

URANIUM MINING IN KAZAKHSTAN AND PERVASIVE STATE PARTICIPATION: A CANADIAN COMPARATIVE PERSPECTIVE

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Introduction

Recent years have seen steady growth in the world's search for alternative energy sources to traditional fossil fuels, both because of concerns over an increasing worldwide energy deficit, and as environmental concerns regarding extensive use of fossil fuels continue to grow around the globe. One such alternative that goes some way to addressing both these concerns is uranium. As extraction and reactor technologies continue to improve, interest in uranium as a safe and clean source of energy has rekindled from its low point in the 1970s and 1980s when a number of reactor accidents (noticeably at Three Mile Island and Chernobyl) led to a significant scaling back of the nuclear energy programs of many nations.

It is not surprising then, that Kazakhstan, blessed with abundant uranium deposits, has now joined Canada and Australia as one of the three top producers in the world, a journey which began in the late 1950s, when large deposits of uranium were discovered over wide areas in north-central Kazakhstan and on the Mangyshlak Peninsula in the west of the country. These discoveries led to construction of uranium facilities at Stepnogorsk and Aktau. By way of contrast, Canada's uranium reserves are much more concentrated, being almost exclusively located in northern Saskatchewan, where its only producing mines are located.

Kazakhstan is estimated to hold between 15% to 19% of the world's recoverable uranium reserves and since 2003, has been aggressively increasing production. For example, in 2007 alone, Kazakhstan boosted its uranium production by 25.7% to 6,637 tonnes (up from 5,281 tonnes in 2006). It has planned to mine approximately 9,600 tonnes in 2008, although whether this will actually be achieved, given the parlous state of the world economy in general during the last quarter of the year,



remains to be seen. Future projections are even more ambitious, with national production slated to grow to 15,000 tonnes per annum by 2010 and 30,000 tonnes per annum by 2030.

Also, by the end of 1990s, uranium extraction methods had largely shifted from conventional and underground operations to in-situ leaching (ISL). ISL is an environmentally superior extraction method that allows for removal of uranium ore without any major ground disturbance and is almost exclusively used for mining operations today.

Coupled with its expansion of mining production, Kazakhstan has also pursued a strategy to sell value-added fuel rather than just yellow cake, pursuant to which it has invested in a major plant making nuclear fuel pellets and worked to increase its role in the world uranium market through energy cooperation with other nations, principally Russia, Japan and China. The goal is to supply 30% of the world uranium fuel fabrication by 2015.

Kazakhstan would therefore appear to be positioned to play a significant role on the world's uranium stage for some years to come. This article looks at the uranium industry in Kazakhstan from the comparative perspective of another uranium-rich industry leader nation, Canada.

KazAtomProm

During the Soviet times, the Soviet State controlled and regulated all uranium mining, reprocessing, export and import operations. Even after independence in 1991, all uranium production, processing and marketing activities were under the management of the Kazakhstan State Corporation for Atomic Power and Industry (KATEP). In 1997, in order to commercialize the uranium sector, the activities under management of KATEP were transferred to a state owned company, NAC KazAtomProm JSC (KazAtomProm). KazAtomProm produces and mines uranium concentrate on its own (though its subsidiaries) and, as the sector has opened up, in joint ventures with foreign partners from Canada, Russia, Japan and other countries. The Betpak Dala, Inkai, Katko and Zarechnoye joint ventures are just some of the significant operations that have been developed in this manner.

It is a measure of KazAtomProm's success at commercializing the uranium industry in Kazakhstan, that KazAtomProm is rated as one of the largest uranium producers in the world, keeping company with such illustrious names as Cameco, AREVA, Rio Tinto and BHP Billiton. That being said, the heritage of State involvement in the industry continues to run deep. KazAtomProm, as the national atomic company, still effectively controls all uranium exploration and mining as well as other nuclear-related activities,

including imports and exports of nuclear materials and this trend looks set to continue, as in October 2008, the President of Kazakhstan signed a Decree whereby a new state holding Fund of National Welfare “Samruk - Kazyna” was established. The intention of the Fund is to further consolidate the Kazakh State’s holdings and interests in various commercial activities of certain national companies, including KazAtomProm. At present, KazAtomProm being a state owned company has to meet certain requirements for procurement of goods and services and currently such procurement is complicated and time consuming. However, after the transfer to the Fund it is likely that these requirements would no longer apply to KazAtomProm as the intention is to simplify and facilitate decision making within the national companies.

The involvement of the Kazakh State as a stakeholder in the commercial aspects of the industry profoundly affects the structure thereof at all levels in Kazakhstan and is in sharp contrast to the structure of the industry in Canada, where the government performs simply a regulatory role.

Regulatory Structure

Unlike Canada, where title can be acquired in a number of ways both at the Federal and Provincial/Territorial level, including in some instances on a freehold basis, in Kazakhstan, the Kazakh State retains ownership of all mineral resources and the only way by which a uranium producer is able to secure the right to explore, develop and produce a uranium deposit is to procure a subsoil use contract from the Kazakhstan government, as represented by the Ministry of Energy and Mineral Resources (“MEMR”). MEMR is responsible not only for the granting of subsoil use rights through the execution of a subsoil use contract, but also for policing compliance with the terms thereof and performing a general supervisory role in respect of the conducting of subsoil use activities. MEMR’s jurisdiction is extremely wide and covers all subsoil use, rather than just that relating to uranium alone.



Once again this differs from the Canadian practice where regulators tend to be put in place for specific purposes. For example, the Canadian Nuclear Safety Commission is charged specifically with uranium regulation in Canada.

In keeping with the pervasive nature of government involvement in the uranium industry in Kazakhstan, subsoil use contracts are generally granted by MEMR only to KazAtomProm in the first instance. In effect the Kazakh State grants itself the right to exploit a particular deposit. This is an important part of the commercialization process, because it means that any third party, such as a foreign investor, who wishes to enter the uranium sector in Kazakhstan has to do so through KazAtomProm. In this way, the Kazakh State is able to dictate not only the commercial terms of entry, but also to ensure an ongoing commercial benefit for the State Budget. A typical investment transaction involves initially KazAtomProm holding subsoil use rights to explore and produce uranium in respect of a specific deposit, all as granted in a subsoil use contract with MEMR. KazAtomProm’s initial interest is invariably held through a Kazakh special purpose subsidiary entity of some form (usually a limited liability partnership). Third parties wishing to become a producer then acquire an interest in the applicable subsoil use rights by farming into an existing contract or purchasing from KazAtomProm a participatory interest in the special purpose entity, a subsoil user.

By way of reiteration, this entrenched level of State involvement is of course totally foreign to the uranium industry in Canada, where the government typically does not play a role in the commercial aspects thereof, but in fact the participation of the Kazakh State is further backstopped by certain protectionist statutes. Specifically, as a matter of Kazakhstan law the Kazakh State has the pre-emptive right before third parties to acquire subsoil use rights (or a part thereof). This right is grandfathered to include any interest in the relevant subsoil user itself or in any legal entity which controls the activities of the subsoil user, if the main activity of this legal entity is connected to subsoil use in Kazakhstan. The pre-emptive right has extra-territorial effect and therefore extends to apply even to beneficial holders of subsoil use rights which are resident outside Kazakhstan. Accordingly foreign investors must obtain a waiver from the State of its pre-emptive right prior to acquiring any direct or indirect interest in a subsoil use contract.

Similarly, in the event that the country’s economic interests can be said to be compromised by the terms of a subsoil use contract (even though it will have been granted upon such terms by MEMR in the first instance), the State, as represented by MEMR is also entitled to unilaterally terminate the relevant subsoil use contract by giving a notice to such effect, or to renegotiate the terms of the subsoil use contract.

Not only does the legislative regime in Kazakhstan ensure that control of the uranium industry remains with the State at every material level, but such control is

further extended by the fact that the policies implemented thereunder are generally interpreted widely in favour of the State. For example, Kazakhstani law expressly prohibits the assignment of subsoil use rights within the initial two years following the grant of a subsoil use contract (other than as a result of events of liquidation, succession or reorganization of the subsoil user entity, or the execution of an encumbrance over pledged subsoil use rights). As a matter of strict law, this moratorium only applies to the assignment of subsoil use rights held by the Kazakhstan subsoil user itself. However, the MEMR's interpretation and policy is that the moratorium should be applied to any beneficial transfer of interest regardless of where such transfer takes place in the chain of ownership. Thus by policy, the legislation is extended to have even extra-territorial effect on foreign companies, which are beneficial owners of the subsoil user. In contrast, the moratorium does not apply to acquisitions where the subsoil use rights or participatory interest are transferred by KazAtomProm.

Finally, even the content of the subsoil use contract itself provides for State benefit. For example, subsoil use contracts typically contain provisions that require the subsoil user to develop the resource and not merely hold it. This is policed by MEMR through a strict reporting requirement whereby every quarter, subsoil users are required to provide updates to MEMR, and to obtain

approval from MEMR for annual working programs. Failure to provide financial investment at local community level and failure to comply with obligations under the working program generally constitutes a breach of the contract. In addition, the terms of subsoil use contracts and the general law of Kazakhstan set forth certain obligations in the area of local content compliance (i.e. hiring local specialists, subcontractors, etc.), mandatory insurance and environmental regulations.

In conclusion, unlike the structure of the uranium industry in Canada, where commercial activity is generally left to the market and the role of government is limited to regulatory compliance, the uranium industry in Kazakhstan is dominated by State involvement at every level. Thus, foreign investors seeking to enter the market in Kazakhstan invariably find themselves dealing with the Kazakh state not only at a regulatory level (in the form of MEMR), but also at a commercial level (in the form of KazAtomProm). Investors need to be mindful of, and to fully appreciate, the degree to which such State involvement permeates the entire structure of the industry in Kazakhstan in order to make informed decisions regarding the appropriate nature and extent of any investment, and cannot simply make the assumption that government involvement in the industry in Kazakhstan is similar to that experienced in Western countries, such as Canada.