the human resources as part of the KMG transformation program. They cover development of competencies model, development of KPIs as part of the evaluation system, streamlining recruitment process, maintaining talent pool and attracting the best international technical expertise. KMG has developed a 'tree of KPIs' cascading from the strategic goals and aimed for value creation. It allows the company to evaluate contributions of every unit towards achievement of strategic goals and objectives. There are corporate and functional KPIs with the former assigned only to the top-management and the latter covering staff's areas of responsibility. The company focused on making the employee hiring, evaluation and remuneration processes more transparent and accountable. Continuous learning and education are supported and promoted with internal training programs.

KMG's Baa3 issuer rating incorporates a three-notch uplift from the company's baseline credit assessment (BCA) of ba3, which reflects Moody's assumptions of a high level of support to be provided to KMG by the government of Kazakhstan in case of need, as well as a high level of dependence between the state and the company.

Challenges, risks and responses

JSC NC KMG Corporate Risk Management System (CRMS) policy[8] was approved by the Board of Directors on December 13, 2016 for the whole group, including affiliates and subsidiaries. KMG consolidated risk management will be implemented through introduction of the corporate risk management system at all KMG Group's levels. Risk management is essential for creating and maintaining the company value, enabling the management to assess and manage risks in case of uncertainty.

Notably, the discussion around Moody's ratings brings out reassessment of credit metrics against company performance and underlying risks. In April 2018, Moody's assigned Baa3 to the senior unsecured notes issued by KMG. This rating reflected Moody's assumptions of a high level of support to be provided to KMG by the government of Kazakhstan in case of need, as well as a high level of dependence between the state and the company, despite a presumed pick-up in net debt by year-end 2018

[8] http://www.kmg.kz/uploads/documents/company/inner_documents/eng/kmg_dzo_risk_policy_en.pdf

following consolidation of minorities' stake in the upstream segment--KMG EP[9]. The rating reflects various positive factors such as crude price recovery, lower capital spending in 2017-18 (mostly due to finished refineries upgrade discussed above), company's strong liquidity, and growing production from Kashagan, among others.

The ongoing risks are connected with the privatisation of KMG and some of its subsidiaries and related uncertainties, such as the extent of government support, unclear terms, timing.

IV Recommendations and follow-up

Company: Presently, KMG does not engage in much public dialogue or debate. The publicly available information is posted on the website. Typical critique of company's conduct and policies is similar to the critique of the state policy and conduct, including lack of decision-making transparency, lacking access to top management, lack of meaningful public consultations and corrupt practices. Aside from the company released reports and press releases on the website, wider public is not generally aware of the details of company performance and internal problems. The following points need to be considered in order to facilitate public engagement and open up some sort of public dialogue:

- Full compliance with EITI reporting
- Disaggregated reporting on social payments by project
- Open consultations and hearings over reporting and revenue management
- Subsidiaries' costs and revenues disclosure
- Accessible public summary reports
-

State: Communications regarding KMG revenue management and Samruk-Kazyna transparency are still very limited and public debate restricted to EITI platform. Overtime, following issues emerged as salient:

- Communicate updates and revisions from the Code on Subsurface Use revisions to the public
- Explaining consequences of delisting KMG EP consequences for NC KMG, Samruk-Kazyna Fund and plans for the future--communicating implications for the public
- Harmonizing disclosure policies across the board for national and foreign companies
- Ensuring public hearings on environmental and SD outcomes, regulations and compliance issues
- Revisions of procurement rules and regulations covering contractors and subcontractors
- Lack of access and public hearings around national companies, national security clause
-

Public: Organized push for transparency and accountability from SOEs has not been very strong. However, the EITI platform provides one of the important legitimate entry points for this dialogue. Media involvement is crucial. Building/maintaining alliances with academia and international organizations is important as well in order to address the following issues:

- EITI coalition organizing to push for greater transparency from SOE
- Keep SOE involved in EITI process
- Monitor/Keep scrutiny over the privatization process
- Analyze and dissect SOE available info, communicating and translating it to the wider public
-

[9] www.moodys.com ; https://www.moodys.com/research/Moodys-assigns-Baa3-rating-to-KMGs-notes--PR_381645

ANNEX I NRGI Database: KMG Profile

NRGI Database Tables: KMG Profile

	2011	2012	2013	2014	2015
GDP (USD million)	200 379	215 902	243 775	227 437	184 361
Total O&G Revenues (USD million)					
General Government Revenue (USD million)	52 096	54 793	58 577	52 569	30 629
General Government Total Expenditure (USD million)	40 902	45 577	46 874	48 615	40 029
Exchange rate (LCU/USD)	146,6208	149,1125	152,1292	179,1917	221,7283

Indicator	Description	2011	2012	2013	2014	2015	Unit
Total Current Assets	Value of assets that can be liquidated to cash within a year	12 030	12 393	13 297	12 566	15 218	USD million
Total Longterm/Fixed Assets	Value of assets that cannot be liquidated to cash within a year	30 106	32 833	36 385	36 761	33 083	USD million
Total Assets		42 136	45 226	49 683	49 326	48 301	USD million
Cash and cash equivalents		12 029	2 784	2 678	4 593	3 473	USD million
Total Current Liabilities	Value of amounts due to be paid to creditors within a year	5 588	7 540	6 674	6 685	5 802	USD million
Total Long-term/Fixed Liabilities	Value of liabilities due to be paid to creditors after more than a year	14 969	14 190	16 478	17 991	15 032	USD million
Total Liabilities	Value of accounts payable, debt and other liabilities	20 557	21 730	23 151	24 676	20 834	USD million
Equity	Value of common stocks, capital surplus, retained earnings, treasury stock and other equity	21 580	24 099	26 531	24 650	27 467	USD million

Indicator	Description	2011	2012	2013	2014	2015	Unit
Capital expenditures	Property, plant and equipment + capitalised exploration expenditures	2 936	2 994	3 800	3 084	2 800	USD million
Operational expenditures	Variable + Fixed Costs	16 443	18 225	19 239	18 015	7 212	USD million
Total expenditures		19 380	21 220	23 039	21 099	10 012	USD million

Table: upstream KMG EP

	2017	2016	2015	2014	2006
Crude oil production (mln tonnes)	11.9	12.2	12.35	12.3	9.5
Average daily production (kbopd)	241	245	167.8		
2P reserves (mln tonnes)	145	145	152	132	205
Export (mln tonnes/year	7.1	6.8	6.4	7.5	6.9
Revenue (bln KZT)	956	727	530	846	412
CAPEX (bln KZT)	111	115	98	128	49
Net profit (bln KZT)	195	132	244	47	123
Net cash (USD mln)	4 028	3 516	3 221	3 984 (727 bln KZT)	2 615
Average Brent price (US$/bbl)	54.19	43.73	52.4	99	65.1

Annex II Background on KZ petroleum sector

Kazakhstan is endowed with 15 sedimentary basins spread over 60 percent of its area. But most of onshore and offshore oil and other mineral deposits are located in the North Caspian Basin. Some oil reserves are also located in Southern Kazakhstan but the prospects for new discoveries there are limited.

The North Caspian basin is spread over Russian and Kazakhstan territory. On the Kazakhstan side (northern Caspian), the offshore Kashagan, located near Atyrau city, and onshore Tengiz are by far the largest Kazakh fields. To the north of the country, close to the Russian borders, rests the Karachaganak field. The North Caspian basin is bound by the Hercynian Ural Mountains to the east and by other orogenic belts to the southeast and south. In the north, the basin is separated by the Voronezh Massif in the west and by the Volga-Urals Platform in the north (Talwani, Belopolsky and Berry 1998). The basin is divided into 15 licensed blocks that include 20 different offshore fields in shallow water. Most fields are under appraisal or development. Tengiz and Kashagan, the two major fields in the country, possess similar geological characteristics with reservoir rocks, fluid properties, pressure gradients, reservoir depths, and sulfur content. Recoverable reserves are rated at 69 billion barrels of light oil (out of 24 billion barrels in place) with associated gas reserves of 64 trillion cubic feet (tcf).

Kazakhstan’s petroleum sector went through several stages of development. During the period following independence in 1991, Kazakhstan’s petroleum industry witnessed stagnant growth and limited production. But since the late discoveries of offshore reserves, petroleum suddenly became the most abundant resource in the country. Today, Kazakhstan's oil resources are the largest of all the former Soviet republics apart from the Russian Federation. Oil reserves at the end of 2011 were estimated at 30.0 billion barrels representing 1.8 percent of world reserves, and 28.5 percent of total reserves in Europe and Eurasia, increasing from 5.4 billion barrels in 2000 (BP 2012). The Tengiz, Kashagan, and Karachaganak fields contain over 50 percent of the country’s reserves, while Uzen, Zhetybai, Zhanazhol, Kalamkas, Kenkiyak, Karazhanbas, Kumkol, North 110 Buzachi , Alibekmola, Central and Eastern Prorva, Kenbai, and Korolevskoye contain nearly 40 percent (Ernst and Young 2011). Gas reserves on the other hand were estimated at 66.4 tcf at the end of 2011, and represented less than 1 percent of world reserves.

The Kashagan field holds the largest oil reserves in Kazakhstan with an estimated potential for 38 billion barrels, of which 79 billion barrels (and up to 13 billion barrels if gas injections is used) are recoverable. Its prospectivity was cited by the Soviets in the early 1970s but was not officially discovered until 2000 (Campaner and Yenikeyeff 2008). Tengiz, the country’s second-largest field, was discovered in 1979 and has an estimated 69 billion barrels that are recoverable. The Tengizchevroil (TCO) partnership has been developing the Tengiz field since 1993. Chevron holds 50 percent equity, ExxonMobil holds 25 percent, the national oil company (NOC) KazMunayGas (KMG) holds 20 percent, and the remaining 5 percent is held by Russian/US LUKArco.

In the downstream sector, Kazakhstan has three processing plants. Currently, they have a capacity of ______________________________CHECK KMG 2018:

- The Atyrau refinery was the first refinery in Kazakhstan, put into operation in 1945 (KMG). During the Soviet era the refinery received a major technical upgrade that included all refinery technological equipment. This enabled the refinery to increase the capacity to 31.5 million barrels per year.
- The Shymkent refinery was put into operation in 1985. The estimated capacity of the plant amounts to 43.9 million barrels per year.

- The Pavlodar petrochemical Plant (PPCP) started operations in 1978. A new joint venture between KMG and ENI took over the plant with plans for upgrading it, which included increasing refining capabilities to 54.9 million barrels per year and increasing petroleum product output and quality.

Transport is carried out through the main active export routes—the Atyrau-Samara pipeline, CPC pipeline, and Atasu-Alashankou.

In the 1990s, there were speculations that the Caspian region could be considered a serious alternative to Middle Eastern oil supplies. However, recent estimates suggest that the combined proven reserves of Kazakhstan and Azerbaijan constitute only half of the reserves of the United Arab Emirates or Kuwait. Moreover, the Caspian region is unlikely to boost the non-OPEC oil supply in the foreseeable future due to the nature of its of reserves, as well as logistical and investment challenges. Meanwhile, declining onshore reserves will force resource-rich nations to develop undersea oil and gas hydrocarbons. According to some forecasts, roughly 40 percent of global oil and gas will be produced offshore by 2015. SOEs, having access to mere 7% of world's oil and gas reserves, will play a major role in future offshore hydrocarbon production.

Kazakhstan's "multi-vector policy" could promote the diversification of the existing export transport infrastructure. In this respect, Kazakhstan, and neighbouring Turkmenistan and Uzbekistan are likely to enjoy the economic and political benefits of the growing competition between Russia, China and Europe for Central Asian hydrocarbons. For the time being, the renegotiation of the conditions of the Kashagan consortium should be seen as a particular case in the context of serious technical, environmental and fiscal challenges of a hugely complex industrial project rather than yet another sign of the systematic projection of "resource nationalism" to the detriment of international oil companies. These challenges also reduce Kashagan's (and with it Kazakhstan's) importance for the future of global oil supplies from "crucial" to "significant". Yet given the fast-changing contours of the new "great game" between the young republics of Central Asia, China, Russia, the United States and Europe, Kazakhstan's governance of its oil and gas sector will continue to be closely watched.

The Chinese rationale behind commercially unsound pipelines is often questioned, unlike its financial endowment and ability to implement large-scale industrial projects. Beijing is keen to secure additional energy supplies to fuel its growing economy at whatever cost the construction of new pipelines may require. Central Asian countries are disposed to engaging with a rapidly growing China, despite their traditional cautiousness towards their Eastern Asian neighbour. Energy co-operation with Beijing can bring other considerable benefits for Central Asian states such as investment, infrastructure development (such as the construction of roads and railways), and growth in other trade sectors. China has an upper hand over Russia in terms of its "cash power" and in terms of effective implementation of large-scale projects. However, the United States and Europe have a serious technological advantage over Russia and China in terms of Caspian offshore oil and gas development. The intensified competition for Central Asian gas has also enabled some Central Asian producers such as Kazakhstan to renegotiate the initial deals reached with international companies during times of low oil prices and the economic chaos of the post-Soviet era.

China already controls up to 30% of oil industry of Kazakhstan. Since 2000 year Kazakhstan has moved from being fully dependent on Russia for oil & gas export toward more diversification, but now there are concerns, that Kazakhstan became dangerously dependent from China. Kazakhstan has legal tools handy to prevent further expansion of Chinese control in energy sector, if needed, that may be an obstacle for some of the energy projects initiated by China under the OBOR initiative: State's priority right to purchase/permission to transfer so-called “strategic assets”. State’s priority right to purchase/permission to transfer in the sphere of subsoil use. State’s priority right to an interest of no less than 51% in any new trunk pipeline projects.

Kazakhstan has high ambitions in OBOR as it is geographically an ideal junction between China and the West and its interest in OBOR is indisputable – with Kazakh government already being involved in Nurly Zhol (Path of Light), a $9 billion domestic economic stimulus plan to develop and modernize roads, railways, etc Kazakhstan plans to sell 1,008 state-owned objects and facilities to private owners within the privatization program in 2014-2020. The Privatisation List of the companies to be privatised/transferred to the competitive environment includes, inter alia: 1) Oil and gas: JSC “National Company “KazMunayGas” (IPO), “PetroKazakhstan Oil Products” LLP, “Atyrau Oil Refinery” LLP, JSC “KazTransGaz Almaty”, “BeineuMunayGas” LLP; 2) Energy: JSC “National Company “Kazatomprom” (IPO), JSC “SamrukEnergy” (IPO), JSC “Almaty Electric Power Plants”, JSC “Alatau Jaryk Kompaniyasy”, “AlmatyEnergoSbyt” LLP etc.

Kazakhstan’s climbed the World Bank’s Ease of Doing Business index and is now ranked 35th . and it is one of the 20 most attractive countries in the world for investors . With the intention of promoting industrialization and diversification of Kazakhstan’s economy, the law provides a system of benefits and preferences (e.g. tax and customs duties exemptions) which supports direct investments in certain areas, that include, among others, manufacture of refined petroleum products . In 2015 the PPP Law has also been adopted and public-private partnerships can now be used to implement projects under the PPP Law framework in any sector of the economy . Green tariffs and guaranteed offtake have been introduced to facilitate development of the renewable energy projects . Chinese energy FDIs under the OBOR initiative can be implemented under the general legislation framework, that is already very investor friendly.