

No return to Kazakhstan

Oil-rich Kazakhstan is making a stand against foreign companies drilling into its land. Such moves could come too soon after the country's financial crisis, leaving investors and banks reluctant to consider Kazakh risk exposure. **Michael Turner** investigates.

British Virgin Island-based Tristan Oil has recently issued a challenging statement to the government of Kazakhstan, accusing the Kazakh ministry of oil and gas of illegitimately cancelling subsoil contracts awarded to two of Tristan's subsidiaries, Kazpolmunay and Tolkyneftegaz. "[Tristan Oil] views the abrupt cancellation of Kazpolmunay and Tolkyneftegaz's subsoil use

contracts as the final step in a systematic campaign commenced by the Kazakh authorities in 2008 to illegally expropriate Kazpolmunay and Tolkyneftegaz's assets and the investments made by their stakeholders in Kazakhstan," the oil company remarks in a statement.

In response, Kazakhstan claims that the oil and gas company has violated a number of laws, including operating without a state-issued license.

For Kazakhstan, who has appointed state-owned KazMunaiGaz as interim management for the sites, this bold criticism comes at a time when its government is already embroiled in a separate battle with oil companies drilling in the country.

With 3% of the world's oil found under Kazakhstan, the country's government has



judged that oil prices have raised enough for them to begin cashing in.

To do this, Kazakhstan has raised the duty on oil exports from an oil company-friendly US\$0 per tonne, to US\$20 per tonne. This works out to US\$2.73 per barrel.

However, this is still significantly less than the US\$139.79 per tonne that the country was charging on oil crossing its borders from May 2008 until January 2009, and almost 15 times less than Russia's US\$292 per tonne.

According to the Kazakh ministry of finance, the move is expected to add approximately KZT177bn (US\$1.2bn) to the nation's state budget with an estimate of 60 million tonnes per year being exported.

Lobbying the decision

Oil companies have strenuously lobbied the decision, including two international consortiums that have production sharing agreements (PSAs), signed with the Kazakh government in the 1990s, which were designed to protect against tax increases, amongst other things.

The two groups, one led by the US's Chevron and the other joint-led by Italy's Eni and UK-based BG, operate two of Kazakhstan's biggest oil fields; Tengiz and Karachaganak, respectively.

"Kazakhstan gave up zero duty on crude oil and set a fee of US\$20 per tonne, which is 10 times smaller than the pre-crisis level, but extended its action to the largest oil and gas companies who did not pay a fee before," Sauat Mynabaev, Kazakhstan's energy minister, tells **GTR**, refusing to go into further detail.

However, a spokesperson from the country's ministry of finance notes that the tax rise might not prove as problematic to oil companies as it first seems: "The government does not foresee any serious economic consequences attributable to introducing the export customs duty for oil companies operating in Kazakhstan."

The ministry of finance claims that the sum of ECD will be deducted from taxable

corporate income, causing corporate income tax payments to drop. Therefore, the total tax requirement for oil companies after the introduction of the ECD is expected to increase by 2.5 to 3%. Kasia Zatorska, economist, Europe, at country risk service D&B, explains to **GTR** that while tapping the oil sector is a viable option, the Kazakh government needs to keep a longer-term strategy in mind: "Though the crisis has been overcome and the banking sector has been stabilised, there is an ongoing risk that comes from a few angles. The government has been using the positive rebound of oil prices to support the fiscal stimulus, but there has to

Zatorska argues that the problem lies in the Kazakh government's continued role in the banking sector: "The government help must be reduced this year, if the state continues helping the banks then it is not very good for transparency. Foreign investors will see this as a negative as it opens the possibility for corruption."

A recent report by Russian bank VTB Capital highlights areas where the government has started pulling out of banks' recovery: "The [Kazakh] state aims to cut support to the two largest banks, which was proved recently when KazMunaiGas Exploration Production, the main production facility of the Kazakh state company KazMunai

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be a medium to long-term plan to it. They need to avoid credit growth growing at uncontrollable levels like it was in 2007 and 2008. In order to make credit growth more controllable, regulation is needed. There's still an ongoing worry that no one really wants to invest in the Kazakhstan assets or banks."

The worry that Zatorska mentions has been dampened by Kazakhstan's impressive growth in GDP, up 8% year on year. However, this has been largely helped by the recovery in the price of oil. Zatorska continues: "Even though the growth accelerated, there's still a problem with the regulations."

Government involvement

Emerging from a period of massive volatility in the banking sector, Kazakhstan has nationalised four of the country's banks; Kazkommertsbank, Halyk Bank, Alliance Bank and BTA through its state-run fund Samruk Kazyna, a move designed, among other things, to provide stability and accountability in senior management.

Gas, announced that it planned to decrease the volume of deposits placed with Kazkommertsbank and Halyk Bank gradually through the end of 2011 from US\$3.1bn at present to US\$750mn."

Recent crises in the eurozone have diverted the attention away from Central Asia, but Kazakhstan's reputation on the international markets is still balanced on a knife edge between banks that were left heavily out of pocket by the ordeal, and banks that are moving in on the market space created by still having an understandable risk appetite for a country that floats on top of a sizeable amount of the world's oil.

Geoffrey Wynne, head of international trade and export finance at law firm Denton Wilde Sapte, worked with the steering committee in the restructuring of Alliance Bank. He describes to **GTR** the misconceptions that helped create the Kazakh banking crisis: "There was a belief that the government of Kazakhstan would stand behind its banks and this perhaps justified the idea that lending more and more money would be acceptable because the government would

3%

of the world's oil found under Kazakhstan.

US\$20

The increase in duty per tonne of oil.

8%

The increase in GDP year-on-year.

always be there. The country is rich in oil, after all.

"However, if we go back through history, there was no reason to believe that the government would do this. The government of Ukraine did not stand behind its banks; the government of Russia did not stand behind its banks in 1998 (during the Russian financial crisis). It is only western governments, with the notable exception of Lehman Brothers, who have provided bailouts when things went wrong, and so western banks were left gnashing their teeth."

"Add to this the fact that a lot of banks lent to Kazakhstan on the belief that trade-related debt would always get priority. When it did not, the western banks got angry."

This was certainly the case for banks involved with BTA's restructuring, as industry groups lobbying the prioritisation of trade finance debts went as far as writing an open letter to Kazakhstan's President Nursultan Nazarbayev requesting his intervention.

However, there was a third factor in the equation which infuriated some parties involved, as Wynne explains: "Kazakhstan passed a law for how debts of banks should be restructured. The perceived problem with this was that it worked as a 'cram down' where a percentage of creditors could bind all the creditors; in this case it was 66%. The problem was that the other 33% might have felt cheated.

"The law was approved by English and US bankruptcy courts. In the end, the possible outcome of 33% rejecting the proposals was much less, as what we saw was that 95% voted in favour of the restructuring, accepting, and sensibly so, that a major restructuring was better than bankruptcy." If the figures that Wynne provide show anything, it's that a very small 5% minority

held a problem with the restructuring terms, as the Denton's partner goes on to say: "People pass laws to try and address the minority blocking what the majority want."

Accepting, but not happy

While 95% agreed with the restructurings, many of the majority would have still lost a significant amount of owed money through haircuts. This has prompted a source that had exposure to the restructuring to declare to **GTR**: "I would not touch

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Kazakhstan with a barge pole."

"It's an understandable knee-jerk reaction; if a bank has been beaten and bloodied by some or all of these elements, maybe they would say 'Kazakhstan, never again'," concedes Wynne.

A further source of ongoing risk, according to D&B's Zatorska, is the difference between borrowers' capabilities and domestic lenders' expectations:

"Kazakhstan is a high risk economy. There's money to be borrowed but the borrowers are not meeting the credit criteria. It is one thing for the government to fix the regulations but there is a problem if not many borrowers are meeting conditions needed. There's money to be given but no one to take it. We can always expect businesses to lag in the improvement in their balance sheets, and as the economy grows and strengthens the situation is going to improve for the companies borrowing money. But it's not going to happen overnight."

Zatorska's points raise concerns for Kazakhstan's short to medium term viability on the international market, a view that Denton's Wynne reiterates: "In the short term people will be wary, and there will be much less cavalier lenders with an appetite for the risk, but I have no doubt that lending will come back to Kazakhstan eventually."

In fact, Wynne provides **GTR** with a preview of renewed appetite as he adds: "I know that we are working on Kazakhstan financings at the moment. There's enough political turmoil in the world, there's enough

'bad countries' from the UN perception, that if there is a country where banks have provided money at a reasonable profit, then they'll want to go back there. Kazakhstan has oil; it's a place where in the right circumstances banks would want to lend money."

While Wynne reveals that there is some current interest in lending to Kazakhstan, the staggering amounts of debt written off means that market sentiment is geared to shun the country for the short term, a move which could possibly stretch out to five years and into the medium term, particularly if the country's government does not react quickly and authoritatively to potential problem areas such as the continued involvement of Samruk Kazyna. However, it seems that regardless of how badly banks lost out, and how much oil companies' look set to be charged, Kazakhstan can be certain that it will be involved in the international market's plans eventually. **GTR**