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Downstream oil and gas project financing in Uzbekistan

Ten things to know



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1 Land rights

Land is owned by the Republic of Uzbekistan. The forms of interests in land are varied and date back to legal concepts that were applicable prior to Uzbekistan's independence in 1991. These include leases as well as rights such as a right to permanent ownership, a right to permanent use and a right of temporary use. However, the concept of freehold title does not exist in Uzbekistan. Foreign entities may benefit from certain land rights and may also own structures (eg, plants, pipelines, etc) built on the land. Market practice in Uzbekistan is, in any event, that local Uzbek companies are established for the purpose of developing oil and gas projects, which includes holding land rights. The security that may be taken over land rights depends on the type of right that has been granted to the project company. In our view, the Uzbek legal regime in connection with land rights, and associated security interests that may be created, is adequate from a bankability perspective, particularly when compared to other jurisdictions that have benefited from raising significant amounts of project finance debt.

2 Ownership of subsoil

The Law on Subsoil provides that exclusive ownership rights over subsoil belong to the Republic of Uzbekistan. Rights to use and develop Uzbekistan's resources are granted by a licensing regime. Any transfer of subsoil ownership rights (including the right of use) to a non-state party is subject to approval by the Government of Uzbekistan (GOU) directly or through authorised state agencies. Rights granted under the licenses are generally not transferable and therefore creating security over these rights is difficult.

3 Role of UNG

The Republic of Uzbekistan traditionally holds an ownership interest in gas development projects, but the percentage of ownership interest is not fixed by law. The state interest is owned through the state owned oil and gas company, National Holding Company Uzbekneftegaz.

4 Investment Agreements and Government Support

Uzbek law permits the Government of Uzbekistan to enter into private contracts, called investment agreements, with foreign investors under which the GOU may grant certain benefits, exemptions, rights and other privileges to foreign investors in connection with investments in a range of sectors, including the oil and gas sector. The provisions typically apply to tax laws, foreign currency regulations, laws applicable to the ownership of property and other similar matters that will be important to both debt and equity investors; a number of the provisions in an investment agreement can benefit third party lenders.

The investment agreement would need to be approved by the President, and the approval takes the form of a Presidential Decree. The investment agreement is a critical document to the bankability of a project in Uzbekistan as it provides a contractual relationship with the GOU with independent dispute resolution procedures. In our experience, these Presidential Decrees can serve to clarify the terms of the Project and will be critical in ensuring that the Project is implemented by all relevant governmental agencies, authorities, etc.

5 Rights of Foreign Investors

Key for foreign investors in Uzbekistan is the Law on Foreign Investment (being Law of the Republic of Uzbekistan On Guarantees and Measures of Protection of Foreign Investors dated 30 April 1998). Among other protections, this law provides that where a new law in Uzbekistan would worsen the investment conditions for an international investor, the old legislation shall apply for ten years from the date of the investment. Lenders are not treated as investors for the purposes of this law.

Uzbek legislation also provides that nationalisation is only permitted in limited situations, such as during natural disasters, accidents and epidemics. In these situations, nationalisation of property is permitted if adequate compensation is paid by the GOU. The quantum of such compensation is not clearly determined by the legislation other than stating that it must be "adequate and proportionate" to the property nationalised.

6 Foreign Currency and Central Bank Approval

Uzbekistan applies rigid foreign exchange controls and currency convertibility is an issue for foreign investors. In order for a project company to hold accounts offshore, and therefore receive and make payments in foreign currency offshore, avoiding any convertibility issues, it will need approval in the investment agreement to hold its accounts offshore and an exemption from the legal requirement to convert 50% of all income into Soum. The approval of the Central Bank of Uzbekistan will then need to be obtained to implement these privileges.

Under the Law on Foreign Investment, foreign investors in Uzbekistan enjoy a right to discontinue investment activity in Uzbekistan at any time and at their own discretion, including the right to freely repatriate assets from the country. However, given currency convertibility issues, to the extent possible accounts should be held offshore. The investment agreement may also address this issue by providing rights and privileges to a project company in respect of the convertibility of currency.

Certain finance documents (eg, loan agreements) that would be required for a project financing must be registered with the Central Bank of Uzbekistan before payments may be made offshore.

7 Taxes and exemptions

There are a number of taxes payable in connection with natural resource projects in Uzbekistan. In addition to normal corporate income tax, value added tax, taxes on dividends, etc, there are taxes payable in connection with the use of subsoil, excess profits taxes, a 'bonus' tax, property taxes and taxes on the use of water. There are also additional forms of taxes which are characterised as 'mandatory contributions to the state budget'.

Lenders will note in particular that withholding tax (WHT) is also payable and regulated by Article 155 of the Tax Code of Uzbekistan. WHT is imposed on income and fees payable to a foreign bank under a loan agreement. The current rate of WHT is 10% on interest payable under a foreign loan by any Uzbek borrower and 20% on other types of fees and expenses payable in connection with the foreign loan. WHT is payable at the source of payment.

Uzbekistan has entered into double tax treaties with a number of countries which may assist in mitigating any taxation issues.

8 Lenders' security package

Security may be granted over the following types of assets: (i) mortgage over any immovable assets attached to the land (when security is taken over an immovable asset on the land, the related land is also secured); (ii) pledge over moveable assets; (iii) pledge over contractual rights / receivables and pledge over the rights of a holder in relation to bank accounts; and (iv) pledge over shares or other forms of equity interest depending on the legal form of the project company.

Key points to note are:

- There are a number of forms of ownership rights in connection with real or immovable property. The security that lenders may benefit from will be determined in part by the rights to real or immovable property which are held by the project company.
- Security can generally not be created over assets which do not exist and therefore security over the plant and facilities can generally only be created at the end of the construction period once the plant and facilities are completed and owned by the project company.

- Rights under consents and licenses can not generally be secured as these are not transferable under Uzbek law.

It is also possible for lenders to benefit from an enterprise mortgage. An enterprise mortgage is a mortgage over the business of a company and is therefore more comprehensive than say a pledge or assignment over any one particular asset.

Registration and perfection of security in Uzbekistan is only available for a mortgage over immoveables, a pledge over vehicles and an enterprise mortgage. No other forms of security can be registered. Counterparties to Project Documents are only informed of security interests at the time of enforcement. Uzbekistan has a Bankruptcy Law and that law provides for secured creditors to have priority over other creditors in the event of a bankruptcy. In the event of competing secured claims, priority is generally determined by the time at which the security was created.

Uzbek law does not recognise the concept of a trust. An agent can be appointed to hold security on behalf of lenders but the agent that is appointed must be a lender to the project and is generally a local bank. We consider that the parallel debt concept generally works in Uzbekistan.

Enforcement of security under Uzbek law depends on the type of security that has been taken, but only limited security interests can be enforced outside of a court process in Uzbekistan.

9 Enforcement regime

Uzbekistan does not automatically recognise judgments issued by courts in England or New York. It is however party to the New York Convention. Uzbek law provides that an arbitral award may not be enforced if it contradicts public limitation rules of Uzbekistan (the scope of such rules is not defined in Uzbek law).

Uzbekistan also has bilateral investment treaties (BIT) in force with a number of countries. Those BITs might provide for a right of arbitration for investors in the event of a breach of BIT rights.

10 Uzbek contract law

Contract law is generally developed in Uzbekistan but there are a number of issues which are peculiar to Uzbekistan which would be of interest to foreign investors. For example, a contract (eg, a gas supply contract) between two Uzbek entities is required to be governed by Uzbek law. Uzbek law also establishes a mandatory 15% advance payment requirement in respect of domestic transactions, and this percentage may be higher in certain contracts. Export contracts have their own advance payment requirements and may require letters of credit to be procured by buyers under those export contracts.

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