

Law of the Republic of Kazakhstan "On State Property"

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On 1 March 2011, the President of the Republic of Kazakhstan has signed a new Law 'On State Property' No. 413-IV (hereinafter – the 'Law') with effective date 10 March 2011. The Law defines the principles for regulating relations in the area of state property management.

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The Law represents an attempt to systemize a legal framework on the state property management, which existed earlier but was fairly odd. The new Law both combines the provisions of the Law of the Republic of Kazakhstan 'On State Enterprise' No. 2335, dated 19 June 1995 (hereinafter – the 'State Enterprise Law') and the Law of the Republic of Kazakhstan 'On Privatization' No. 2721, dated 23 December 1995 (hereinafter – the 'Privatization Law'), and also introduce a number of new concepts in the area of state assets management. The Law, thus, is a kind of unification of the legislation in the area of state property.

The Law provides for two important groups of changes, which can affect activities of foreign investors in Kazakhstan:

- I. Legal Regime of Strategic Objects
- II. Legal Regulation of Nationalization

I. Legal Regime of Strategic Objects

A separate section covers the limitation of title to the property of strategic importance, which means the property having the social and economic value for stable development of the Kazakhstani society, possession and (or) use and (or) disposal of which would affect the condition of the national security of the Republic of Kazakhstan, which is owned by individuals and non-state legal entities, as well as describe the procedure for exercising pre-emptive right of the Republic of Kazakhstan to purchase strategic objects, when an owner thereof intends to sell, to pledge, or to rent. In case of disposal of the pledged property, the State has the pre-emptive right to buy (on behalf of the Republic of Kazakhstan - Government of the Republic of Kazakhstan or a national holding upon its instruction) the given strategic objects at a market value. However, the period for buying out strategic objects should not exceed two years after the acceptance by the Government of Kazakhstan of the decision to exercise the pre-emptive right. The period for buying-out strategic objects in case of disposal sale of the pledged property should not exceed the period of the rehabilitation procedure or bankruptcy proceeding, established by the Law of the Republic of Kazakhstan 'On Bankruptcy'.

Strategic objects may include:

- participatory interests in legal entities that owns strategic objects; and, moreover,
- participatory interest in legal entities that indirectly control (through its subsidiaries) legal entities, which own strategic objects in Kazakhstan.

The list of specific strategic objects was approved by the Government of Kazakhstan in 2008. The list includes a number of objects not owned by the State and its affiliated legal entities, which includes main oil-and-gas pipelines, international airports, HPPs, communication lines and shares of some large private companies.

According to the provisions of the Law, an owner of strategic object, who intends to burden such an object with the rights of third parties, can only make it upon the availability of the

relevant permit of the Government of Kazakhstan. This rule also applies in case of the placement of declared shares by the owner (owner-company) in the organized securities market. Transactions with these shares, when one entity or affiliates acquire shares at the organized securities market, which amount to 20% of the total number of voting shares of an issuer, also require the governmental permit.

The Law defines the procedure for obtaining a permit to burden strategic objects, list of documents to be submitted by owners for obtaining the permit, as well as the period of obtaining the permit. The general period for consideration of applications should not exceed 60 business days (we, however, believe that in practice, obtaining the permit takes a longer period).

II. Legal Regulation of Nationalization

Nationalization represents an exceptional case of alienation of the property owned by individuals and non-state legal entities, which can be performed for the public benefits in order to ensure national security of the Republic of Kazakhstan with equivalent compensation of market value of nationalized property and other damages in full. The exclusivity of nationalization mainly means that it can only apply when other possible forms of the property alienation stipulated by the civil laws of Kazakhstan has been through.

In this case, compensation is allowed to be paid by other property, and nationalized assets can only be transferred after equal compensation. The Law, thus, not only makes the nationalization as measure applied in exceptional cases, but also is aimed at the minimization of adverse effect. The said warranties with respect to the rights of an owner in case of the nationalization as well as well limited periods for compensation create a favorable investment climate in the country for both domestic and foreign investors.

The Law has amended and completed the provisions of the Privatization Law: reduced the list of privatization parties, excluded, thereat, foreign legal entities. The new Law, thus, deprives foreign legal entities of the rights to privatize state property, while provides for the possibility for the development of small business entities and for privatization of objects included into the state housing funds. The provision concerning the privatization objects has been significantly amended: the list of privatization objects has excluded state entities, property of an enterprise and other state property assigned for state entities, as well as the cases when privatization of property of state legal entities is impossible have been detailed. We are of the opinion that the shortage of the Law is the exclusion of the dispute settlement provision. The introduced restrictions will, probably, dissatisfy foreign investors, however will promote economic development of small business entities in Kazakhstan.

In addition, the Law contains other important provisions including:

- strengthening the state role in relation to the state property management: introduction of the classification of joint-stock companies (hereinafter – the 'JSC') and limited liability partnerships (hereinafter – the 'LLP') with the state participation in the charter capital, which founders can be either the Republic of Kazakhstan or an administrative-territorial unit; prohibition of shares transfer into trust management with full waiver by the State of the right to dividends; introduction of the full accounting systems for the State property on a permanent basis and formation of the state property register, which will be effective upon the expiry of two years after the first official publication of the Law; development by JSCs and LLPs controlled by the State of the development plans for 5 years;
- control over activities of national holdings and companies, in particular, – changes in the decision-making procedure for a large transaction in the national companies: the decision on implementing a transaction by a national company with the state participation, which results in purchase or alienation by the company of the property, which cost from ten up to twenty five percent of the total amount of assets cost, shall be made by the board of directors of the company, less than ten percent of the total amount of assets cost - by the management board of the national company, twenty five and more percent of the total amount of assets cost
- by the general meeting of shareholders of the national company (by the decision of the sole shareholder of the national company) as advised by the board of directors of the company; and restriction to dispose of shares of national companies transferred into the charter capital, and shares of national holdings;
- operation of state enterprises: introduction of a new ground for establishment, in particular, usage and maintenance of strategic objects owned by the State; extension of the

scope of activities, within which state enterprises can be formed under the right of economic management;

- the concept 'requisition is detailed;

- accounting and usage of the state property: the Law provides for the grounds for delivery of property into the state ownership, as well as the procedure for accounting, storage and sale of such property.

We are of the opinion that the Law is intended to complete two main tasks. First, to detail provisions of Civil Code and other legislative acts of Kazakhstan that specify the procedure for usage of strategic objects and the nationalization mechanism. Second, the Law is destined to reduce for investors adverse effects of the state actions for the implementation of mechanisms stipulated by Law, in particular, nationalization mechanism.

Actually, it is currently difficult to judge on prospects of application of the Law provisions for protection of investors' rights in Kazakhstan. However, occurrence of the Law can itself testify that the state intends to reduce the probability of impairment of investors' rights.

Considered all, the Law can favorably affect an investment climate of Kazakhstan, since as a result of inventory accounting, passportization and reappraisal of the state property, which is to be held in 2013 according to the Minister on Economic Integration Affairs, a part of state assets will be sold to private individuals, which will cause the encouragement of investment activeness and, therefore, the socioeconomic development of the country due to the increase of the Republican budget income.

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