

Investment barriers to the implementation of large renewable energy projects in Kazakhstan

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Background

The Government of Kazakhstan has approved several program documents to form a common understanding of how Kazakhstan aims to prevent the negative consequences of global climate change, reduce greenhouse gas emissions (CO₂), and achieve “carbon neutrality” pursuant to the Paris Agreement.¹

Specifically, the Carbon Neutrality Strategy of the Republic of Kazakhstan until 2060² stipulates that the country needs to generate at least 6% of all generating capacities using renewable energy sources (“RES”) by 2025, at least 15% by 2030, and at least 50% by 2050. At the same time, it has decided to unconditionally reduce its carbon balance by at least 15% by December 31, 2030³ compared to 1990⁴ and achieve carbon neutrality by 2060.⁵

As mentioned in the strategy, the “low-carbon policy will be accompanied by steps to ensure a favorable investment climate. To do so, it is intended to create a favorable legislative and institutional environment, support the creation and development of the

necessary financial and physical infrastructure of the “green” economy. Special emphasis will be made on the efforts to ensure steady attraction and support of private investments (including international) in the course of decarbonization”.

The government predicts that the investment needed to achieve the goals of the strategy by 2030 will be in the amount of US\$ 10 billion, with an additional US\$ 600 billion to be invested by the end of 2060.⁶

Current implementation mechanisms for RES projects

Below we briefly describe the existing legal mechanisms for the implementation of RES projects in Kazakhstan (excluding “green” financing mechanisms). Then, we will present our vision of possible changes to the legal framework regulating RES projects, which would make it more attractive for investors (including subsoil users) financing large RES projects.

1. Adopted by the parties to the UN Framework Convention on Climate Change, Paris, 12 December 2015.
2. Approved by Presidential Decree No. 121 of February 2, 2023 (“Strategy”).
3. Carbon balance is the volume of actual CO₂ emissions minus the volume of actual CO₂ absorption.
4. Article 283.1 of the Environmental Code of the Republic of Kazakhstan dated 2 January 2021.
5. Clause 3.1 of the Strategy.
6. Clause 3.2 of the Strategy.

1. RES auction

Since 2017 (when the legislative amendments were made), the main mechanism for the development of RES projects by the state has been to hold real-time RES auctions using the KOREM electronic platform to guarantee the full transparency of the process according to best international practices. The auction winner is awarded the right to sell electricity to a single purchaser at a fixed tariff, with a possibility of indexation, for a period of 20 years.

The Law dated July 4, 2009, “On the Support to the Use of Renewable Energy Sources”, and the Law dated July 9, 2004, “On Electric Power Industry”, are the legislative acts governing the operation of the RES sector, including those defining the basic regulation of auction trading. The latter also defines in more detail the operating mechanisms of the broader electricity industry, including the functioning of the wholesale market and balancing market.

Although the regulator holds auctions regularly, they only allow the implementation of small to medium-sized RES projects with a total installed capacity of up to 200 MW (auction projects with such capacity were introduced for the first time in 2024; before that, they did not exceed 100 MW). As of September 2024, the share of green electricity in the country’s total energy mix is 6.67%.⁷

The volume of RES auctions has been increasing annually by an average of 30%. Thus, in 2020, the capacity purchased through RES auctions was 250 MW, in 2021 – 300.8 MW, in 2022 – 690 MW, in 2023 – 1,060 MW, in 2024 – 1,270 MW. The auction schedule also sets out the regulator’s RES auction plans for the next 3 years. Specifically, it plans to purchase 1,390 MW in 2025, 1,590 MW in 2026, and 1,560 MW in 2027. However, as practice shows, the actual volumes of electricity sold by RES projects within the auction mechanism are considerably less than planned, since not all the announced auctions end with a winner and some of them are declared failed. Moreover, even if the auction was successful some RES projects do not reach full completion.

Accordingly, to date the auction mechanism has not been sufficient to achieve the necessary pace to

reach carbon neutrality objectives. The volume of auctions being currently held do not fully meet the needs of large investors and “green” private equity funds,⁸ with the latter showing greater interest in projects with higher margins and projected payback.

2. Bilateral corporate power purchase agreement (CPPA)

The alternative mechanism for the implementation of RES projects is a bilateral power purchase agreement (“corporate power purchase agreement” or “CPPA”). There is no standard CPPA form approved by the regulator, as there is for power purchase agreements applicable to RES auctions. This is one of the advantages of the CPPA option since it provides the parties with freedom in framing their commercial intentions and flexibility in terms of risk balancing.

Furthermore, no restrictions are imposed in terms of determining the purchase price under a CPPA (to be determined by agreement of the parties), the minimum or maximum term of the CPPA, or number of consumers.

At the same time, the potential of CPPAs in the RES industry has not yet been fully utilized due to a number of key barriers:

1. A power producing entity (PPE) that generates RES power, and its consumer (buyer) should be in the same *group of persons* (i.e. buyer must hold more than 50% of the participation interest/shares in PPE, or act as an executive body therein);⁹
2. In case of sale of electricity under CPPAs, PPEs may not participate in RES auctions;¹⁰
3. Buyers are required to fully consume the purchased electricity for their own needs (i.e., without a right to resell);
4. There is a lack of legal measures to support CPPA projects by the state;
5. Obligation to purchase electricity on the balancing market, which significantly reduces the margin of the project due to the high cost of electricity.

7. <https://qazaqgreen.com/news/kazakhstan/2347/>

8. Most large among them are Mirova, Infracapital, Macquarie, Global Infrastructure Partners, IFM Investors, Stonepeak Infrastructure Partners, I Squared Capital, ArcLight Capital, Dalmore Capital, Energy Capital Partners, and other.

9. Article 2. 3-2 of the Law dated 4 July 2009 “On Supporting the Use of Renewable Energy Sources”.

10. Article 9.1 of the Law dated 4 July 2009 “On Supporting the Use of Renewable Energy Sources”.

The restriction referred to in paragraph 1 above came into force on July 1, 2023, concurrently with the amendments stimulating the development of the wholesale electricity market and launch of the balancing market, which previously operated in a simulation mode (i.e., without actual financial settlements). Prior to these amendments, CPPAs could be entered into by entities that were not necessarily part of the same group.

The CPPA option may also be used to implement offset projects that generate offset credits (which is a separate product from electricity) for sale to companies with carbon quota obligations (i.e., operating facilities that generate 10,000 to 20,000 tons of CO₂ emissions per year in regulated sectors of the economy).¹¹ A significant part of such companies are subsoil users.

There are also financial restrictions, namely the high cost of RES electricity compared to the electricity generated by conventional fuels (for example, coal, heavy fuel oil (mazut) or natural gas), which may also be sold through the CPPA mechanism.

Thus, the CPPA option is mainly used now by large industrial groups to generate RES electricity for their own needs. One example is Bukhtarma HPP with the installed capacity of 675 MW, managed by Kazzinc LLP.

3. CPPAs with a power supplying organization (“PSO”)

The option of purchasing electricity directly from PSOs was introduced on July 1, 2024. This option requires PSOs to purchase electricity at a set tariff primarily from hydroelectric power plants (i) with a total installed capacity of not more than 10 MW, (ii) located in PSO service areas, (iii) commissioned before July 1, 2023, and (iv) that have not entered into a PPA with the single purchaser as of July 1, 2023.

As seen from the above criteria, this option is rather limited, and due to the power limitation of 10 MW, would unlikely be of interest to major developers or “green” private equity funds.

4. Sales within a hybrid group

As of September 9, 2024,¹² another option for purchase of electricity is available for PPEs using RES – within a hybrid group.

To implement this scheme, The participants in the hybrid group must meet the following criteria:

- i. Must be entities of the wholesale electricity market,
- ii. Holding a total share of RES in the electricity production of at least 25%,
- iii. Located in the same energy hub (i.e., within one region (oblast)), and
- iv. Included in a list of hybrid groups as per the procedure approved by the authorized body.

Specifically, the above option is designed for legal entities, in which *more than 25 percent of voting shares* (participatory interests in the charter capital, shares), are held directly or indirectly by the same person, namely:

- i. PPEs that jointly use (a) RES, and (b) generating facilities with a maneuverable generation mode, which were commissioned on or before July 1, 2024 and are connected to the national or regional power grids at one connection point;
- ii. Hybrid group consumers; and
- iii. A hybrid group administrator.

The administrator is a legal entity that is part of a hybrid group, which purchases electricity from PPEs which are members of the hybrid group for the purpose of its subsequent sale to consumers within such hybrid group and/or on the balancing market.

Strictly speaking, the above option is not entirely “green”, as it requires the use of facilities with a maneuverable generation mode (e.g., using gas generation). However, from the technical standpoint, this option could solve the problem of all RES generators, that is, intermittency of generation due to unfavorable weather conditions, which create imbalances and hence the obligation to compensate such imbalances through the balancing market (i.e., purchase additional volumes of electricity from other generators in order to meet the declared/

11. Article 301.1 of the Environmental Code of the Republic of Kazakhstan.

12. Law dated 8 July 2014 “On the amendments and alterations to certain legislative acts of the Republic of Kazakhstan concerning heat Power, electricity industry and regulated services.”

planned volume of electricity supply, approved by the system operator for one day ahead for all PGEs).

That said, the main challenge is that this option is only workable if the project is structured exactly as envisaged in the law. Therefore, it remains to be seen if other investors would be willing to structure their project using this particular option.

Dentons acted as a legal advisor on the project,¹³ in connection with which this option was originally introduced. The project in question is being implemented by NC KazMunayGas JSC and Arm Wind LLP (a subsidiary of Plentitude owned by ENI) and involves the construction of a 250 MW hybrid power plant (50 MW solar generation and 77 MW wind generation + 118 MW gas generation) in the City of Zhanaozen, Mangistau Oblast.

5. Intergovernmental agreement (“IGA”)

The Government of Kazakhstan started utilizing this option in 2022 for large RES projects with a planned total installed capacity of 1 GW. Previously, the government avoided granting special treatment to specific RES projects, as it considered RES auctions as the sole mechanism for granting state support measures and long-term contracts for the purchase of electricity.

Currently, there are three IGAs executed with the UAE, KSA and France providing a legal framework for projects implemented by such renewable developers as Masdar, AcwaPower, and TotalEren.

In accordance with the Constitution of the Republic of Kazakhstan, IGAs are subject to ratification to prevail over the national legislation of Kazakhstan,¹⁴ since they contain a wide range of preferences and exceptions from the national regime (e.g., exemptions from various permits applicable to RES projects).

However, apart from securing the support of the Kazakh government the investor should also secure the support of its own government to enter into an IGA. We advised on two different projects, where the Government of Kazakhstan was willing to enter into an IGA. However the government of the investor’s country refused to act as a party to the IGA because

such support could be viewed by other investors from the same jurisdiction as an uncompetitive advantage.

The key feature of the IGA option is the exclusion or simplification of numerous procedures for RES projects established by the laws of Kazakhstan. However, given the above complexity in obtaining support from the government of the investor’s country, this option may not be available to many investors.

Proposals for adjusting the legislation of Kazakhstan

Based on the above overview, we would like to share our views on ways to develop the current legislation of Kazakhstan to enable large RES projects to be implemented on a non-exclusive (e.g., as in the case of IGA) and transparent basis. Our proposed changes would be made to the existing laws, so as not to entail the creation of a completely new regulatory framework. This would significantly simplify their practical implementation.

1. Improving the concept of implementing RES projects under investment agreements

Kazakhstan’s Entrepreneurial Code provides for a diverse range of investment agreements and contracts, depending on the size of investment and project profile. These may include granting investment, tax and customs preferences and benefits, as well as corresponding responsibilities of the investor. There are several types of investment agreements:

1. Investment contract (with no minimum investment amount)
2. Priority investment project/contract (to create new production facilities, the amount of investment must be at least 2,000,000 times the MCI = ~ US\$15,500,000; to expand/upgrade existing production facilities, the amount of investment must be at least 5,000,000 times the MCI = ~ US\$38,700,000)

13. https://www.eni.com/en-IT/media/press-release/2024/07/eni-kmg-announce-commencement-construction-250mw-hybrid_power-plant-kazakhstan.html

14. Article 4.3 of the Constitution of the Republic of Kazakhstan.

3. Special investment contract (where the investor is registered as a participant in the special economic zone¹⁵)
4. Investment agreement with a state body authorized by the Government of Kazakhstan (with a minimum investment amount of at least 7,500,000 times the MCI = ~ US\$58,050,000)
5. Investment obligations agreement (with a minimum investment amount of at least 75,000,000 times the MCI = ~ US\$580,500,000)

Even RES projects of a relatively small capacity (50 MW) and required investment, may qualify as priority investment projects. Larger RES projects may qualify for an investment agreement and related support measures. Notably, the production, transmission, distribution and sale of electricity to consumers are included by the government in the list of priority activities approved for implementation of investment (including priority investment) projects.¹⁶

Each type of investment agreement provides legal entities of the Republic of Kazakhstan with certain investment and tax preferences and as well as certain restrictions. In general, investment agreements may provide for the following types of benefits:

- i. Exemption from an auction requirement when obtaining a land plot (as a state in-kind grant),
- ii. Guarantees of stability (in the event of changes in the tax legislation or legislation on engaging foreign labor),
- iii. Exemption from customs duties and VAT on imports,
- iv. Other types of state in-kind grants and tax benefits.

Although electricity-related activities are considered as priorities, the Entrepreneurial Code and other laws regulating the renewable industry do not envisage the state's obligation to enter into a long-term offtake contract for purchase of electricity with

an investor (e.g., as in the auction trading option). Accordingly, the investor has no statutory guarantee of return on investment made in the implementation of a RES project.

Furthermore, the rules for integrating a facility in the RES facility citing plan and the list of PPEs using RES are linked to RES auction trades. The standard power purchase agreement with the single purchaser is also applicable to RES auctions. There is also a direct ban on receiving investment incentives for priority investment projects where the investment activities are carried out through a public-private partnership agreement.¹⁷

For completeness, another disadvantage of the investment agreement option are the restrictions on the stability guarantee. The legal entities that implement (a) priority investment projects, (b) strategic investment projects (under investment contracts executed before January 1, 2015) or (c) investment project under an investment agreement signed with a state body authorized by the Government of Kazakhstan are only eligible for stability guarantees¹⁸ in the event of a change in (i) tax legislation, and/or (ii) legislation on the engagement of foreign labor.

Conclusions. To sum up, we propose supplementing the investment support measures with a state guarantee of a long-term power purchase agreement, e.g., for RES projects of at least 500 MW total installed capacity that meet certain criteria applicable to all potential investors. Such criteria may include a requirement to locate the plant in areas with a significant shortage of power generation and to use Kazakhstan-made equipment, if any, install systems of battery energy storage or hybrid generation for balancing. In such a case, the investment agreement option may become an effective and attractive tool for implementing large RES projects. Consequently, this should assist the Government of Kazakhstan in achieving its renewable energy targets.

15. Article 284 of the Business Code. There are other reasons, for example: a special investment project means an investment project implemented (implemented) by a legal entity of the Republic of Kazakhstan, registered as a participant in a special economic zone or owner of a free warehouse in accordance with the customs legislation of the Republic of Kazakhstan, and (or) purchased from a participant in a special economic zone or implemented by a legal entity of the Republic of Kazakhstan, which has concluded an agreement on the industrial assembly of motor vehicles.

16. Clause 35 of Section 1 and Clause 35 of Section 2 of the list approved by Government Decree No. 13 of January 14, 2016.

17. Article 286.5(7) of the Entrepreneurial Code of the Republic of Kazakhstan.

18. Article 289.1 of the Entrepreneurial Code of the Republic of Kazakhstan.

Of course, to maintain the balance of interests between the state and investor, further analysis is needed to come up with an adequate set of investment and tax support measures that can be made available to such large RES projects. Also, further clarity is required to define a uniform and transparent pricing mechanism for the purchase of electricity by the state, keeping in mind the practices developed by the Government of Kazakhstan as part of negotiations under the IGAs with Masdar, AcwaPower and TotalEren.

The barriers listed above are the most significant ones, but there are also other obstacles, including at the level of subordinate legislation, which should be analyzed and adjusted when preparing any regulatory changes.

2. Public-private partnership (PPP)

The PPP mechanism is another tool for the state to attract investors, but it works on different principles than investment agreements pursuant to the Entrepreneurial Code. Under the Law dated October 31, 2015 “On the Public-Private Partnership” (the “**PPP Law**”), a PPP agreement can be entered into between a responsible state body and an investor (private partner), and may provide for certain measures of state support, depending on the type of agreement and project.

There are two types of PPP, institutional (implemented by a PPP company under a PPP agreement) and contractual (in other cases).¹⁹ Contractual PPPs can be implemented, *inter alia*, through the execution of the following agreements (i) concession, (ii) trust management of state property, (iii) lease, (iv) finance lease, (v) agreement for development of technology, production of a prototype, pilot industrial testing and small-scale production, (vi) life cycle contract, (vii) service contract, and (viii) other contracts qualifying for PPP.²⁰

Not all types of PPP agreements can be used for structuring a RES project. Presumably, a life cycle contract or a service contract would be more suitable for the traditional models of RES projects historically prevailing in Kazakhstan (since the design, construction and operation of a RES generation facility are always the responsibility of the investor).

The PPP Law also provides for a number of sources of cost recovery and income generation for investors²¹, including a guarantee of state consumption of a certain volume of goods, works or services produced in the course the PPP project, implemented through an offtake contract.²² Such guarantee could be extended to cover the purchase of electricity by the state. Currently, the minimum period established for such consumption is three years with the possibility of extension. For RES projects, it would be necessary to establish a longer period of guaranteed purchase, for example, 20-25 years.²³ Other types of cost recovery and revenue generation, in our view, are of less relevance for RES investors, and hence could be explicitly excluded for RES projects, since the return on financing can be achieved through the agreed tariff that includes all CapEx and OpEx.

The PPP Law requires investors to transfer PPP facilities into state ownership, provided that the state pays compensation for investment costs (CIC).²⁴ Assuming the state provides the guarantee of purchase of electricity, CIC would not be needed, and hence investors would have the prospect to retain RES facilities in their ownership and attract debt financing against the collateral of a RES facility.

The government may decide to select the private partner in a simplified manner, namely on the basis of direct negotiations. To this end, the RES project must (i) be a unique project, and (ii) provide for technology transfer²⁵ (these criteria are not expressly defined in the PPP Law). At present, there is one precedent where the Government of Kazakhstan

19. Article 7.1 of the PPP Law.

20. Article 7.3 of the PPP Law.

21. Article 9.2 of the PPP Law provides for the following sources of compensation (1) sale of goods, works or services under a PPP agreement, (2) subsidies from the state in cases established by the legislation of Kazakhstan, (3) compensation of investment costs, (4) compensation of operating costs, (5) fee for the management of a state-owned PPP facility, as well as rent for the use thereof, and (6) accessibility fees.

22. Article 27.2(6) of the PPP Law and paragraph 28 of Appendix 7 to the Order of the acting Minister of National Economy dated 25 November 2015 No. 725 “On some issues of planning and implementation of public-private partnership projects”.

23. Article 27.2 of the PPP Law.

24. Article 12.2 of the PPP Law.

25. Article 44 of the PPP Law.

approved the implementation of a PPP project through direct negotiations.²⁶ The project concerns the provision of drinking water to settlements with a cascade of HPPs.

Conclusions. We believe that RES facilities may also be qualified as unique facilities (depending on the proposed technical solutions) and provide for technology transfer (e.g., projects involving battery storage systems/BESS or hybrid generation). This would allow investors to use the mechanism of direct negotiations with the government through the PPP Law. In turn, the government would be able to obtain such technologies allowing it to independently implement RES projects in the future.

Having said that, the PPP option (in its current form) is not yet feasible for the implementation of RES projects, since, similar to the investment agreement option, there is no long-term obligation for the state to purchase electricity nor the necessary pricing mechanism, that are critical for project feasibility.

We have summarized only the key provisions (and obstacles) in the PPP Law that should be modernized to cover large RES projects. In addition, there are numerous less significant and procedural provisions that we do not cover in this review.

To sum up, we propose introducing a number of amendments to the Law “On supporting the use of RES sources”, PPP Law and, possibly, the Law “On Electric Power Industry”, as well as certain secondary acts.

Conclusion

The above is a summary of issues from the perspective of a practicing lawyer, based on our experience and knowledge of the problems and bottlenecks that our clients face. We did not intend this to be a scholarly analysis.

We hope that these proposals will contribute to the achievement of Kazakhstan’s targets under the Paris Agreement, the exchange of best practices and technologies in the renewable sector, the local industrial production of equipment, and increased competencies of local RES specialists.

Finally, these proposals would provide large investors with an additional tool for investing in “green” energy sectors, based on the latest global practices to combat climate change.



26. The Resolution of the Government of the Republic of Kazakhstan dated 26 June 2024 “On Direct Negotiations on the Basis of Private Initiative as Part of the Implementation of Public-Private Partnership Projects”.

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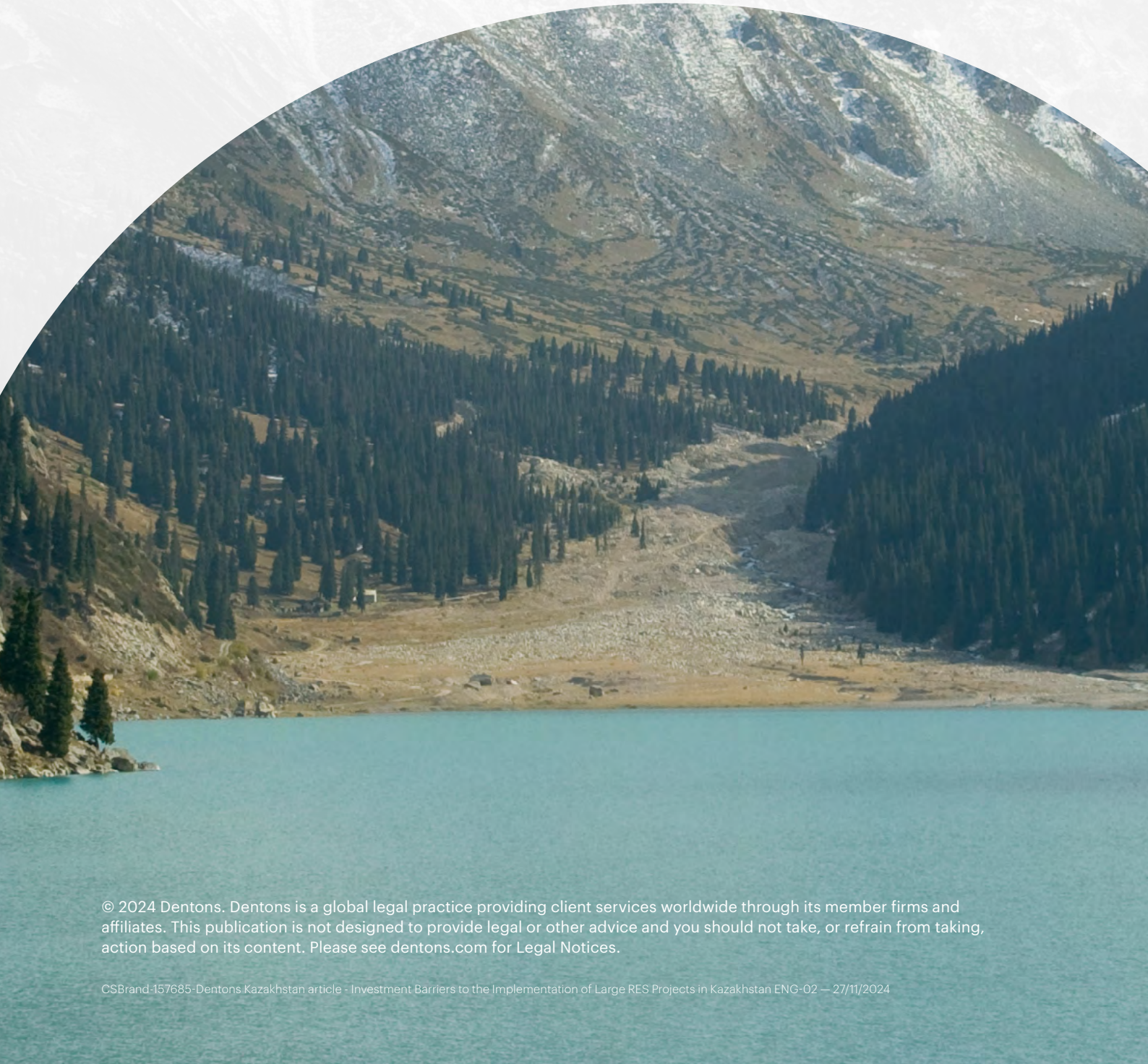
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