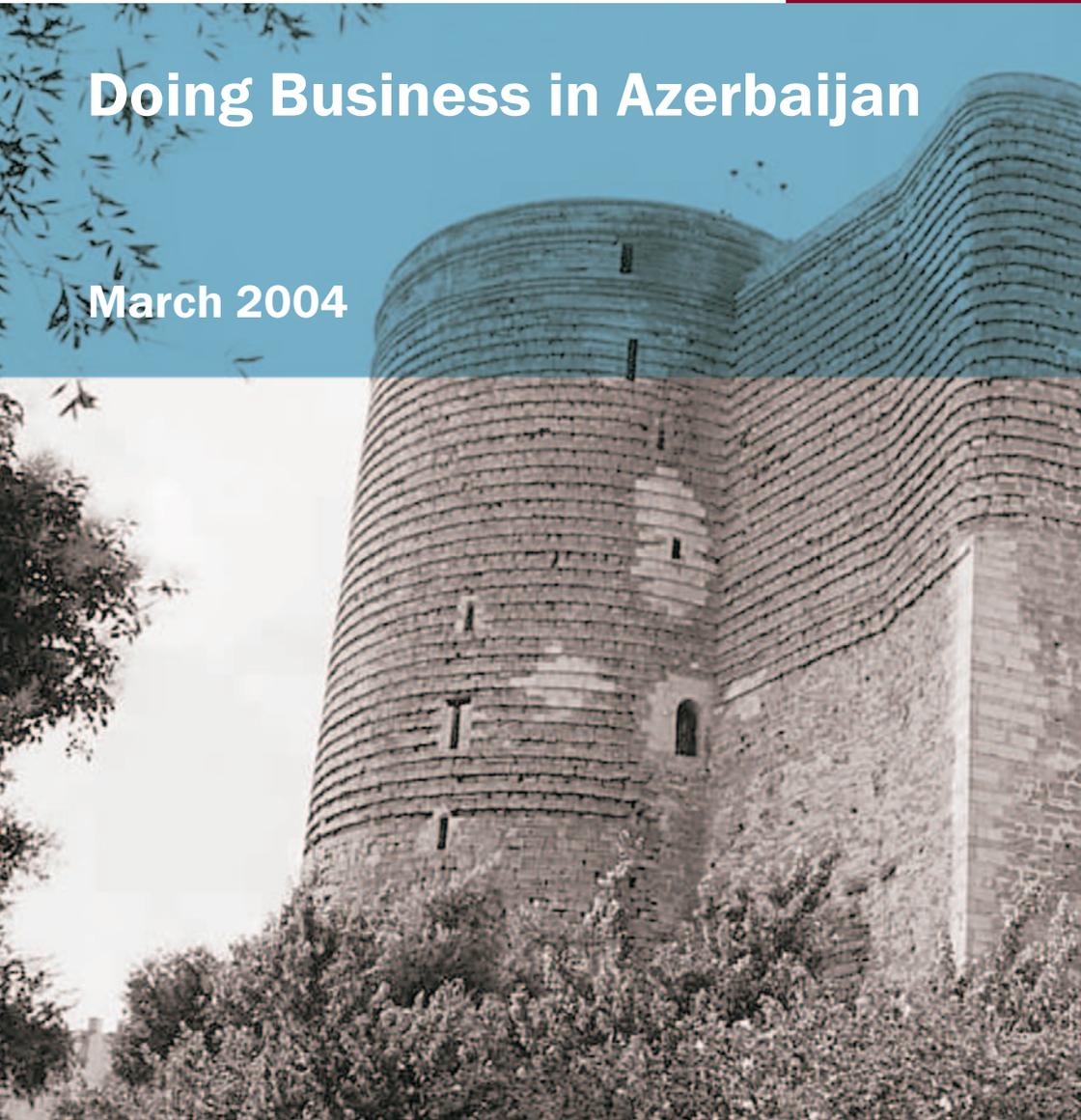


BAKER & MCKENZIE

Doing Business in Azerbaijan

March 2004



Doing Business in Azerbaijan

March 2004

AZERBAIJAN PRACTICE

The Landmark Building
96 Nizami Street
Baku AZ1000 Azerbaijan
Tel.: (994 12) 97-18-01
Fax.: (994 12) 97-18-05
E-mail: baku.info@bakernet.com

All of the information included in this document is for informational purposes only, and may not reflect the most current legal developments, judgments, or settlements. This information is not offered as legal or any other advice on any particular matter. The Firm and the contributing authors expressly disclaim all liability to any person in respect of anything, and in respect of the consequences of anything, done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of Baker & McKenzie's "Doing Business in Azerbaijan" brochure. No client or other reader should act or refrain from acting on the basis of any matter contained in this document without seeking the appropriate legal or other professional advice on the particular facts and circumstances.

Table of Contents

PREFACE7

1. AZERBAIJAN - AN OVERVIEW.....8

1.1 Location, Area and Topography8

1.2 Demographics.....8

1.3 History9

1.4 Government Organization11

1.5 Results of Elections and Political Considerations12

1.6 Foreign Relations and International Organizations12

1.7 Economy13

1.7.1 Background13

1.7.2 Gross Domestic Product14

1.7.3 Employment, Wages and Inflation.....14

1.7.4 Foreign Trade and Balance of Payments.....15

1.7.5 Internal and External Debt.....15

1.7.6 Privatization.....15

2. FOREIGN INVESTMENT IN AZERBAIJAN17

2.1 Introduction17

2.2 Foreign Investment Law.....17

2.3 Guarantees Available to Foreign Investors18

2.4 Bilateral Investment Treaties.....19

2.5 Foreign Investment Regime under Privatization Programs20

3. ESTABLISHING A LEGAL PRESENCE22

3.1 Introduction22

3.2 Representative Offices and Branches.....22

3.2.1 Legal Form22

3.2.2 Registration23

3.3 Forming a Commercial Legal Entity.....23

3.3.1 Joint Stock Companies24

3.3.2 General Partnership27

3.3.3 Limited Partnership.....28

3.3.4 Limited Liability Company29

3.3.5 Additional Liability Company.....30

3.3.6 Cooperative31

3.4 Non-Commercial Organizations32

3.4.1 Public Associations32

3.4.2 Funds32

3.4.3 Unions of Legal Entities33

3.5 Subsidiaries33

4.	ISSUANCE AND REGISTRATION OF SECURITIES	34
4.1	Introduction	34
4.1.1	Issuance and Placement of Emissive Securities	34
4.1.2	Additional Issuance.....	35
4.1.3	Disclosure Requirements	35
4.2	Regulation of the Securities Market	36
4.2.1	Stock Exchanges	36
5.	LICENSES	37
5.1	Introduction	37
5.2	Issuance of Licenses	37
5.3	Applying for a License	40
5.4	Consequences of Operating Without an Appropriate License...40	
6.	TAXATION.....	41
6.1	Introduction	41
6.2	Administration of Taxes	42
6.3	Types of Tax.....	42
6.3.1	Corporate Income Tax.....	42
6.3.2	Individual Income Tax.....	43
6.3.3	VAT.....	43
6.3.4	Subsoil Use Taxes.....	44
6.3.5	Excise	44
6.3.6	Highway Tax	45
6.3.7	Property Tax	45
6.3.8	Land Tax	45
6.4	Social Taxes and Charges.....	45
6.5	Double Tax Treaties.....	45
6.6	Transfer Pricing	46
6.7	Accounting	47
7.	CURRENCY REGULATIONS	48
7.1	Introduction	48
7.2	Foreign Exchange.....	48
7.2.1	Residents	48
7.2.2	Non-residents	50
7.2.3	Import/Export of Foreign Currency in Cash by Individuals.....	50
8.	EMPLOYMENT	52
8.1	Introduction	52
8.2	Direct Employment	52
8.3	Compensation in Foreign Currency.....	52
8.4	Work Books.....	52

8.5	Probationary Period	52
8.6	Minimum Wage.....	52
8.7	Work Week.....	53
8.8	Holidays	53
8.9	Sick Leave	53
8.10	Maternity Leave.....	53
8.11	Dismissal.....	53
8.12	Cost of Employment.....	53
8.13	Income Tax	54
8.14	Foreign Workers in Azerbaijan	54
9.	ACQUIRING RIGHTS TO OWN AND USE LAND.....	55
9.1	Introduction	55
9.2	Limitations on Ownership	55
9.3	Use of Land	55
9.4	Land Transfers.....	56
10.	LANGUAGE POLICY	58
11.	CIVIL LEGISLATION.....	59
12.	BANKING AND FINANCE	60
12.1	Description of the Banking System.....	60
12.2	Licensing.....	61
12.3	Reformation of the Banking System	61
12.4	Standards for Domestic Banks	61
12.5	Banks with Foreign Participation	61
12.6	Liquidation and Reorganization of Banks	62
12.7	Non-Banking Activity of Banks	62
13.	INTELLECTUAL PROPERTY.....	63
13.1	Introduction	63
13.2	State Patent Issuing Agencies	63
13.3	International Conventions	63
13.4	Registration.....	64
13.5	Patent Protection, Utility Models and Industrial Designs	64
13.6	Trademarks and Geographic Names	64
13.7	Copyrights	64
13.8	Computer Programs and Database.....	65
14.	PRODUCT LIABILITY	66
14.1	Product Liability.....	66
14.2	Product Quality	66
14.3	Protection from Unfair Competition	67
15.1	Oil and Gas	68

15.1.1	Introduction	68
15.1.2	Oil and Gas Legislation	68
15.1.3	Licenses	68
15.1.4	Contracts	70
15.2	Power	76
15.2.1	Legislation	76
15.2.2	Elimination of State Monopoly in the Power Sector	77
15.2.3	Regulatory State Agency	78
15.2.4	Licenses	78
15.2.5	Consumption and Distribution	79
15.2.6	Anti-Monopoly Regulation.....	80
15.2.7	Incentives in the Power Sector	81
15.3	Telecommunications	81
15.4	Construction.....	82
15.4.1	Legislation	82
15.4.2	Foreign Contractors.....	83
15.4.3	State Involvement	83
16.	COURT SYSTEM IN AZERBAIJAN.....	84
16.1	Court System	84
16.2	Judges	85
16.3	International Arbitration.....	85
16.4	Enforcement of Foreign Judgments and Court Assignments.....	86

PREFACE

Baker & McKenzie was established 55 years ago, and now has 68 offices in 38 jurisdictions. The Firm established a truly global presence, with an office in each of the world's major money centers.

We established a presence in Baku in April 1998 and on October 20 of that year became the first international law firm to be licensed to practice law in Azerbaijan. Today our work includes a full range of legal services for foreign investors doing business in Azerbaijan. Baker & McKenzie now has the largest legal practice in the former Soviet Union.

Since gaining its independence in 1991, Azerbaijan has adopted new laws at a rapid pace. It remains a country in transition and its legal system is continuing to develop. Therefore, we have prepared *Doing Business in Azerbaijan* as a general guide for those companies or persons considering making an investment in Azerbaijan. As the legal landscape continues to change frequently, this document should be taken as a basic guideline intended to assist investors in understanding Azerbaijan's overall investment climate and cannot be relied upon as legal advice in relation to any transaction as a substitute to seeking specific legal advice.

We will be happy to provide you with updates on the material contained herein or to provide you with further information regarding a specific industry or area of Azerbaijani law in which you may have a particular interest.

March 2004

1. AZERBAIJAN - AN OVERVIEW

1.1 Location, Area and Topography

Three physical features dominate Azerbaijan: the Caspian Sea, its shoreline forming a natural boundary to the east; the Greater Caucasus mountain range to the north; and the extensive flatlands at the country's center. About the size of Portugal and the state of Maine, Azerbaijan has a total land area of 86,600 square kilometers. Of the three Transcaucasian states, Azerbaijan has the greatest land area. Azerbaijan also has a special administrative subdivision, the Nakhchivan Autonomous Republic, which is separated from the rest of Azerbaijan by a strip of Armenian territory.

Located in the region of the southern Caucasus Mountains, Azerbaijan borders the Caspian Sea to the east, Georgia and Russia to the north, Iran to the south, and Armenia to the southwest and west. A small part of Nakhchivan also borders Turkey to the north-west. The capital of Azerbaijan is the ancient city of Baku, which has the largest and best harbor on the Caspian Sea and has long been the center of the region's oil industry.

The climate varies from subtropical and dry in central and eastern Azerbaijan to subtropical and humid in the southeast, temperate along the shores of the Caspian Sea, and cold at the higher mountain elevations. Baku, on the Caspian, enjoys mild weather, averaging 4°C in January and 25°C in July. As most of Azerbaijan receives scant rainfall (an average of 152 to 254 mm annually), agricultural areas require irrigation. The heaviest precipitation occurs in the highest elevations of the Caucasus and in the Lenkoran lowlands in the far southeast where annual precipitation 1,000 mm.¹

1.2 Demographics

In October 1999, Azerbaijan celebrated the birth of its 8 millionth citizen. At the beginning of 2003, Azerbaijan's population was 8,202,000 with an annual growth rate of 0.7%. Approximately 30% of the population is under 15 years old; 61% is between 16-61 years old; and 9% is over 61. Azerbaijanis account for 90.6% of the population, the remainder being Daghestani, Russian, Armenian and other minorities.²

¹ United States Library Congress, <http://lcweb2.loc.gov/frd/cs/aztoc.html>

² United States Library Congress, <http://lcweb2.loc.gov/frd/cs/aztoc.html>

Approximately 50.7% of Azerbaijanis reside in urban areas, the remainder live in rural regions. The overall population density is about 90 persons per sq. km. Thirty-five percent of the approximately three million members of the labor force work in the agricultural and forestry sectors, 26% work in industry and construction, with balance in other occupations.

While Azerbaijan is constitutionally a secular state, the vast majority (93.4%) of the population is Muslim. The official language is Azerbaijani, a Turkic language.

1.3 History

Azerbaijan's history is deeply rooted in the ancient period. In the Ninth Century B.C., the semi-nomadic Scythians settled in areas of Azerbaijan. A century later, the Medes, who were related ethnically to the Persians, established an empire that included southernmost Azerbaijan. In the Sixth Century B.C., the Archaemenid Persians, under Cyrus the Great, took over the western part of Azerbaijan when they subdued the Assyrian Empire to the west. In 330 B.C., Alexander the Great absorbed the entire Archaemenid Empire into his holdings, leaving Persian satraps to govern as they advanced eastward. According to one account, Atropates, a Persian general under Alexander's command, whose name means "protected by fire," lent his name to the region when Alexander made him its governor. Another legend explains that Azerbaijan's name derives from the Persian words meaning "land of fire," a reference either to the natural burning of surface oil deposits or to the oil-fueled fires in temples of the once-dominant Zoroastrian religion. From the First Century A.D., Zoroastrianism in the south and central areas and Christianity in the north were the predominant religions in ancient Azerbaijan.

Between the First and Third Centuries A.D., the Romans conquered the Scythians and Seleucids, who were among the successor groups to Alexander's fragmented empire. The Romans annexed the region of present-day Azerbaijan and called the area Albania. As Roman control weakened, the Sasanid Dynasty reestablished Persian control. In the Seventh Century, Arabs conquered Azerbaijan, bringing Islam with them. After the Ninth Century, Arab rule weakened and several small independent states came into being.

In the Mid-11th Century, Turkic-speaking groups, including the Oghuz tribes and their Seljuk Turkish dynasty ended Arab control by invading Azerbaijan from Central Asia asserting political domination. The Seljuks brought with them Turkish language and customs. By the 13th Century, the basic

characteristics of the Azerbaijani nation had been established. Several masterpieces of Azerbaijani architecture and literature were created during a cultural golden age that spanned the 11th through 13th Centuries. Among the most notable cultural monuments of this period are the writings of Nizami Ganjavi and the mausoleum of Momine-Khatun in Nakhchivan.

Under the leadership of Hulegu Khan, the Mongols invaded Azerbaijan in the early 13th Century. Hulegu ruled Azerbaijan and Persia from his capital in the Persian city of Tabriz. At the end of the 14th Century, another Mongol, Timur (also known as Tamarlane), invaded Azerbaijan at about the same time that Azerbaijani rule was reviving under the Shirvan Dynasty. Shirvan Shah Ibrahim ibn Sultan Muhammad briefly accepted Timur as his overlord. (In earlier times, the Shirvan shahs had accepted Seljuk rule.) Another extant architectural treasure, the Shirvan Shah Palace in Baku, dates from this period. In the 16th Century, the Azerbaijani Safavid Dynasty took power in Persia. This dynasty fought off efforts by the Ottoman Turks during the 18th Century to establish control over Azerbaijan; the Safavids could not, however, halt Russian advances into the region.³

The end of the 19th Century was characterized by the oil boom in Baku, which became the “oil capital of the world.” In the late 1890s, the annual oil output was 11 million tons, or more than 48% of the world total.

On May 28, 1918, Azerbaijan declared independence from Russia and founded the Azerbaijan Democratic Republic, becoming the first secular republic in the Islamic world. In April 1920, Azerbaijan was occupied by the Red Army and became part of the USSR in 1922. On October 18, 1991, after the disintegration of the USSR, Azerbaijan declared its independence and succession to the 1918 Azerbaijan Democratic Republic.

Under the domination of the Soviet Union for most of the 20th Century, Azerbaijan began a period of tentative autonomy when the Soviet state collapsed at the end of 1991. A culturally and linguistically Turkic people, the Azerbaijanis have retained a rich cultural heritage despite long periods of Persian and Russian domination. In the 1990s, the newly independent nation still faced strong and contrary religious and political influences from neighbors such as Iran to the south, Turkey to the west, and Russia to the north. Furthermore, in the early 1990s, a long military and diplomatic

³ United States Library Congress, <http://lcweb2.loc.gov/frd/cs/aztoc.html>

struggle with neighboring Armenia was sapping resources and distracting the country from the task of devising post-Soviet internal systems and establishing international relations.

In response to the separatist sentiments of the Nagorno-Karabakh region's ethnic Armenians, a popular nationalist movement developed in the late 1980s. This movement acted to thwart the secessionist claims of Armenians in Nagorno-Karabakh and protect the territorial integrity of Azerbaijan. By and large, the movement subsequently formed the basis of the Azerbaijan Popular Front led by Abulfaz Elchibey, who was elected president in June 1992. The principal tenets of the Popular Front were national independence and closer unity among Turkic states. However, due to internal instability and territorial losses in Nagorno-Karabakh after major military defeats, Abulfaz Elchibey *de facto* surrendered the President's office to Heydar Aliyev in June 1993.

1.4 Government Organization

The current *Constitution of the Republic of Azerbaijan* was ratified by popular referendum in November 1995 and amended in August 2002. It contains a system of checks and balances aimed at securing separation of powers among the legislative, executive and judiciary branches of the government. The Constitution provides for a unicameral parliament (the National Assembly or *Milli Majlis*), a president and a prime minister. The members of the National Assembly are elected for five-year terms. Prior to the recent amendments, the Constitution provided for majority vote and proportional representation electoral systems for the elections to the National Assembly. Following the amendments, however, the National Assembly members will be elected by majority vote only.

The President is elected for a five-year term by popular vote. He is the head of the executive branch and, with the consent of the National Assembly, appoints the Prime Minister. The President directly appoints members of the Cabinet of Ministers.

Judicial power in Azerbaijan is exercised by a court system whose independence is guaranteed by the Constitution. The Constitutional Court decides issues relating to the form and substance of laws and other acts of authorized agencies, court decisions and international treaties concluded on behalf of the Republic of Azerbaijan. It resolves disputes among the branches of government and interprets the Constitution and the laws of the Republic of Azerbaijan with

regard to the human rights and fundamental freedoms of individuals. The recent amendments have also authorized the Constitutional Court to directly hear cases by physical persons claiming violations of their human rights and fundamental freedoms. The Supreme Court is also the court of last resort for all civil, criminal, administrative and other matters.

1.5 Results of Elections and Political Considerations

The current president, Ilham Aliyev, was elected in October 2003. As a result of the 2000 parliamentary elections, the majority of the National Assembly seats are held taken by members of the New Azerbaijan Party, established by former president Heydar Aliyev.

The political situation is stable. Establishment of a cease-fire with Armenia and suspension of active military operations in the Nagorno-Karabakh region has contributed much to this stability.

1.6 Foreign Relations and International Organizations

Azerbaijan became a member of the Commonwealth of Independent States (the "CIS") in September 1993. The major obstacle to Azerbaijan's increased involvement in this organization has been the unresolved sixteen-year-old conflict over the Nagorno-Karabakh region. Both sides of the conflict have generally observed a Russian-mediated cease-fire in place since May 1994 and support the OSCE-mediated peace process. Nevertheless, the parties remain far apart on most substantive issues from the placement and composition of a peacekeeping force to Nagorno-Karabakh's ultimate political status.

Azerbaijan has joined several major international organizations since gaining its independence. It is a member of the UN, OSCE, Council of Europe, EBRD, World Bank, IMF, Interpol, the Black Sea Region Countries Cooperation Union, the Black Sea Trade and Development Bank, Asian Development Bank and other international and regional organizations. Azerbaijan has observer status at the WTO. Azerbaijan has also joined NATO's "Partnership for Peace" program.

Since gaining independence, Azerbaijan has maintained very close relations with Turkey, with which it shares a similar language, culture and religion. Turkey was the first country to recognize Azerbaijan as an independent state. In line with its course to build a democratic, secular and civil society, Azerbaijan is also trying to secure a strategic partnership with the United States.

1.7 Economy

1.7.1 Background

Azerbaijan possesses fertile agricultural lands, rich industrial resources, including considerable oil reserves, and a relatively developed industrial sector. Utilization of those resources in the Soviet period, however, was subject to the usual distortions of centralized planning. In the early 1990s, economic output declined drastically. The major factors in that decline were the deterioration of trade relations with the other former Soviet republics, the conflict in Nagorno-Karabakh, erosion of consumer buying power, and retention of the ruble alongside the national currency.

Most of Azerbaijan's 3,500 industrial enterprises are located in Baku, Sumgait, and Ganja. Heavy industry consists of petroleum extraction and refining equipment, metallurgy, aluminum mining and refining, petrochemicals, and chemical production. Light industry consists of food processing, textiles, and wine production. Baku's main industries are oil and gas equipment and light manufacturing; Sumgait's production centers on chemical and petrochemical production, textiles and aluminum smelting; Ganja is home to an aluminum refining plant and also specializes in textiles, machine building and metallurgy.

Although industrial production grew during the late 1980s, due to the collapse of the USSR, the disruption of economic ties with other countries of the former Soviet Union and the conflict with Armenia over the Nagorno-Karabakh region (approximately 16% of Azerbaijan's territory is occupied and controlled by separatists), the economy has significantly declined for several years. Thus, the rate of economic growth was a negative 22% in 1994 compared to 1993 year indices. By 1995, output had declined 50% in the petrochemical and machine-building industries, with less dramatic declines in light industries.

A decline was also reported in the agricultural sector of economy, a critically important sector in Azerbaijan employing about 35% of the labor force. Cotton is Azerbaijan's leading cash crop, followed by wine grapes, fruits, vegetables, and tobacco. Much of that production, however, never reaches foreign markets. Food storage, processing and packaging technologies are needed to fully utilize Azerbaijan's agricultural potential. The privatization of agriculture is expected to stimulate rapid growth in the agricultural sector.

Despite the economic difficulties of the early 1990s, positive growth in Azerbaijan's economy has been reflected in the economic data set out below. Investment in the oil sector, the long awaited oil production from fields developed by the first international oil consortium in Azerbaijan, completion of the Baku – Supsa (Georgia) oil pipeline, and the current construction of the Baku-Tbilisi-Ceyhan oil pipeline and South Caucasus gas pipelines have had a determinative impact on Azerbaijan's economic growth in recent years.

1.7.2 Gross Domestic Product

GDP for 2002 rose by approximately 10.6% over the previous year.

For 2002, the GDP composition was: industry – 38.4%; agriculture – 10.2%; construction – 11.7%; transport and communication – 10.2%; other services – 29.5%.

1.7.3 Employment, Wages and Inflation

Official unemployment figures for the beginning of 2002 put the number of unemployed people at 50,963. In reality, though, taking into consideration the large number of internally displaced persons from Nagorno-Karabakh, there are over 1 million unemployed. Additionally, many of Azerbaijan's workers are idle or forced to take unpaid leave.

For 2002, the average nominal wage was approximately US \$64.

During the last half of 1994, Azerbaijan was teetering on the brink of hyper-inflation. During November and December of 1994, monthly retail price increases exceeded 50%. During the last quarter of 1994, the Government of Azerbaijan worked closely with the IMF on a Structural Transformation Facility (STF) program. The National Bank tightened the credit policies of state-owned banks and halted interest-free loans to moribund state enterprises. The Ministry of Finance put together a restrictive budget for 1995, which the National Assembly passed. The government also eliminated huge consumer subsidies for gasoline and bread. As a result, the rate of retail inflation fell dramatically. Inflation in 1997 was only 3.7% and has remained low since. The exchange rate of the manat, the local Azerbaijani currency, now stands at approximately 4,900 per US dollar.

1.7.4 Foreign Trade and Balance of Payments

Azerbaijan's foreign trade turnover for 2002 totaled US \$3.833 billion of which imports were US \$1.665 billion and exports amounted to US \$2.168 billion. Foreign trade turnover in 2002 increased by 2.3% compared to 2001. In 2002, Azerbaijan had trade relations with more than 125 countries.

The major export is oil and gas and oil products. Major imports include food, machines and metalwork, light industrial products, chemicals, petrochemicals and agricultural products.

The Azerbaijani government has made a significant effort to attract foreign investors to develop the domestic oil and gas industry. Foreign investment has grown sharply since 1995 as a result of international oil contracts signed over the past years.

1.7.5 Internal and External Debt

Azerbaijan has a relatively low level of external indebtedness, as of January 2004, it is estimated at US \$1.57 billion. This is considered to be one of the lowest rates among CIS countries. According to the 2004 State Budget, nearly US \$28.5 million were allocated to pay internal and external debts, of which approximately US \$18.5 million were allocated to repay foreign debts.

1.7.6 Privatization

The privatization process in Azerbaijan has been divided into two stages. During the first stage under the first privatization program from 1995 until 1998 (which, however, was extended until the second privatization program was adopted in 2000), four methods of privatization of state-owned property were authorized: privatization of small enterprises; privatization of medium and large-scale enterprises; privatization of banks (which, however, were later excluded from the scope of the program); and the sale of shares in specialized investment funds which did not develop into an effective privatization tool.

With the purpose of "spreading the wealth" from privatization directly to the populace, the program introduced privatization checks (vouchers) which are bearer securities of equal value. The vouchers can be sold or otherwise disposed of or redeemed in exchange for assets subject to privatization. All privatized medium and large-scale enterprises (except those already existing as joint stock companies) were to be restructured into joint stock companies, the shares of

which were distributed through discount sales to employees of privatized enterprises, voucher auctions, investment tenders, or cash auctions.

While the first privatization program did not achieve all of its goals, on August 11, 2000, Law No. 878-IQ of the Republic of Azerbaijan, *On the Privatization of State Property*, dated May 16, 2000 (the “Privatization Law”), and on August 12, 2000, the *Second Program of the Privatization of State Property of the Republic of Azerbaijan* (the “Second Privatization Program”) came into effect to allow privatization of the remaining large-scale enterprises and “strategic units” in the oil and gas, chemical and petrochemical, infrastructure and metallurgy sectors. While the new program introduced certain new methods of privatization (such as “special project” privatization designed to attract strategic investors), it retained the principal methods as provided under the first program, such as voucher auctions and investment contests (tenders).

2. FOREIGN INVESTMENT IN AZERBAIJAN

2.1 Introduction

Foreign investment in Azerbaijan is regulated by a number of legislative acts including the laws *On the Protection of Foreign Investment*, dated January 15, 1992 (the “Foreign Investment Law”), and *On Investment Activity*, dated January 13, 1995 (the “Investment Activity Law”), the Privatization Law and the Second Privatization Program, as well as laws that regulate separate sectors of the Azerbaijani economy.

2.2 Foreign Investment Law

Under Azerbaijani legislation, foreign investors may engage in any investment activity not prohibited by Azerbaijani law. Pursuant to the Foreign Investment Law, foreign investment may take any of the following forms:

- participation in enterprises and organizations established with legal entities and citizens of the Republic of Azerbaijan on a shared basis;
- establishment of enterprises wholly-owned by foreign investors;
- purchase of enterprises, proprietary complexes, buildings, structures, shares in enterprises, other shares, bonds, securities and also other property which under the law of the Republic of Azerbaijan may be owned by foreign investors;
- acquisition of rights to use land and other natural resources and also other proprietary rights; and
- conclusion of agreements with legal entities and citizens of the Republic of Azerbaijan providing for other forms of realization of foreign investments.

Enterprises with foreign investment include joint ventures, enterprises wholly-owned by foreign investors, and representations (offices and branches) of foreign legal entities.

2.3 Guarantees Available to Foreign Investors

Under the Foreign Investment Law, foreign investments are provided with the following guarantees:

- The “not-less-favored” regime applies to foreign investors in the Republic of Azerbaijan: (i) except as otherwise provided in the Foreign Investment Law, foreign investors have the same rights as local investors, and (ii) foreign investors may be granted preferential rights which might not be accorded to local investors;
- Foreign investors have the right to repatriate profits, revenues and other amounts received in connection with investments, provided that all applicable Azerbaijani taxes have been paid;
- If a change in Azerbaijani legislation adversely affects an investment, the application of that change is subject to a 10-year moratorium. The moratorium has the force of law: it is automatically enforceable and binding upon all Azerbaijani state agencies. Legislation which governs national security, defense, public order, morality, public health and environmental protection and acts affecting credits and finances fall outside the scope of the moratorium. However, under the Investment Activity Law, subsequent acts (including acts governing defense, national security, public order, tax, *etc.*) adversely affecting investment terms should not apply to the investor for the term of an investment contract;
- Nationalization is possible by resolution of the National Assembly under exceptional circumstances to prevent harm to the people and damage to the state interests of the Republic of Azerbaijan. Confiscation is possible only under circumstances of natural disaster, epidemics, and other extraordinary situations by a decision of the Cabinet of Ministers. In both cases, foreign investors are entitled to compensation which must be “prompt, adequate and effective”;
- Free access to international arbitration. The use of arbitration for dispute resolution is possible where two conditions are present: (i) the existence of law not prohibiting a particular type of dispute to be submitted for consideration to an arbitration tribunal, and (ii) an agreement of the parties to transfer specific disputes to such tribunal.

Incentives may be available to foreign investors and enterprises with foreign investment engaged in certain sectors of the Azerbaijani economy such as energy. Such incentives are granted by legislative acts regulating those sectors of the economy, as well as by agreements concluded by the state with investors.

International agreements to which Azerbaijan is a party, such as bilateral investment treaties, may establish a more favorable investment climate and provide additional guarantees to foreign investors. Under Azerbaijani law, international treaties prevail over local law (except for the Constitution and acts adopted by referendum) regulating the same issue.

2.4 Bilateral Investment Treaties

Azerbaijan has concluded 18 bilateral treaties on the mutual protection of investments with several more treaties currently under negotiation. Azerbaijan is also a party to a number of multilateral treaties concerning foreign investment.

Azerbaijan has bilateral treaties on the encouragement and protection of investments with the following countries:⁴

Country	Signed On	Ratification Date by Azerbaijan
Turkey	February 9, 1994	June 14, 1994
USA	August 1, 1997	April 14, 1998
Pakistan	October 9, 1995	March 12, 1996
Germany	December 22, 1995	June 25, 1996
Great Britain	January 4, 1996	March 15, 1996
Georgia	March 8, 1996	April 19, 1996
Uzbekistan	May 27, 1996	July 16, 1996
Kazakhstan	September 16, 1996	November 15, 1996
Ukraine	March 25, 1997	June 6, 1997

⁴ The Bilateral Investment Treaty On Mutual Protection and Encouragement of Investments between Azerbaijan and China was signed on March 7, 1994, but has not yet been ratified either by Azerbaijan or China.

Kyrgyzstan	April 23, 1997	June 26, 1997
Poland	August 26, 1996	February 13, 1998
Iran	October 28, 1996	December 1, 1998
Italy	September 25, 1997	February 17, 1998
Moldova	November 27, 1997	December 8, 1998
Lebanon	February 11, 1998	December 4, 1998
France	September 1, 1998	November 27, 1998
Austria	July 4, 2000	October 24, 2000
Egypt	October 24, 2002	May 13, 2003

2.5 Foreign Investment Regime under Privatization Programs

Under the general principles of the Privatization Law, all state-owned property, except that prohibited by law, may be privatized. Property that may not be privatized includes subsoil reserves, military facilities, certain entities and organizations funded out of the state budget and other units of the state importance, as well as certain public facilities. According to the Second Privatization Program, state property subject to privatization is further divided into categories depending on the authority taking decision on the privatization. The most important state assets are included into the category privatized at the decision of the president. The president approves the foreign investors' participation in the privatization of state assets within this category. Special rules applicable to foreign investors may be established in the case of investment contests.

Under the Privatization Law, the following are considered to be foreign investors:

- foreign legal entities;
- Azerbaijani legal entities in which participation of foreign investment exceeds 50% of the entity's charter capital;
- foreigners; and
- stateless persons.

The Second Privatization Program retained the provision from the previous program pursuant to which foreign investors are allowed to participate in privatization by means of a special instrument called an option. An option is a registered non-documentary security. Options are valid until July 1, 2004. The Second Privatization Program slightly modified the rule excluding the requirement for options where profits obtained in Azerbaijan are being re-invested by foreign investors. Thus, the options are not required from foreign investors (and not only the local enterprises with foreign investment as was the case under the first privatization program) funding their participation in the privatization with net profits obtained in Azerbaijan. Equally important, the Second Privatization Program and related acts do not require the use of options on the secondary stock or commodity markets.

3. ESTABLISHING A LEGAL PRESENCE

3.1 Introduction

Establishing a legal presence in the Republic of Azerbaijan is regulated mainly by the *Civil Code*⁵ effective September 1, 2000 (the “Civil Code”), the law On State Registration and State Register of Legal Entities, dated December 12, 2003, and the law *On Limited Liability Companies*, dated December 29, 1998.

A foreign investor may choose either a limited presence, in the form of a representative office or a branch, or a full presence in a number of other forms.

3.2 Representative Offices and Branches

3.2.1 Legal Form

A representative office and a branch of a foreign legal entity are not considered to be Azerbaijani legal entities. A representative office is a separate subdivision of a legal entity which represents and protects the legal entity’s interests. A branch is also a separate subdivision of a legal entity engaging in some or all of the functions of the legal entity, including functions of a representative office. The definitions suggest that the scope of a branch’s activities is wider than that of a representative office.

Since a representative office may only represent and protect the interests of a legal entity, without engaging even in some of the legal entity’s functions, a representative office may probably not engage in commercial or business activity. A branch, on the other hand, being able to carry out all or part of legal entity’s functions, can engage in business or commercial activity.

Both a representative office and a branch operate in Azerbaijan on the basis of regulations (similar to a charter) approved by their parent legal entity.

A representative office and a branch are subject to the same registration procedure and submit the same set of documents for state registration.

⁵ Approved by Law No. 779-IQ of the Republic of Azerbaijan dated December 28, 1999.

3.2.2 Registration

Representative offices or branches of foreign legal entities are registered with the Ministry of Justice. The Ministry of Justice is required to effect registration within forty (40) days after the submission of the necessary documents. The registration fee for a branch or representative office of a foreign legal entity is approximately US \$220.

In order to register as a representative office or branch, an applicant must submit to the Ministry of Justice an application together with a set of statutorily required corporate and other documentation. Documents from the parent entity must be notarized and legalized in the home country. Any document written in a language other than Azerbaijani must be accompanied by a notarized translation of the same into Azerbaijani.

Following state registration, a representative office or branch must comply with a number of post-registration formalities, including obtaining an official seal, registration with the State Statistics Committee, registration with the Ministry of Taxes, opening bank accounts in manat and foreign currency; and registration with social protection funds.

3.3 Forming a Commercial Legal Entity

Under the Civil Code, legal entities may be either commercial or non-commercial. The Civil Code provides for the following business forms of commercial legal entities:

- Joint Stock Companies (“JSC”);
- General Partnerships (“GP”);
- Limited Partnerships (“LP”);
- Limited Liability Companies (“LLC”);
- Additional Liability Companies (“ALC”); and
- Cooperatives.

Azerbaijani entities are incorporated or established generally pursuant to a foundation agreement and a charter. The foundation agreement is not,

however, required for the creation of companies with one participant. The foundation agreement governs the rights and obligations of the founders and the relations between the founders and the corporation. The charter generally governs the structure and management of the corporation and the rights of participants and shareholders in connection therewith. Certain provisions of the foundation documents defined in the Civil Code are mandatory. The Ministry of Justice refuses to register an entity whose foundation documents do not contain the mandatory provisions.

Azerbaijani general corporate legislation fixes a minimum amount of charter capital for JSCs only.

3.3.1 Joint Stock Companies

3.3.1.1 Joint Stock Company (“JSC”)

A JSC is a legal entity whose charter capital is divided into a certain number of shares, which are securities. JSC shareholders are liable for the obligations of the JSC only to the extent of their shares’ par value. One individual or legal entity may be the founder or the shareholder of a JSC.

3.3.1.2 Types of Joint Stock Company

A JSC may be either open or closed. Closed JSCs with more than 50 shareholders must be reorganized into open JSCs. Shares of a closed JSC are distributed only among the founders and transferred to third parties only upon failure of shareholders to exercise the right of first refusal and upon failure of a closed JSC to purchase such shares. A shareholder has the right to receive the fair market value of its share.

Shares of an open JSC are publicly sold and can be alienated by shareholders to third parties without restriction.

3.3.1.3 Creation of Joint Stock Company

The process of establishing a JSC is initiated at the founders’ meeting, which adopts the foundation agreement and charter of the JSC. It includes state registration of the JSC, state registration of the issuance of shares and the placement of shares either among the founders in closed JSCs or through a public offering in open JSCs. A public offering may be conducted by an open JSC itself or through banks or stock exchanges.

3.3.1.4 Charter Capital

The charter capital of a JSC is divided into a fixed number of shares of a stated par value. For a closed JSC, the minimum amount of the charter capital is approximately US \$1,015 (calculated at 4,930 manats to US \$1) and twice that for an open JSC.

The charter capital of a JSC must be fully paid on or before the date of its state registration. If the value of the net assets of a JSC is less than half the amount of its charter capital at the end of the JSC's second and, thereafter, each subsequent fiscal year, such JSC must announce the decrease of its charter capital and register such decrease with the Ministry of Justice of Azerbaijan.

3.3.1.5 Charter Capital Contributions

Contributions to the charter capital of a JSC may be made in cash or in-kind. The value of the contributions made in-kind must be confirmed by the founder's meeting.

3.3.1.6 Shares

Shares in a JSC are securities and must be registered with the State Committee for Securities before issuance. Shares may be either common or preferred shares. Preferred shares may not be issued in an amount exceeding 25% of the charter capital. Shares may be merged, divided or converted into other shares.

3.3.1.7 Rights of Shareholders

Shareholders of a JSC have the following rights, among others: (1) the right to receive the JSC's declared dividends; (2) the right to vote at the general meeting of shareholders; (3) the right to have the access to the JSC's records; and (4) the right to receive dividends and a share of the property of a JSC upon liquidation after payment to creditors. Shareholders owning preferred shares have a preferential right to dividends and to distributed assets upon liquidation, but do not have the right to vote, unless so provided in the JSC's charter. Shareholders have one vote for each share of common stock owned.

3.3.1.8 Management Structure

General Meeting of Shareholders

The General Meeting of Shareholders (“GMS”) is the highest management body of a JSC and has the exclusive competence to:

- Amend the JSC’s charter and charter capital;
- Appoint and terminate the JSC’s Management Board, Supervisory Council and Audit Commission;
- Approve the JSC’s annual reports, balance sheets and financial statements and distribution of its dividends and losses;
- Reorganize and liquidate the JSC.

The GMS makes its decisions unanimously or by a simple or qualified majority of votes present at such GMS. The minimum number of votes necessary to make a decision must be set forth by the JSC’s Charter.

A quorum for a GMS is obtained if shareholders owning 60% of the voting shares participate in GMS.

A GMS must be held not less than annually. Any GMS other than the annual GMS is an extraordinary GMS (“Extraordinary GMS”). The Management Board, the Supervisory Council, the Audit Commission or shareholders holding at least 10% of the shares may call an Extraordinary GMS. Notice (with an agenda) must be sent to each shareholder at least 45 days before the GMS.

Supervisory Council

A JSC has a Supervisory Council comprised of at least three individuals who are either shareholders or outsiders. The Supervisory Council monitors the activity of the Management Board. A member of the Supervisory Council may not be a member of the Management Board, a lawyer for the JSC, or a person authorized to act on behalf of the JSC. Representatives of enterprises dependent on the JSC and state officials are also precluded from being members of the Supervisory Council.

Management Board

A JSC's Management Board is responsible for the JSC's day-to-day management. It reports to the GMS and the Supervisory Council. Alternatively, a JSC may be managed by an outside management company.

Members of the Management Board are initially elected at the founder's meeting, and thereafter by the GMS. Both shareholders of the JSC and outsiders may be members of the Management Board. Shareholders holding more than 20% of shares can not be members of the Management Board. Members of the Supervisory Council can not be members of the Management Board. The Management Board is competent to make any decision not reserved by law or the foundation documents to the exclusive competence of the GMS or the Supervisory Council.

Management of a JSC by an outside company, however, must be approved by the GMS.

Audit Commission

The Audit Commission is mandatory for JSCs with more than 50 shareholders. This body monitors the activities of the JSC and prepares an opinion on the JSC's annual reports and accounts. The Audit Commission must conduct an audit at the end of the financial year, at the request of shareholders holding in the aggregate 10% of the shares, at the request of the GMS, the Management Board, or the Supervisory Council as well as in other cases provided for in the charter.

Chief Executive Officer

The chief executive officer ("CEO") is hired by a JSC pursuant to an employment contract. The CEO represents the JSC without a power of attorney, issues powers of attorney, disposes of the JSC's assets and otherwise acts on behalf of the JSC within the power granted to him by the company's charter.

3.3.2 General Partnership ("GP")

A general partnership is a legal entity comprised of at least two individuals and/or legal entities. An individual may participate in creation of the GP only if such individual is registered as an entrepreneur. Individuals and/or legal entities may participate in only one GP. General partners are jointly and

severally liable for the partnership's liabilities. To the extent that the partnership does not have sufficient assets to cover its obligations, the partners are then personally liable for its obligations.

3.3.2.1 Rights of Partners

A partner may withdraw from a GP under the terms and under the procedure provided for in the foundation documents without causing the dissolution of the GP. The withdrawing partner must provide other partners with at least six months notice prior to the actual date of withdrawal. The withdrawing partner receives payment for the value of his/her interest in the partnership.

The withdrawing partner may transfer his/her share in the GP to any other person or entity only with the consent of other partners. The remaining partners have the preemptive right to acquire the share. The transfer of the partnership share must be notarized.

The withdrawing partner and remaining partners are equally liable for the GP's debts arising prior to the withdrawal. Additionally, a newly admitted partner is liable for all partnership debts of the GP which arose prior to his admittance.

3.3.2.2 Management Structure

The supreme body of a GP is the General Meeting of Partners ("GMP"). The topics addressed at the GMP are essentially the same as those addressed at the GMS of a JSC.

The management over the GP's activities is conducted with mutual consent of all partners. Each general partner has only one vote and may act on behalf of the GP unless otherwise is provided by the GP's charter. Alternatively, a GP may create the Management Board to manage a GP. Members of the Management Board are elected at the GMP.

3.3.3 Limited Partnership

A limited partnership ("LP") has one or more general partners and one or more limited partners. General partners are personally liable for the partnership's obligations. Limited partners' liability is limited to the amount of their contributions. An individual may participate as a general partner only in one LP. Similarly, a partner of the GP may not participate as a general partner in the LP.

3.3.3.1 Rights of Partners

A partner may withdraw from an LP without causing the dissolution of the LP. The withdrawing partner must provide the other partners with at least six months notice prior to the actual date of withdrawal. The LP must pay to a withdrawing partner the value of his/her share.

A withdrawing partner may transfer his/her share to third parties only with the consent of the general partners. Both general and limited partners have a preemptive right to purchase the withdrawing partner's share. The share transfer agreement must be notarized.

A withdrawing general partner and remaining general partners are equally liable for the GP's debts which arose prior to the withdrawal. A newly admitted general partner becomes liable for all the debts of the LP which arose prior to the admission of the new partner.

Limited partners have the same rights as general partners, but cannot participate in the management of the LP and cannot vote in elections for members of the Board or vote on any matter which concerns only the rights of general partners.

3.3.3.2 Management Structure

The management over an LP's activities is conducted by the general partners. The law provides for the same management structure for an LP as it does for a GP.

3.3.4 Limited Liability Company

A limited liability company ("LLC") is an entity established by one or more individuals and/or legal entities contributing their participatory interests to the charter capital. An LLC having only one participant may not be a sole participant of another LLC. The participants in an LLC are liable only to the extent of their contributions.

3.3.4.1 Rights of Participants

A participant in an LLC has the same basic rights as those provided for a shareholder of a JSC. A participant of an LLC is not liable for the LLC's obligations and bears the risk of loss for the LLC's activities only to the extent of its contributions to the LLC's charter capital.

3.3.4.2 Management Structure

The supreme body of an LLC is the General Meeting of Participants. The topics addressed at this meeting are essentially the same as those addressed at the GMS of a JSC. Between General Meetings, the Supervisory Council (if such has been provided by the foundation documents), composed of at least three individuals who may be either participants or outsiders, supervises the LLC's executive body, the Management Board. Members of the Management Board are elected at the General Meeting. A member of the Supervisory Council may not be a member of the Management Board. The Management Board is responsible for hiring the LLC's Manager, who performs duties similar to those performed by the CEO of the JSC. Alternatively, the LLC may have only the Management Board which will manage the LLC without hiring a Manager, or if provided by the charter, hire a Manager (either an individual or entity) which may run the LLC without the Management Board.

3.3.4.3 Charter Capital

Charter capital consists of contributions of the participants. The charter capital of an LLC is divided into a fixed number of participatory interests set forth by the LLC's charter.

All of the founding participants must make their contributions to the charter capital by the date of the LLC's state registration. In the event that the net value of the LLC's assets is less than the amount of its charter capital at the end of the second and, thereafter, each subsequent fiscal year, LLC must decrease its charter capital and register such decrease with the Ministry of Justice.

The value of "in-kind" contributions (e.g., equipment, property) or contributions in the form of property rights are determined by an agreement of the participants or pursuant to a resolution of the General Meeting.

3.3.5 Additional Liability Company

An additional liability company ("ALC") is an entity established by one or more individuals and/or legal entities contributing their shares to the charter capital. Legal structure of an ALC is similar to an LLC. The exception is that the participants in an ALC may assume liability for the company in excess of their contributions as regulated by the charter.

3.3.6 Cooperative

A cooperative is a voluntary union of individuals and legal entities with the purpose of satisfying material and other needs of the participants through consolidation of their material contributions. Based on their activity purposes, cooperatives may be of different kind such as consumer cooperatives and condominiums.

3.3.6.1 Rights of Members

In essence, a cooperative's member enjoys the same rights available to founders of other types of legal entities, including a right to participate in management of the cooperative.

3.3.6.2 Cooperative's Property

Members of a cooperative must make their respective contributions to charter capital in full prior to the state registration of the cooperative. The cooperative's property is divided into shares of its members determined in accordance with the charter.

A certain portion of a cooperative's property may be composed of indivisible funds to be used for purposes specified by the charter. A decision to establish indivisible funds may be taken by a unanimous vote of the cooperative's members, unless otherwise provided by the cooperative's charter.

If, pursuant to the results of the fiscal year, a cooperative suffered financial losses, the members must cover such loss by way of additional contributions made not later than two months from the date of approval of the annual balance sheet. The cooperative's members bear joint secondary liability for its obligations to the extent of the unpaid portion of their additional contributions.

3.3.6.3 Management Structure

The supreme management body of a cooperative is a General Meeting of Members. Each member of the cooperative has one vote at the General Meeting, without regard to the size of its share in the charter capital. A cooperative having more than 50 members may have a Supervisory Council which controls the activities of the cooperative's executive bodies. The executive bodies of the cooperative are a Management Board and/or a Chairman of the Cooperative.

3.4 Non-Commercial Organizations

An Azerbaijani non-commercial or not-for-profit organization is an entity created to engage in various social and economic activities not related to the generation of profit and distribution of such profit to its equity-holders. Because an Azerbaijani non-commercial organization is treated as a legal entity, it may own property, enter into contracts, acquire ownership and intellectual property rights and incur obligations in its own name, maintain an independent balance sheet, maintain settlement and other bank accounts, and act as a claimant and defendant in courts and arbitration tribunals. Azerbaijani non-commercial organizations are presumed to engage in non-commercial activities.

Under the Civil Code, non-commercial organizations may be created in any of the following forms: (1) public association; (2) fund; and (3) union of legal entities.

3.4.1 Public Associations

A public association is a voluntary, not-for-profit organization created by its members to engage in activities in their mutual interest. Azerbaijani law authorizes both individual and corporate membership in public associations.

A public organization's members lose any ownership or other rights to property that they transferred to the public association, including their membership contributions. The public association's members are not responsible for the public association's obligations. Likewise, the public association is not responsible for the obligations of its members.

In the event of liquidation of a public association, any property remaining after liquidation is allocated for the purposes specified in the charter. If this is impossible, such property is remitted to the state budget.

3.4.2 Funds

A fund is a not-for-profit organisation created by individuals and/or legal entities to engage in public, charitable, educational and other kinds of social activities. As an Azerbaijani fund is not subject to a minimum requirement for the number of founders, it may be created by one individual or legal entity. Moreover, funds are not based on membership, *i.e.*, founders of the fund do not become its members. A fund's founders are not responsible for the fund's obligations. Likewise, a fund is not responsible for the obligations of its founders.

The management structure of a fund must be established by a charter approved by the founders. The law does not grant the founders a right to participate in the management of the fund through any kind of general meetings. All the management decisions are made by the governing bodies established by the charter. For instance, such governing bodies may amend the charter, whereas in other legal entities only founders have a right to do this. If, according to the charter, the governing bodies do not have this right either, the fund's charter may be amended only by a court based on an application of the fund's governing bodies.

A fund may be liquidated only pursuant to a court decision in the cases established by law. A fund's property remaining after liquidation must be used for the purposes specified in the charter. If this is impossible, such property must be remitted to the state budget.

3.4.3 Unions of Legal Entities

A union of legal entities is created by business or non-commercial entities to provide for cooperation and coordination of their entrepreneurial or non-commercial activities, representation and protection of their common interests. A union is not responsible for the obligations of its corporate members. Corporate members, however, are responsible for the union's obligations to the extent provided under the union's charter.

If, pursuant to a decision of its members, a union of legal entities is to engage in any commercial activity, then such union must either: (1) be reorganized into a commercial company or partnership; or (2) establish or become a participant in a commercial company.

3.5 Subsidiaries

A legal entity, whether or not established in Azerbaijan may form in Azerbaijan a subsidiary in one of the three legal forms available for commercial purposes, *i.e.* JSC, LLC and ALC. A subsidiary is a separate and distinct legal entity; the parent enterprise may contribute property to its subsidiary but, typically, is not liable for the obligations of the subsidiary. A parent company, however, may be held liable for obligations of its subsidiary in bankruptcy if such bankruptcy was caused through the fault of the parent company in connection with execution of its instructions. Additionally, a parent company and its subsidiary are jointly and severally liable for obligations incurred by the latter as a direct result of implementation of instructions of the former even if the former is not in bankruptcy.

4. ISSUANCE AND REGISTRATION OF SECURITIES

4.1 Introduction

The securities market in Azerbaijan is regulated by provisions in the Civil Code and a number of presidential decrees, resolutions of the Cabinet of Ministers and acts of the State Committee for Securities. The State Committee for Securities, created at the end of 1998, has been authorized to regulate activities on the securities market.

Under the Civil Code, securities may be issued as registered or bearer securities or order papers. In addition, depending on the methods of placement, securities are of two types:

- Emissive securities are placed through separate emissions which, regardless of the time of their acquisition, have equal scope and period for realization of the rights thereunder within the respective emission, such as shares and bonds;
- Non-emissive securities are placed otherwise and have different scope and periods of realization for the rights thereunder, such as options, warrants, privatization checks, futures, mortgage certificates, bills of lading, *etc.*;

and of two forms:

- Documentary - the rights of securities holders to the securities are established by a paper document or, in the case of depositing securities, by entries in a deposit account. The specific requirements for the certificates are determined by the State Committee for Securities; and
- Non-documentary - when the rights of the securities holders to the securities are evidenced by the entries made in the shareholder register or by the entries made in a deposit account.

4.1.1 Issuance and Placement of Emissive Securities

The issuance and placement of emissive securities involve the following stages:

- The decision by the issuer to issue and place the securities. The decision on initial issuance and placement of securities is made by the founders

of the issuer; decisions on subsequent issuance and placements are made by the governing body of the issuer;

- Registration of the issuance and an issuance prospectus (if applicable) with the State Committee for Securities. The issuance of all emissive securities is subject to state registration. The prospectus and its registration are required only under an “open” (public) placement;
- Placement of the securities; and
- Registration of the report on the results of the issuance with the State Committee for Securities.

Placement can be of two types:

- Closed - the securities are placed without announcing public sale; or
- Public or open – the securities are placed by a publicly announced sale and the issuer publishes a prospectus in the mass media.

4.1.2 Additional Issuance

An additional issuance of emissive securities can be carried out only after previously issued securities have been placed.

4.1.3 Disclosure Requirements

The Civil Code imposes different reporting and disclosure requirements depending on the nature of the placement, with more extensive requirements being imposed on an open JSC.

Regardless of the type of securities placement, the issuer must present a report to the State Committee for Securities on the results of the issuance and placement of the emissive securities not later than thirty (30) days after completing the placement. An issuer who has announced a public placement must publish the balance sheet and the report on the results of its business in the mass media annually.

Acquisition of a certain percentage of shares of the issuer by affiliated persons may be regulated by anti-monopoly legislation.

Under the Civil Code, any information other than that which is publicly available regarding the issuer and the issuer's securities is considered to be inside information. A person who obtains such information *ex-officio* or under an agreement concluded with the issuer cannot use such information while concluding transactions nor transfer such information to third parties for concluding transactions.

4.2 Regulation of the Securities Market

The following professional activities on the securities market may be carried out by legal entities and individuals which have obtained a license from the State Committee for Securities:

- brokering;
- dealing;
- depositary activities;
- acting as a registrar;
- portfolio management;
- securities clearing;
- organizing trade at stock market;
- operating a stock exchange;
- operating a commodity exchange;
- printing and sale of security blanks.

4.2.1 Stock Exchanges

A stock exchange may be formed only in the form of a closed joint stock company and must obtain a license from the State Committee for Securities to operate. The Committee organized establishment of the Baku Stock Exchange at the end of December 1999. Shareholders of the exchange include banks and investment companies.

5. LICENSES

5.1 Introduction

Azerbaijan's licensing law⁶ lists the activities that require licenses and permits before they may be performed. Licenses may be granted to citizens and legal entities of Azerbaijan as well as to foreign legal entities and foreign citizens. An interstate agreement may recognize a license obtained by a foreign entity in the home country.

Presidential Decree No. 782, *On Improving the License Issuance Rules for Some Types of Activity*, dated September 2, 2002, decreased the number of activities requiring licenses from 240 to 30. Moreover, the decree unified the licensing rules for all types of licenses.

A license is granted without discrimination to any entity that satisfies the requirements for that specific license. Thus, with certain exceptions, foreign investors may obtain licenses under the same conditions and in accordance with the same procedure applicable to Azerbaijani nationals.

A licensee may not transfer a license to another legal entity or individual unless otherwise provided by law.

5.2 Issuance of Licenses

The Cabinet of Ministers of the Republic of Azerbaijan is authorized to regulate the issuance of licenses. According to the Presidential Decree, the Ministry of Economic Development of the Republic of Azerbaijan is the specific ministry empowered to exercise overall control in the field of licensing and to maintain a single register of licenses. The resolutions of the Ministry of Economic Development concerning license issues are mandatory for organs of central and local executive authorities of Azerbaijan.

The following activities are licensed by the indicated state agencies:

⁶ The primary legislation regulating licensing is Law No. 405 of the Republic of Azerbaijan, *On Entrepreneurial Activity*, dated December 15, 1992, as amended, and the Presidential Decree No. 782 *On Improving the License Issuance Rules for Some Types of Activity* dated September 2, 2002.

Type of Activity	Executive Agency Issuing License
Disposal and burial of radioactive and ion-emitting substances; Utilization and elimination of hazards of industrial toxic wastes;	Ministry of Ecology and Natural Resources
Sale of oil products; Sale of gas products;	Ministry of Fuel and Energy
Storage, processing and sale of wastes of non-ferrous metals, industrial and factory wastes containing precious metals and stones; Production and import of ethanol (alcohol) and alcoholic drinks; Production and import of certain tobacco products; Commodity exchange;	Ministry of Economic Development
Communication services (telephone, cellular and paging communication; radio link, installation and operation of cable TV, courier services).	Ministry of Communications
Projection and engineering research of I and II class buildings and constructions meeting state standards.	State Committee for Construction and Architecture
Water and air transportation of passengers and cargo.	Ministry of Transportation
Sale of ethanol (alcohol) and alcoholic drinks; Sale of tobacco products.	City and District Executive Authorities (except for city districts)
Educational (secondary, secondary specialized and higher) institutions.	Ministry of Education

Non-state social funds activities; Printing financial reporting documents; Insurance.	Ministry of Finance
Managing securities portfolio; Maintaining register of securities owners; Depository; Securities dealer; Securities broker; Organizing trade at stock market; Clearing; Stock exchange; Investment funds; Printing and sale of security blanks.	State Committee for Securities
Pharmaceutical and medical activities.	Ministry of Health
Employment brokerage services for an employment of Azerbaijan citizens abroad.	Ministry of Labor and Social Protection of the Population
Auditing.	Audit Chamber
Banking activity.	National Bank
Tourism activity.	Ministry of Youth, Sports and Tourism
Making various types of seals and stamps.	Ministry of Internal Affairs
Performing cartographic work.	The State Committee for Land and Cartography
Design and production of information protection devices; Processing, production, sale, purchase, import, export of technical devices for illicit obtaining of information by natural persons and legal entities not entitled to perform operative investigation activity.	Ministry of National Security

Customs brokerage activity;
Establishing of customs warehouses,
temporary detention warehouses,
free warehouses

State Customs Committee of
the Republic of Azerbaijan

5.3 Applying for a License

Generally, the Cabinet of Ministers issues regulations on the procedures for licensing specific types of activities to be implemented by a relevant state agency. An applicant must submit all documents specified in the regulations and pay the required fee. If the application meets all of the requirements, a license is issued within fifteen (15) days after the date the application was submitted. The term of any type of license is five years.

5.4 Consequences of Operating Without an Appropriate License

Penalties for operating without a license can be severe and an individual or entity can be held liable under applicable law.

6. TAXATION

6.1 Introduction

The bases of Azerbaijani tax system were first laid out with the adoption on May 15, 1991, of the law *On the Fundamentals of Economic Independence of the Republic of Azerbaijan*. The system has undergone further development with the adoption following almost three years of drafting, numerous discussions and three readings in the parliament, of the first codified digest of Azerbaijani tax laws, the *Tax Code* (the “Tax Code”) signed by the president into law on July 11, 2000. The Tax Code came into effect on January 1, 2001, replacing most of the individual tax acts adopted prior to it.

The Tax Code is divided into two main parts: general and special. Issues dealt with in the general part describe the tax system; list defined terms used in the Tax Code; describe the powers and duties of the tax authorities; provide penalties for non-compliance with tax laws; set out the procedural rules for taxpayers to appeal actions taken by the tax authorities; and address general issues of tax payment and collection. The special part of the Code deals with each of the taxes imposed by the Code: the income tax of individuals; profits (corporate income) tax; value added tax; excise; property tax; land tax; highway tax; mining tax; and the simplified tax (“ST”).

In furtherance of the provisions of the Azerbaijani Constitution, the Tax Code stipulates a three-level tax system with state taxes levied at the first level, taxes of the Nakhchivan Autonomous Republic within Azerbaijan at the second, and the local or municipal taxes levied at the third level. While certain taxes listed in the Code are levied only at one level, certain other taxes are shared between the state and Autonomous governments and the state and municipal governments.

Taxes levied at the state level consist of all the taxes listed in the special part of the Tax Code with the exception of land and property taxes payable by individuals, mining tax (only for those minerals consumed at the local level) and profits tax of enterprises owned by municipalities which are all payable at the local level. Again, taxes levied at the second level are all the taxes (except highway tax which is payable at the state level) listed in the special part of the Tax Code payable in the Autonomous Republic. Finally, municipal taxes are land and property taxes payable by individuals, mining tax (only for those

minerals consumed at the local level), and profits taxes of entities owned by municipalities. Other obligatory payments payable at the municipal level are determined by the relevant act adopted at the state level.

The Tax Code also recognizes the existence of special tax regimes different from those of general application. In Azerbaijan, such regimes are by and large applicable to the contracting and subcontracting parties to the oil and gas production sharing agreements signed between Azerbaijani Government and foreign companies. While tax regimes applicable under such agreements differ from agreement to agreement, generally they provide for lower withholding income tax rates, exemption from value added tax, simplified reporting and accounting procedures, and the like.

6.2 Administration of Taxes

Collection of taxes is administered by the Ministry of Taxes and its divisions and, accordingly, tax control is exercised by the Ministry of Taxes. In certain cases, where a determination must be made as to the appropriate payment of customs duties, tax control is also exercised by the customs authorities.

All Azerbaijani enterprises, representative offices, branches, individuals engaged in business activities as well as foreign entities and, presumably, individuals which conduct business activity in Azerbaijan through a “permanent establishment” (as defined in the Tax Code, “PE”) must register with the tax authorities without regard to whether their activities are taxable in Azerbaijan.

6.3 Types of Tax

The most significant taxes levied at the state level are listed below.

6.3.1 Corporate Income Tax

Azerbaijani legal entities are subject to a corporate income (profits) tax of 24% on their worldwide income. Certain types of payment due to such entities are taxed at the source of payment. For instance, dividends paid by resident enterprises (as defined in the Tax Code) and interest payable (except that payable to banks in Azerbaijan) by a resident or PE or on behalf of PE are subject to a 10% tax withheld at the source of payment. Enterprises which are not required to register for value added tax purposes (except for those manufacturing excisable goods, credit and insurance institutions, investment funds, and professional participants of securities market) may be subject to ST.

ST is levied on gross proceeds of the business at the rate of 4% in Baku and 2% in other cities or regions.

Foreign legal entities operating in Azerbaijan are also subject to a 24% corporate income tax on profits earned by their PE in Azerbaijan. Foreign legal entities are also subject to an income (whether obtained through a PE or not) tax withholding on dividends and interest at the rate of 10%. Tax is also withheld from the income of a foreign entity obtained from the source in Azerbaijan not through its PE in Azerbaijan. Most types of such income are subject to 10% (communication and freight fees are subject to 6%; and insurance premiums and payments under finance leases are subject to 4%).

The tax base for resident enterprises and PEs is gross annual income less allowable deductions. The aggregate annual income of a resident taxpayer includes all income irrespective of source. Income of a non-resident taxpayer consists only of Azerbaijani source income. Deductions include all expenses connected with deriving income including wages, bad debts and depreciation. Deductions for travel, entertainment and certain other expenses may be limited. Foreign entities can take deductions generally only with regard to such items of income that are obtained through their PEs. With the adoption of the Tax Code, foreign entities operating through PEs in Azerbaijan no longer enjoy tax free offshore remittances, which are now subject to 10% tax, bringing the overall effective rate of taxation of foreign entities operating through PEs in Azerbaijan to 32.5%.

Expenditures for the acquisition of capital assets may be amortized at rates stated in the Tax Code.

6.3.2 Individual Income Tax

Individual income is subject to tax according to a progressive scale. Employers are obliged to withhold income tax from employees' salaries as well as from certain other kinds of monetary and other compensation. The progressive tax rates range effectively from 0% (for certain exempt income) to up to 35% (highest marginal bracket). Income tax on worldwide income must be paid by residents. Non-residents pay tax only on income originating from the source in Azerbaijan.

6.3.3 VAT

Value added tax ("VAT") is imposed on the turnover of most goods, works and services in Azerbaijan and on the importation of goods. VAT is charged by the

seller of goods, the provider of services or, in the case of goods being imported, by customs officials. Input VAT representing a business expense can be offset against output VAT collectable by a business. The VAT rate is 18% of the price of goods, works and services or of the customs value of goods.

Separate VAT registration requirement is introduced by the Tax Code. The Tax Code also adopted a reverse-charge VAT as a mechanism to impose Azerbaijani VAT on the goods, works and services sold to tax agents in Azerbaijan by non-residents that are not required to undertake Azerbaijani VAT registration. A definite set of rules, absent from the old tax laws, for determination of the place of supply of goods, services and works has been also introduced by the Tax Code.

Import and turnover of certain goods, as well as works and services for certain purposes are exempt from VAT, which exemption means that the recovery of certain input VAT in the chain is not allowed. Financial services (including, finance lease) are the representative examples of such exemptions. Certain other transactions are zero-rated, which is essentially an exemption with credit giving rise to the recovery of the input VAT. Export of goods, supply and import of goods, works and services at the expense of foreign grants, *etc.*, are examples of zero-rated transactions.

6.3.4 Subsoil Use Taxes

Companies engaged in the extraction of subsoil resources are subject to a special mining tax the rate of which depends on the particular type of the produced mineral as set out in the Tax Code. In addition, subsoil users can be subject to various payments, such as various bonuses and fees, the method of calculation and application of which are stipulated by a contract between the companies undertaking such activities and the relevant state agency.

6.3.5 Excise

Excise is imposed on a consumption basis and applies upon departure of excisable goods from the production site or importation of excisable goods. Rates of excise vary depending on the kind of goods produced or imported and are subject to frequent changes. Excise paid for goods used for production of other excisable goods can be offset against excise charged for finished products. Alternatively, such excise can be claimed from the budget. Export of excisable goods is subject to 0%.

6.3.6 Highway Tax

Highway tax is imposed on foreign-registered vehicles engaged in transportation of passengers or cargo upon entry into the Republic of Azerbaijan in the amount dependent on the weight of the vehicle and, in the case of cargo transportation, the nature of imported products. The tax is collected by customs authorities.

6.3.7 Property Tax

Property tax is assessed annually on the book value of fixed assets maintained by a resident enterprise or non-resident enterprise operating in Azerbaijan through PE. Property tax is also payable by both resident and non-resident individuals that own structures or transportation means in Azerbaijan. Rates generally differ depending on the types of asset and their value.

6.3.8 Land Tax

Land tax is imposed on the owners or users of land in an amount dependent on the location, quality and size of the land plot. Rates are set out in the Tax Code. The tax is payable by both resident and non-resident individuals and resident enterprises and non-resident enterprises operating in Azerbaijan through PEs.

6.4 Social Taxes and Charges

All employers in Azerbaijan are required to contribute to the Social Protection Fund based on the gross salaries paid to employees. This tax is assessed at the rate of 27% (general rate paid by employer) payable to the Social Protection Fund. All categories of employees (except for foreign employees unless otherwise provided by interstate agreements) are also obliged to contribute and employers are obligated to withhold 2% of wages for payment to the Social Protection Fund.

Employers are not obliged to make contributions to the Social Protection Fund with respect to the income of foreign employees except as otherwise provided by interstate agreements.

6.5 Double Tax Treaties

Azerbaijan has entered into bilateral treaties for the avoidance of double taxation with 16 countries, as set out below. Where the provisions of the tax

and other relevant treaty contradict the Tax Code, the treaty provisions normally prevail:

Country	Date of Ratification by Azerbaijan
Great Britain	September 29, 1995
Pakistan	June 25, 1996
Norway	June 25, 1996
Uzbekistan	July 16, 1996
Germany	July 16, 1996
Kazakhstan	November 15, 1996
Turkey	December 27, 1996
Georgia	April 15, 1997
Poland	February 13, 1998
Russia	April 10, 1998
Moldova	December 8, 1998
Ukraine	March 24, 2000
Austria	October 24, 2000
Belarus	February 1, 2002
France	February 19, 2002
Romania	December 5, 2003

6.6 Transfer Pricing

The Tax Code introduced several detailed tests related to transfer pricing. While the presumption is that for the tax assessment purposes the price agreed to by the parties to a contract is the “market price,” there are exceptions in which the tax authorities may exercise control over the contract price. Specifically, such control may be exercised upon: (1) barter or import-export transactions; (2) transactions between affiliated parties (as defined by the Tax Code); or (3) 30% price fluctuations in transactions involving similar or identical goods, works or services.

The Tax Code also introduced certain anti-avoidance provisions, such as the limitation on deductibility of interest payable between affiliated parties; taxation of income from effectively controlled foreign corporations; *etc.*

6.7 Accounting

Azerbaijani law requires every legal entity, including PEs of foreign legal entities, to maintain accounts according to Azerbaijani accounting standards. An enterprise with foreign participation is required to submit its annual financial reports to its owners as well as to the state statistical and relevant monitoring agencies.

7. CURRENCY REGULATIONS

7.1 Introduction

Azerbaijan's national currency, the manat, was introduced in 1992. Currency regulation in Azerbaijan is carried out by the National Bank of Azerbaijan ("NBA").

7.2 Foreign Exchange

The law *On Currency Regulation*⁷ governs foreign exchange transactions and the NBA administers the overall enforcement of currency regulation. Various aspects of foreign currency regulation also cover precious metals and foreign securities, among other matters.

7.2.1 Residents

Azerbaijan's currency control legislation distinguishes between "residents" and "non-residents". Currently, more stringent requirements apply to residents. The definition of "resident" includes private individuals having a permanent place of residence in Azerbaijan and legal entities established in accordance with Azerbaijani legislation. Branches and representative offices of foreign entities established in Azerbaijan do not fall within the definition of resident.

Resident entities need the consent of the NBA to open a bank account in a jurisdiction outside Azerbaijan although they can freely open manat and foreign currency accounts with banks established in Azerbaijan. To open a foreign currency account outside of Azerbaijan, a resident must have a representative office, branch or subsidiary abroad. Permission may also be obtained in other cases when necessary for implementation of projects related mainly to foreign financing of the applicant.

Additionally, certain restrictions exist on the withdrawal or transfer of foreign currency from the accounts of residents. For instance, without specific NBA permission, residents may not withdraw more than US \$50,000 in cash or its equivalent in other foreign currency in the absence of supporting customs documents. However, residents can make such withdrawals only if they are entitled to do so under import contracts. In any case of a cash withdrawal, residents must submit a report to the bank explaining the purpose for such withdrawal.

⁷ Law No. 910 of the Republic of Azerbaijan, *On Currency Regulation*, dated October 21, 1994.

Both residents and non-residents must comply with the following requirements:

1. The manat is the only currency for payment under contracts for the sale and purchase of goods and services in Azerbaijan unless the recipient has an NBA license to render services or sell goods using foreign currency.
2. The purchase, sale and exchange of foreign currency in Azerbaijan must be carried out through authorized banks or authorized non-banking financial institutions. Transactions conducted outside these institutions are prohibited.
3. Non-residents may transfer advance overseas payments from their accounts in Azerbaijan for goods and services not in excess of US \$25,000. In certain cases, an advance overseas payments of a larger amount may be transferred with the permission of the NBA. Residents may transfer an advance payment not in excess of US \$25,000 or its equivalent in other foreign currency if this is envisioned in their contracts. An advance payment of a larger amount must be approved by the NBA.

Currency operations are divided into routine currency operations and operations involving the movement of capital. Routine currency operations include:

- transfers in payment for goods and services under import/export contracts with a term of the payment not exceeding 180 days;
- transfers in connection with financing of the export/import transactions with a term of the financing not exceeding 180 days;
- transfers of dividends, interest and other income from deposits, investments, credits and other operations; and
- non-commercial transfers, including transfers of inheritances, wages, pensions, alimony and the like.

Operations involving the movement of capital include all other currency operations that are not routine currency operations, such as:

- direct investment in entities for the purpose of deriving profit and obtaining control over the entity;

- purchasing securities;
- payments for ownership and other rights to immovable property;
- import/export transactions under credit terms of more than 180 days for payments;
- deposits by banks of currency values for more than 180 days; and
- any other currency operation not deemed as a routine currency operation.

Currency operations involving the movement of capital must be performed in a manner approved by the NBA. No such manner, however, has been established by the NBA and, in effect, no licensing of the currency operations involving the movement of capital is required at present. In principle, however, the NBA could impose such restrictions at any time.

7.2.2 Non-residents

Foreign exchange regulations are relatively less restrictive for non-residents. Non-residents are permitted to have offshore bank accounts without restriction, may deposit their funds off-shore and are not bound to sell foreign currency proceeds or submit a report upon withdrawal of foreign cash. Non-resident legal entities may purchase foreign currency on the domestic foreign currency market for routine currency operations and in other cases stipulated by legislative acts.

7.2.3 Import/Export of Foreign Currency in Cash by Individuals

Resident and non-resident individuals are treated similarly with regard to the import/export of foreign currency in cash. There are no limitations on the amount of foreign currency that an individual may bring into Azerbaijan provided that an individual declares that amount with the Azerbaijani customs authorities. Azerbaijani customs authorities must issue a certificate to an individual bringing more than US \$10,000 or its equivalent into Azerbaijan.

Upon submitting supporting documents, non-resident individuals may freely take foreign cash out of Azerbaijan in an amount equal to the amount of cash they brought into Azerbaijan and declared to customs (or otherwise legally imported). Foreign employees working in Azerbaijan may also take out business trip expenses upon presentation to customs officials of supporting documents issued by their employers.

Non-resident individuals may freely open and operate foreign currency accounts at Azerbaijani banks.

8. EMPLOYMENT

8.1 Introduction

Labor relations of all workers and employees in the Republic of Azerbaijan are regulated by the *Labor Code*, effective July 1, 1999 (the “Labor Code”), as well as other laws issued pursuant to the Labor Code.

8.2 Direct Employment

Individuals are guaranteed freedom of choice of employment according to their desires, abilities and training. It is possible for foreign legal entities operating in Azerbaijan to hire employees directly, without having to go through intermediary agencies. Employment contracts cannot provide for employee working conditions less favorable than those granted by law.

8.3 Compensation in Foreign Currency

All salaries paid in Azerbaijan must be paid in manats.

8.4 Work Books

An employer must make an appropriate notation in the work book of an employee working at his/her primary place of employment for more than five (5) days. A work book is a record of employment and is the key to establishing the employee’s rights to state-provided pension benefits. An employee entering into an employment contract (except in cases where a contract is concluded for the first time) must present his employer with his or her work book. However, this requirement does not apply to forced migrants, refugees, foreigners or stateless persons.

8.5 Probationary Period

To be effective, a probationary period must be stated in an employment contract, and the probationary period may not exceed three months.

8.6 Minimum Wage

Wages may not be lower than the minimum monthly wage. The current minimum wage is 60,000 manats (approximately US \$12) per month.

8.7 Work Week

The regular work week is forty hours; less for certain groups of people. Overtime work, as a rule, may not be required unless necessary for state defense, public safety, ensuring the supply of public utilities and in certain other situations. The duration of overtime work may not exceed a certain limit established by the Labor Code. For each hour of overtime work, an employee must be compensated at least at double his normal hourly rate.

8.8 Holidays

There are fifteen (15) official non-working days, fourteen (14) of which are public holidays and one a day of mourning. The minimum paid annual leave is twenty one (21) calendar days, more for certain groups of employees.

8.9 Sick Leave

Sick leave pay is provided by the State Social Protection Fund, not the employer.

8.10 Maternity Leave

Women are entitled to paid maternity leave for seventy calendar days prior to and fifty-six days (in certain cases seventy) after the birth of a child. Maternity leave pay is provided by the State Social Protection Fund, not the employer.

8.11 Dismissal

Grounds for dismissal include among other things: staff reduction, lack or insufficiency of professionalism and qualification to perform required employment duties and violation of employment duties as determined by the employment contract. There are certain restrictions for dismissal of certain categories of employees. Also, in certain cases, an employer must report an employee's dismissal to the appropriate state authorities.

8.12 Cost of Employment

Employers are required to pay social security contributions as described in section 6.4 on behalf of its employees.

8.13 Income Tax

The employer is obliged to withhold income taxes for its employees as described in section 6.3.2 and certain social contributions as described in section 6.4.

8.14 Foreign Workers in Azerbaijan

Foreign employees who are employed by enterprises (affiliates or representations) operating in Azerbaijan are subject to Azerbaijani labor law, except for those who work in enterprises, branches or representative offices located in Azerbaijan under employment contracts concluded with a foreign person or legal entity in a foreign state.

To work in Azerbaijan, foreigners must register at his/her place of residence and obtain a work permit. Work permits are issued by the Ministry of Labor and Social Protection of the Population. The requirement to obtain the work permit does not apply to the heads of representative offices and branches of foreign legal entities and their deputies.

9. ACQUIRING RIGHTS TO OWN AND USE LAND

9.1 Introduction

Legislation regulating land rights in Azerbaijan consists of the Civil Code, Land Code of the Republic of Azerbaijan dated June 25, 1999 (the “Land Code”), the law *On Land Reform*, dated July 16, 1996 (the “Land Reform Law”), the law *On Land Lease*, dated March 17, 1999 (the “Land Lease Law”), the law *On the Land Market*, dated May 7, 1999 (the “Land Market Law”) and other legislative acts adopted pursuant thereto. Land rights are also regulated by the relevant provisions of the Civil Code.

Except for the Land Reform Law, other laws regulating land use are relatively new and have not yet been implemented in practice. The regulations to be adopted pursuant to them are still pending before various state authorities. In some instances, the mechanism for effecting certain provisions of the laws has not been established.

9.2 Limitations on Ownership

The Land Code recognizes state, municipal and private ownership of land in Azerbaijan. All types of the ownership rights are equal. Only Azerbaijani citizens and Azerbaijani legal entities (including enterprises with foreign investments) may legally own land in Azerbaijan. International organizations, foreign legal entities and foreign citizens and states may only lease land in Azerbaijan and may not be granted purchase option in the lease.

Certain categories of land parcels are in the exclusive ownership of the state or municipalities and can be only leased by or granted to the use of private persons. Individuals can own land within the limits established by law.

9.3 Use of Land

In addition to ownership, the Land Code recognizes perpetual and temporary land use rights, lease rights and easements.

A perpetual or temporary land use right is granted free of charge. The temporary land use right is granted for up to 99 years and can be prolonged by the parties. The perpetual land use right is granted for an indefinite period. The right-holder pays only the land tax for the land use. The state and municipalities grant perpetual and temporary land use right only in exceptional

circumstances to a limited number of persons listed in the Land Code. Landowners can grant perpetual or temporary land use right under the agreement with a land user. The land use terms are defined by an agreement between the landowner and the land user.

Land lease is the use of land for a definite period for charge. Leases are concluded for the period agreed by parties. Rent payments for the lease of privately held land parcels are freely negotiable. Rent payments for state or municipally owned land parcels are determined according to the market conditions but cannot be less than the specified statutory rent. For agricultural land, discounts from statutory rents are available depending on the market conditions in the agricultural sector.

Landowners and holders of a perpetual or temporary land use right, if the conditions of the land use so provide, can be lessors. Under the Land Lease Law, foreign individuals and legal entities can only be lessees or sub-lessees of land plots. Purchase option provisions in land lease agreements concluded with foreign individuals and legal entities and enterprises owned by foreign individuals and legal entities are prohibited.

Lessees can sub-lease the leased land parcels unless the lease prohibits this.

An easement is a right to the restricted use of a third party's land parcel. It can be established by agreement between interested parties or by court. Generally, the easement holder must pay for the easement right, unless otherwise provided for by law. Easements established on agrarian lands for enterprises or individuals engaged in agriculture are free. Upon the transfer of the land or land use right, the easement rights remain in place.

9.4 Land Transfers

Landowners have the right to transfer their land by sale, contribution to charter capital, mortgage, exchange, grant or by other means, subject to certain restrictions established by law. A foreign owner must sell a land parcel within one year if the land parcel was transferred to a foreigner as a result of inheritance, gift or foreclosure. State or municipal authorities, as the case may be, have the right to enforce a mandatory sale if a foreigner fails to comply with this requirement.

The state or municipalities, depending on the status of the land, can transfer land parcels from the state or municipal fund respectively into ownership or use

of citizens and legal entities of Azerbaijan with or without payment. Certain land parcels of the state or municipal fund cannot be transferred into private ownership. Land users and lessees have the right to transfer their land use rights subject to restrictions that may be imposed by the landowner.

The value of land set forth in land transactions must correspond to its market value and, in any case, cannot be less than the minimum statutory value fixed by law.

All land use rights, including easements and servitudes, and transactions therewith are subject to state registration. Land transactions between private persons are subject to notarization. Transactions relating to state owned land parcels and rights to use of such parcels must also be registered in the Register of State Owned Property kept by the Ministry of Economic Development.

10. LANGUAGE POLICY

Under the Constitution of Azerbaijan and the law *On the State Language*, effective January 4, 2003 (the “State Language Law”), the state language is Azerbaijani. This is the official language of administration, legislation, court proceedings and record keeping in all state agencies, state-owned enterprises and organizations and business or other entities in Azerbaijan.

Unofficial interpersonal communications are not required to be in the state language. However, all state bodies, local authorities, state agencies, political parties, non-governmental organizations (funds and public associations), trade unions as well as legal entities (including their representative or branch offices) must use Azerbaijani in their official interactions and transactions. Any notarization, legalization, registration or other forms of formalization of a foreign language document requires translation into Azerbaijani with subsequent notarization of the translation.

Seals and stamps of entities operating in the Republic of Azerbaijan must be in Azerbaijani. Letterhead, signs, announcements, advertisements, price lists, price tags, labels, certifications and instructions to goods produced in Azerbaijan and other visual information must be in Azerbaijani and, additionally, may be in other languages where necessary or desirable. However, for services rendered to foreigners, a foreign language may be used together with Azerbaijani.

Pursuant to the Presidential Decree, *On the Further Use of the State Language*, dated June 18, 2001, and the State Language Law, mass media in Azerbaijani must use the Latin alphabet as opposed to the Cyrillic alphabet used during the Soviet era. This requirement is also applicable to advertising.

11. CIVIL LEGISLATION

The Civil Code, adopted on December 28, 1999, and effective of September 1, 2000, is the foundation of civil legislation in Azerbaijan. Article 2.6 of the Civil Code establishes the supremacy of the Civil Code over other legislative acts that regulate civil relations. Other legislative acts that regulate civil relations are only applicable to the extent that they do not contradict the Civil Code.

The Civil Code consists of two parts: General and Special. The articles of the General Part include provisions applicable to legal entities, property and property rights, rules governing enforcement of obligations, and the conclusion, validity and termination of contracts.

Among provisions applicable to legal entities are provisions generally regulating different types and organizational forms of legal entities and the main principles of the legal entity's establishment, state registration, management, activity, liquidation and reorganization. Investors should also be aware of the Civil Code's provisions applicable to inventory of assets of legal entities, compilation of the balance sheet and the audit of legal entities.

The Civil Code has introduced two important principles for immovable property transactions: the principle of state registration of the rights to immovable property and the principle of certification of immovable property transactions by notary public. Previously, the state registration and notary certification was mandatory only with respect to certain types of immovable property transactions.

The Special Part contains different sets of rules governing particular types of contracts. Apart from types of contracts that were regulated in the old Civil Code (sale and purchase, lease, loan, commission, transportation, storage and supply), the Civil Code regulates certain new types of contracts, such as franchise and concession. It also regulates inheritance and reimbursement for damage caused through contractual or non-contractual relationships and general aspects of transactions with different types of securities.

Unlike the old Civil Code, the Civil Code addresses intellectual property rights only in general terms and does not address conflict of laws in international transactions. Rather, these have been left for detailed regulation by specific legislative acts.

12. BANKING AND FINANCE

12.1 Description of the Banking System

Banking in Azerbaijan is regulated by the law *On Banks and Banking*⁸ and the law *On the National Bank*.⁹ Banks and credit organizations are covered by the general notion “credit organization.” While banks are allowed to carry out all types of banking operations, credit organizations are still subject to the NBA’s regulations and may conduct only certain types of banking operations. A new law on banking is currently under discussion.

Azerbaijan has a two-tiered banking system, with the NBA comprising the first tier and the remaining banks comprising the second tier.

The NBA is the national central bank and a legal entity with independent status, capitalized at 15 billion manats. It operates as the central banking authority with supervisory control over the banking sector. The main objective of the NBA is to establish and implement the state monetary and currency policy. Maintaining domestic and external stability of the manat is one of the most important parts of the current monetary policy.

As the banking supervisory authority, the NBA issues licenses for banking operations, establishes minimum charter capital and net worth requirements, and other prudential requirements for second-tier banks. The NBA also sets the requirements for professional qualifications of the senior management and accounting personnel of second-tier banks, including branches of foreign banks.

The NBA reports to the president of Azerbaijan. Upon nomination by the president, the National Assembly appoints the seven-member board of the NBA. The president appoints the chairman from among the board members, approves annual reports, appoints auditors and has the right to demand any information related to the NBA’s activity.

Currently, there are approximately 47 banks registered in Azerbaijan, including 15 banks with foreign participation.

⁸ Law No. 123-IQ of the Republic of Azerbaijan, *On Banks and Banking*, dated July 14, 1996, as amended.

⁹ Law No. 118-IQ of the Republic of Azerbaijan, *On the National Bank of the Republic of Azerbaijan*, dated June 10, 1996.

12.2 Licensing

All banking activities, including the acceptance of deposits, maintenance of correspondent accounts, cash operations, money transfers, and lending, *etc.*, are subject to licensing. Only the NBA has the right to grant licenses for banking activity.

12.3 Reformation of the Banking System

The banking system has recently undergone reform with the state consolidating nearly insolvent second-tier banks owned by the state. The consolidation should help to eliminate redundancy in the bank branch network.

The state holding in the largest bank in Azerbaijan, the International Bank of the Republic of Azerbaijan, has also been made subject to partial privatization. A 20% percent stake is currently in the process of being sold to a multilateral financial institution.

12.4 Standards for Domestic Banks

The Management Board of the NBA establishes standard prudential requirements (including minimum capital and the ratio between monetary and non-monetary portions of a bank's capital) and reserve fund requirements.

The senior management of banks (the chairman of the board and his/her deputies, the chief accountant, the head and chief accountant of branches) are subject to certain compulsory standards. The NBA must certify persons in the management of a bank and its branches who have been given the authority to sign documents in the name of the bank.

Banks are restricted from engaging directly in insurance, commercial and manufacturing activities.

12.5 Banks with Foreign Participation

Foreign banks may operate representative offices, branches, joint ventures, and wholly-owned subsidiaries in Azerbaijan. Representative offices may not obtain a banking license.

In addition, foreign individuals and foreign entities that are not banks may set up, operate and acquire shares in banks in Azerbaijan. Azerbaijani law does not define the term "bank with foreign participation," so this term should be

broadly construed to embrace virtually all banks with foreign capital regardless of the amount of the foreign share.

Banks with foreign participation are subject to restrictions set for domestic banks as well as to certain additional restrictions. For example, the general manager or his/her deputy of a bank with foreign participation or its branches must be a citizen of the Republic of Azerbaijan. Furthermore, the total capital of banks with foreign participation must not exceed a certain percentage (determined by the NBA on a regular basis¹⁰) of the aggregate capital of all banks in Azerbaijan. For this purpose, a bank in which more than 50% of its paid capital is owned or attributed to foreign individuals or entities is considered to be a bank with foreign participation.

12.6 Liquidation and Reorganization of Banks

Banks may be liquidated or reorganized upon the revocation of their licenses by the NBA, by court order, or by a voluntary decision of the bank. Revocation by the NBA of the banking license triggers general liquidation procedures as provided for by corporate laws. The NBA may also conserve nearly bankrupt banks to protect them from further loss or damage for a period of up to 18 months.

12.7 Non-Banking Activity of Banks

Banks may carry out the following non-banking activities subject to NBA consent and obtaining a license from the relevant license issuing authority:

- suretyship;
- asset management;
- factoring; and
- other activity in accordance with applicable law.

¹⁰ Typically this ranges from 20 to 30%.

13. INTELLECTUAL PROPERTY

13.1 Introduction

In 1996 and 1997, Azerbaijan began to implement a national system for registering and protecting intellectual property rights. Intellectual property rights in Azerbaijan include: (i) all rights to industrial property (including inventions, industrial designs, utility models, trademarks and geographic names); and (ii) copyright and related rights. Current law pertaining to intellectual property includes the laws *On Copyrights and Related Rights*¹¹ (the “Copyright Law”), *On Trademarks and Geographic Names*,¹² *On Patents*,¹³ and on *Topology of Integral Schemes*.¹⁴

13.2 State Patent Issuing Agencies

There is no central state agency that deals with protection of all rights related to intellectual property. Under Azerbaijani law, the Cabinet of Ministers is empowered to authorize various state agencies to register and protect intellectual property rights in respective areas. The State Agency for Standardization, Metrology and Patents is the main agency that issues a patent for industrial property rights. The procedure for registering and protecting various intellectual property rights differs from one state agency to another.

13.3 International Conventions

Azerbaijan is a party to several international agreements including the *Convention Establishing the World Intellectual Property Organization*; the *Paris Convention for the Protection of Industrial Property*, the *Madrid Agreement Concerning the International Registration of Trade Marks*, the *Patent Cooperation Treaty* and the *Eurasian Patent Convention*.

¹¹ Law No. 438-IQ of the Republic of Azerbaijan, *On Copyrights and Related Rights*, dated October 8, 1996.

¹² Law No. 504-IQ of the Republic of Azerbaijan, *On Trademarks and Geographic Names*, dated June 12, 1998.

¹³ Law No. 312-IQ of the Republic of Azerbaijan, *On Patents*, dated June 10, 1997.

¹⁴ Law No. 337-IIQ of the Republic of Azerbaijan, *On Topology of Integral Schemes*, dated May 31, 2002.

13.4 Registration

Azerbaijan is a “first to file” and not a “first to use” jurisdiction, meaning it is important to register as soon as possible to protect intellectual property rights in Azerbaijan.

13.5 Patent Protection, Utility Models and Industrial Designs

Patent protection is granted to an invention if it is novel, inventive and useful. The maximum duration of protection for an invention patent is 20 years.

Utility models are granted patent protection if they are new and “industrially applicable.” The term of utility patents is 10 years.

An industrial design right is characterized by an artistic and structural form which determines its external appearance. Patent protection is granted if an industrial design is novel, original and capable of industrial application. The term is ten years.

Patents may be assigned and/or licensed by their owner(s) to natural persons or legal entities. However, an assignment must be registered with the relevant state agencies to be valid. Infringement carries civil, criminal and administrative liability.

13.6 Trademarks and Geographic Names

The right to a trademark is based on registration with the respective state agencies. Trademark registration is granted for a term of ten years, renewable every ten years. Assignments of licenses for trademarks and geographic names must be registered with the relevant state agencies.

Legal protection is given to the appellation of origin of goods based on its registration with the relevant state agencies, and to trademarks existing under international agreements on the registration thereof or bearing the status of a known trademark. A violation of rights carries civil, criminal and administrative liability.

13.7 Copyrights

The Copyright Law protects works of science, literature and the arts (copyrights) as well as stage productions and phonograms of radio broadcasting or cable broadcasts and computer programs and databases (allied rights). Copyright protection is normally granted to the author without any registration requirements. The right to use a copyrighted work may be

assigned. A copyright provides protection for the lifetime of the author and normally for a period of 50 years following his or her death.

13.8 Computer Programs and Database

Rights to computer programs, databases and topology of integral schemes are protected under the Copyright Law and the law *On Topology of Integral Schemes*. The unauthorized re-creation (copying) of computer programs, alteration of existing programs and unlawful accessing of legally protected computer information are criminal offenses.

14. PRODUCT LIABILITY

14.1 Product Liability

Product liability is an emerging legal concept in Azerbaijan. The new Civil Code of Azerbaijan and the law *On Consumer Protection*, dated September 19, 1995 (the “Consumer Protection Law”), govern product liability. The Consumer Protection Law addresses basic consumer issues governing: (i) the right to enter into agreements to purchase goods and services; (ii) the quality and safety of goods and services; (iii) information concerning goods and services; and (iv) the right to protect consumer rights in court and be reimbursed for damages caused by any defects including moral damages.

Azerbaijani Civil Code recognizes an implied warranty of merchantability and implied warranty of fitness for a particular purpose. A seller or supplier of merchandise, however, is liable for any defects in its merchandise covered by the warranty only within the warranty period specified by contract. If merchandise is sold to a purchaser without any warranty, the seller of such merchandise is liable for any latent defects of its merchandise for a “reasonable time” after such defects are discovered by the purchaser but not later than two years from the date that the merchandise was transferred to the purchaser’s physical possession.

Sellers and manufacturers may not, directly or indirectly, restrict any consumer protection rights guaranteed under the Civil Code and Consumer Protection Law. Provisions of agreements that restrict such rights are void. Sellers and manufacturers are obliged to ensure proper quality of the product and have a duty to inform the consumer of any possible defects.

A consumer may claim compensation against a seller and/or manufacturer when a defect exists, the consumer has received unreliable or incomplete information concerning the product, or the product has caused injury to health, life or property. The Consumer Protection Law obliges the court to consider the issue of compensation for moral damages when satisfying consumer claims.

14.2 Product Quality

Proper quality is determined by legislative norms and technical specifications applicable to a particular product. Certain goods are subject to mandatory certification by state agencies in accordance with the procedure established by

legislation. Advertisement and distribution of goods without such certification is prohibited.

14.3 Protection from Unfair Competition

In accordance with laws pertaining to competition and monopolies, the following activities constitute unfair competition:

- Spreading false or incorrect information about the goods and services of a competitor;
- Misleading customers as to the function, place of origin, features, usefulness or quality of goods;
- False advertising;
- Unfair comparison of goods in advertising;
- Unauthorized use of trademarks, names of companies or the marking of goods as well as copying the shape, packaging or appearance of goods of another legal entity;
- Unauthorized receipt, use, or divulgence of confidential information, including trade secrets;
- Unauthorized receipt, use or divulgence of confidential research and development, production or trade information including commercial secrets without the consent of the owner;
- Price-fixing and other business acts designed to limit competition;
- Mergers of companies designed to limit competition; and
- Restriction of the rights of consumers by the sole distributors of a product by virtue of their market position.

These laws, together with the civil, administrative and criminal legislation of Azerbaijan, provide for protection against unfair competition.

15. SPECIFIC INDUSTRIES

15.1 Oil and Gas

15.1.1 Introduction

Subsoil resources such as oil and gas are the sole and exclusive property of the Azerbaijani state. Rights to engage in subsoil activity may be granted to Azerbaijani citizens and entities as well as to foreign individuals and legal entities.

The primary legislative act regulating subsoil use in Azerbaijan is the law *On Subsoil Reserves* (the “Subsoil Law”).¹⁵ The Subsoil Law governs exploration, use, protection, safety and supervision over the use of subsoil reserves located both within Azerbaijan and the sector of the Caspian Sea belonging to it. Therefore, the Subsoil Law implicitly endorses the sector division of the Caspian Sea although the dispute among the littoral states over the methods of the Caspian’s division has not yet been resolved.

15.1.2 Oil and Gas Legislation

In the absence of any specific oil and gas legislation in effect, the main legislative acts regulating the oil and gas industry in Azerbaijan is the Subsoil Law and the law *On Energy* (the “Energy Law”).¹⁶ A draft law *On Oil and Gas* is currently being reviewed by working groups within the government and the industry. This process, however, appears to have slowed considerably.

15.1.3 Licenses

Under the Subsoil Law, no person or legal entity may engage in oil or gas exploration and production without a license. Licenses are awarded by tender, auction or, in exceptional cases, negotiation. Tenders may be open or closed, and licenses are available to foreign investors in the areas of exploration or production or both.

Whereas a license for exploration may be issued for a term of up to five years, a license for production is issued for a period of up to 25 years. A combined license for exploration and production is issued for a period of up to 30 years.

¹⁵ Law No. 439-IQ of the Republic of Azerbaijan, *On Subsoil, Reserves*, dated February 13, 1998.

¹⁶ Law No. 541-IQ of the Republic of Azerbaijan, *On Energy*, dated November 24, 1998.

The effective terms of each of the exploration, production, and combined licenses may be extended, subject to the subsoil user's compliance with the terms of the license. Such an extension may be granted for a term agreed between the subsoil user and the licensor. An existing license holder acquires a preemptive right upon obtaining the extension.

The Subsoil Law outlines the following requirements to be met by the subsoil user in order to obtain the license and operate thereafter:

- win a tender or auction or, in exceptional cases, to directly negotiate the terms of a license;
- secure preliminary consent of the owner of the land situated above the subsoil structure;
- obtain a license;
- in the case of a production license, submit technical plans for state expert evaluation and agree on the production lot size with the relevant agencies. The detailed description of the production lot is attached to the license;
- obtain the right to use the parcel of land situated above a subsoil structure;
- obtain a permit for construction work to be performed in connection with subsoil use;
- register any subsoil use operations with the state registrar; and
- in the case of exploration, an expert evaluation by the relevant state authority is necessary with respect to: (i) conditions for availability of minerals; (ii) reserves of minerals; and (iii) information on subsoil structures suitable for underground construction not related to commercial recovery (production).

The license and the rights contained therein may not be assigned to third parties except as provided by Azerbaijani legislation. Succession of subsoil use rights or a change of the subsoil user's name will entail re-issuance of the license.

The license may be terminated in the following circumstances:

- expiration of the term of the license;
- withdrawal of the subsoil user from the project ; or
- revocation of the license by the licensor under certain conditions, including liquidation of the subsoil user.

In the case of a subsoil user's withdrawal, the subsoil user is obliged to reimburse the licensor for damages caused by such withdrawal. The measure of damages, however, is not determined.

A subsoil user may appeal to a court a decision to revoke a license.

15.1.4 Contracts

The Energy Law stipulates among other things that the production rights to a specified lot (block) are granted on the basis of an "energy contract." However, under the Subsoil Law such rights are granted solely by license. Therefore, there are certain contradictions between the Subsoil Law and the Energy Law. Given the fact that neither of these laws has thus far been tested (nor, in some instances, especially in the oil and gas sector, even implemented), it is not clear how the above contradictions as well as others will be reconciled in theory and practice.

So far, all major oil and gas deals have been made on the basis of production sharing agreements ("PSA"). While the regulations of the newly established Fuel and Energy Ministry suggest that the oil and gas matters are generally vested in this Ministry, the State Oil Company of the Azerbaijan Republic ("SOCAR") continues to play an important role with respect to such matters.

After a contract with a subsoil user is signed, the contract is then submitted to the National Assembly, which adopts a law on approval of the contract. This procedure is outlined in the Foreign Investment Law, which has been the legislative mainstay in the regulatory framework for PSAs.

Below is a list of the major oil and gas PSAs concluded between the government of Azerbaijan and foreign companies:

Azeri, Chyrag, Gunashly

This agreement was signed on September 20, 1994, and was ratified by the National Assembly on December 2, 1994. The contract area includes the Azeri, Chyrag and the deep-water portion of the Gunashly offshore fields. Oil reserves in the contract area are 630 million tons. The required capital investment amount is up to US \$12 billion. Production was commenced in November 1997. The consortium led by BP now includes ten companies:

- BP (34.0%; UK)
- Unocal (10.3%; US)
- Inpex (10.0%; Japan)
- Statoil (8.6%; Norway)
- ExxonMobil (8.0%; US)
- TPAO (6.8%; Turkey)
- Devon Energy (5.6%; US)
- Itochu (4.0%; Japan)
- Delta Hess (Delta Oil (Saudi Arabia)/Amerada Hess (US)) (2.7%)
- SOCAR (10.0%)

Shah Deniz

The Shah Deniz agreement was signed on June 4, 1996, and was ratified by the National Assembly on October 4, 1996. The contract area includes the Shah Deniz offshore field. The US \$4 billion project is for a block with estimated oil reserves of 200 million tons and gas reserves of 50 billion cubic meters. Recent findings suggest gas and condensate reserves to be very large. On February 27, 2003, the project participants sanctioned the first stage of the field's development. BP acts as the operating company for Shah Deniz. The Shah Deniz group includes:

- BP (25.5%; UK)
- Statoil (25.5%; Norway)
- OIEC (10.0%; Iran)
- LUKAgip (10.0%; Russia/Italy)

TotalFinaElf (10.0%; France)

TPAO (9.0%; Turkey)

SOCAR (10.0%)

D-222 (Yalama-Deniz)

LUKoil and SOCAR signed this agreement on July 3, 1997, for the Yalama-Deniz offshore field which was ratified on November 4, 1997. Estimated oil reserves of this offshore field are 100 million tons and require approximately US \$2 billion investment. The participants are:

LUKoil (80.0%; Russia)

SOCAR (20.0%)

Nakhchivan

This agreement was signed on August 1, 1997, in Washington D.C. and was ratified by the National Assembly on November 14, 1997. The contract area includes the Nakhchivan field, consisting of three deep-water fields: D-3 (Rasulzade), D-9 (Vezirov), and D-38 (Shimali Vezirov) with estimated reserves of 78 million tons of oil and 172 billion cubic meters of gas. The project calls for US \$2 billion investment. The participants are:

ExxonMobil (50.0%; US)

SOCAR (50.0%)

South Western Gobustan

This contract was also signed on June 2, 1998, in Baku and was ratified by the National Assembly on November 13, 1998. The estimated reserves of this onshore field are 50-70 million tons of oil and 25 billion cubic meters of gas. The amount of investment is US \$0.9 billion. The participants include:

CNPC (50.26%; China)

Commonwealth Oil & Gas (29.74%; Canada)

SOCAR (20.0%)

Araz, Alov and Sharg

This contract was signed on July 21, 1998, in London originally among BP, Statoil and SOCAR. Later on, 10.0% share participation was transferred by SOCAR to TPAO (Turkey), 5.0% to Alberta Energy (Canada) and 15.0% to ExxonMobil (US). The contract was ratified as law on December 18, 1998. The estimated reserves of these offshore structures are 300 million tons of oil requiring up to US \$9 billion investment. Current participants are:

BP (15.0%; UK)
Statoil (15.0%; Norway)
ExxonMobil (15.0%; US)
TPAO (10.0%; Turkey)
Alberta Energy (5.0%; Canada)
SOCAR (40.0%)

Inam

This contract was also signed on July 21, 1998, in London and was ratified on December 1, 1998. The estimated reserves of this offshore structure are 200 million tons of oil and require up to US \$2 billion of investment. The participants are:

BP (25.0%; UK)
Royal Dutch Shell (25.0%; UK/Netherlands)
SOCAR (50.0%)

Kursangi and Garabaghly Fields

The PSA for these onshore fields was signed on December 15, 1998, in Baku and ratified as law on April 16, 1999. The project calls for approximately US \$1 billion of investment. The approximate reserves of oil are 100 million tons. The participants are:

CNPC (30.0%; China)
Delta Hess (Delta Oil (Saudi Arabia)/Amerada Hess (US))
(10.0%/10.0%)
SOCAR (50.0%)

Yanan Tava, Ateshgah and Mughan-Deniz

The contract regarding this offshore block with estimated reserves of 100 million tons of oil was signed on December 25, 1998, in Baku and was ratified by law of June 11, 1999. The project is a joint undertaking between SOCAR and Japanese companies and calls for US \$2 billion of investment. The participants are:

- Japan Petroleum (JAPEX) (22.5%; Japan)
- Indonesia Petroleum (INPEX) (12.5%; Japan)
- Itochu Oil Exploration (7.5%; Japan)
- Teykoku Oil (7.5%; Japan)
- SOCAR (50.0%)

Zafar and Mashal

The contract for these offshore structures with estimated reserves of 120-140 million tons of oil was signed on April 27, 1999, in Washington and was ratified by law of April 21, 2000. Required investment is US \$2 billion. The participants are:

- ExxonMobil (30.0%; US)
- Conoco (20.0%; US)
- SOCAR (50.0%)

Lerik-Deniz, Dalga, Savalan and Jenub

The contract for these offshore structures was also signed on April 27, 1999, in Washington. Estimated reserves are 120 million tons of oil. The required investment is US \$2 billion. The shares comprise:

- ExxonMobil (30.0%; US)
- SOCAR (50.0%)

Padar Harami

The contract for this onshore prospective block was signed on April 27, 1999 in Washington and was approved into law on June 9, 2000. Required investment is estimated at US \$1 billion. Estimate of reserves are 20-30 million tons of oil. Shares are effectively as follows:

Nations Energy (80.0%; Canada)

SOCAR (20.0%)

Kelameddin Mishovdag

These onshore fields were initially developed under a joint venture structure, however, by the contract signed on September 12, 2000, were transferred under a PSA regime. The PSA was ratified by law of October 25, 2000. Estimated recoverable reserves of the fields are 10 million tons of oil. Shareholders are:

Nations Energy (85%; Canada)

SOCAR (15%)

Zykh and Hovsan

The contract for the block of these onshore fields was signed on January 9, 2001 in Baku. The contract also includes the rehabilitation stage on these fields with the remaining reserves around 20 million tons of oil. Shareholders are:

LUKoil (50.0%; Russia)

SOCAR (50.0%)

Baku-Tbilisi-Ceyhan Oil Pipeline

On November 18, 1999, the Governments of Azerbaijan, Georgia and Turkey concluded the Intergovernmental Agreement relating to the transportation of petroleum across those countries through the Baku-Tbilisi-Ceyhan Main Export Pipeline ("BTC"). The BTC oil pipeline will deliver the oil produced from the oil fields in the Caspian Sea to the world markets. Construction in Azerbaijan and Georgia started in 2003. The BTC project will cost approximately \$2.95 billion. The first oil deliveries to the world markets are expected in early 2005.

On August 1, 2002, the BTC participants established BTC Co. to build and operate the BTC oil pipeline. BP operates BTC Co. and SOCAR president is the chairman of BTC Co's ruling board.

The participants are:

BP (30.1%)

SOCAR (25%)

Unocal (8.9%)
Statoil (8.71%)
TPAO (6.53%)
Eni (5%)
Itochu (3.4%)
ConocoPhillips (2.5%)
Inpex (2.5%)
TotalFinalElf (5%)
Amerada Hess (2.36%)

Pirsaat

The contract for the onshore field Pirsaat was signed on June 4, 2003, and ratified on 2 December 2004. Estimates of reserves are 7 million tons of oil. The shares comprise:

Sheng Lee Oilfield (50.0%; China)
Middle East Petrol Farm (30.0%; UAE)
SOCAR (20.0%)

15.2 Power

15.2.1 Legislation

The main legislative acts in the Republic of Azerbaijan which regulate the power sector are the *Energy Law*, the law *On the Use of Energy Resources* (the “Energy Resources Law”) dated May 30, 1996, the law *On Electrical Energy* (the “Electricity Law”), dated June 13, 1998 and the law *On Electricity and Heat Power Stations*, dated December 28, 1999.

Legislation in the power sector is relatively new and has not yet been fully implemented. Therefore, many provisions of these laws outline the intentions of the state with respect to restructuring the power sector of Azerbaijan and do not reflect its present real condition.

Under the Electricity Law, the energy system of the Republic of Azerbaijan will consist of:

- the State Electrical Enterprise¹⁷ which joins transmission lines of more than 110 kV, dispatching centers and energy production enterprises which are subordinate to the State Electrical Enterprise. The State Electrical Enterprise purchases energy produced by independent energy producers for its further transportation through its transmission network and conducts interstate energy exchanges;
- energy suppliers owned by the state or private persons that purchase electricity from the State Electrical Enterprise or other independent energy producers and sell it to consumers; and
- independent energy producers owned by the state or private persons that generate energy and supply it to consumers directly through their own distribution networks or via the State Electrical Enterprise or energy suppliers. They may export their energy as well.

15.2.2 Elimination of State Monopoly in the Power Sector

The state undertook steps in unbundling of Azerenerji and eliminating state monopoly in the power sector to create the above structure of the Azerbaijani power system. Pursuant to presidential orders, Azerenerji was instructed to transfer distribution networks to private companies. At present, distribution networks of Azerbaijan, except the network of Nakhchivan Autonomous Republic, are operated by private companies under long-term management contracts.

Certainly, the transfer of Azerenerji's distribution assets to newly created distribution companies and transfer of these companies into long-term management is the first step in reforming the power sector of Azerbaijan. Following the management, privatization of the power distribution companies is expected.

While the Government still hesitates to privatize large distribution or generation companies, it has already started the privatization of smaller-scale generation assets. Currently, pursuant to presidential decree dated December 21, 2001, nine small hydro power plants belonging to Azerenerji are open for privatization.

¹⁷ Currently, the functions of a State Electrical Enterprise are performed by the state-owned JSC Azerenerji.

15.2.3 Regulatory State Agency

For a long time, implementation of the legislation in the power sector has been complicated by, among other things, the absence of a state agency that performs functions such as issuance of relevant licenses, tariff regulation and conclusion of contracts with investors. Creation of such regulatory agency became an urgent issue by 2001 in light of the mentioned developments in the power sector.

On April 18, 2001, the president issued the decree *On Establishment of the Ministry of Fuel and Energy of the Republic of Azerbaijan*. On September 6, 2001, the President approved the Regulations of the Ministry of Fuel and Energy (“MFE”). Under the Regulations, MFE is to assume certain functions and authorities of each of SOCAR, Azerenerji and Azerigaz. For instance, pursuant to the Regulations, MFE is to represent the state in PSAs and act as a licensing authority in the fuel and energy sector. The matters within the Ministry’s competence include the preparation and implementation of state policy in the fuel and energy complex, including production, transportation and processing of oil and gas. Specifically, Ministry prepares, negotiates, executes and oversees implementation of the production sharing or other agreements on behalf of the state with respect to the development of hydrocarbon reserves in the Republic of Azerbaijan. Further, on the instruction of the President, the Ministry represents the State in the oil and gas production sharing agreements enacted prior to the approval of the Ministry’s regulations.

15.2.4 Licenses

Under the Energy Law, to enter the power market, a foreign investor must obtain a permit to do so and, thereafter, conclude a contract with authorized state agencies to conduct certain activities. After the contracts are concluded, the contractors must have their business plans approved by the central and local state executive authorities.

As a general rule, special permissions to carry out activity in the power sector are granted and the contractors are determined on a tender basis. The Electricity Law requires that individuals and legal entities must obtain special permission for conducting activities in generating, transporting and distributing electricity. Such permission is issued by the relevant executive authority pursuant to an application of any interested party. In order to obtain special permission, an applicant is required to meet the quantitative needs for electrical energy, provide for an economical and effective supply of electricity within the boundaries of the area, and prevent possible damage to

the environment and historical and cultural monuments. In addition, to obtain special permission, information of technical and financial character must also be provided.

All power projects and production, technological processes and services, facilities and devices connected with or related to the use of energy resources, their production, transmission and consumption are subject to mandatory certification, i.e., confirmation that they comply with the established norms and standards including ecological, sanitary-hygiene, fire, construction, health and safety standards. Additionally, the major projects defined in the Energy Resources Law require a feasibility examination by the state commission created for such purposes.

15.2.5 Consumption and Distribution

The laws provide that consumers will have the right to choose any energy supplier regardless of its location. Energy is supplied under agreements between consumers and energy suppliers. Agreements on sale and purchase, transportation and exchange of electricity and heat must comply with the Rules on the Use of Electricity and Heat. Energy consumption is subject to mandatory metering.

The procedure for disconnecting consumers from the network or termination of power supply is regulated by the Rules on the Use of Electricity and Heat as well as by agreements with consumers. Suspension of power supply or disconnection of some consumers is prohibited. The list of such consumers is determined by an authorized state agency.

Under the Energy Resources Law, independent power generating facilities are granted the right to use the state-owned energy supply system in order to transport electricity. Distribution network enterprises are obligated to grant such access at tariffs and under conditions established by law on a non-discriminatory basis. These enterprises, however, have the right to refuse to connect a consumer to the network in exceptional circumstances.

In order to transport and distribute electricity and heat to consumers within a certain area it is necessary to conclude an agreement with municipal and state authorities in addition to obtaining permission. The agreement is concluded for a fixed period but for not more than 30 years and specifies the particular area within which the distributor has the right to operate.

Termination of the operations stipulated in the agreement without the consent of state authorities is prohibited.

15.2.6 Anti-Monopoly Regulation

Entities and facilities in the unified energy system engaged in power production, transportation, distribution and supply are considered to be natural monopolies. Their activities are regulated by the state. The list of measures that the state can take to regulate the activity of natural monopolies is not exhaustive.

Setting prices and tariffs, determining the list of customers to whom the natural monopolies must serve or are required to provide with a minimum power supplies, reviewing investments made by natural monopolies and issuing permits for effectuating certain types of transactions are the methods of regulating activities of natural monopolies. The particular methods are determined and taken by the state with respect to each natural monopolist individually.

The following tariffs for electricity and heat are subject to state regulation:

- tariffs applicable to purchases of electricity/heat by producers;
- electricity/heat wholesale tariffs;
- retail electricity/heat tariffs; and
- import-export electricity tariffs.

The Electricity Law requires that the tariffs must cover all costs connected with generation, transportation and distribution of power and must ensure profitability of power enterprises and development of the energy sector under conditions of natural growth of energy consumption. Typically, retail tariffs are differentiated by two categories of consumers: household consumers and other consumers.

Tariffs are calculated by the power enterprises and approved by the relevant state authorities. Given that MFE has been recently established, presumably, the bulk of authority in power tariffs regulation and approval will be transferred to MFE.

15.2.7 Incentives in the Power Sector

Investment incentives for foreign investors in the power sector include those generally available under the Foreign Investment Law as well as additional incentives in the form of subsidies, tax, credit or other benefits available under the Energy Resources Law to implement energy saving policies and projects.

15.3 Telecommunications

Telecommunications is an area of great potential growth in Azerbaijan. Legislation pertaining to the telecommunications industry has been developing at a rapid pace. The law *On Communications*¹⁸ (the “Communications Law”) is the main legislative act regulating the industry.

Pursuant to Presidential Decree No. 782, *On Improving the License Issuance Rules for Some Types of Activity*, dated September 2, 2002, telecommunications services must be licensed. The Ministry of Communications is the agency authorized to issue express courier postal service and telecommunications service licenses.

Generally, foreign legal entities and individuals must obtain a license to provide express courier postal services or telecommunication services on an equal footing with Azerbaijani nationals. Licenses are issued for a period of five years. However, this requirement may be waived on the basis of certain international agreements.

Under the Communications Law, the state has exclusive ownership of the spectrum of radio frequencies. The State Radio Frequencies Commission is authorized to issue radio frequency use permits to telecommunications businesses. This Commission also prescribes the rules and procedures for obtaining such permits and for operating at various frequencies.

The Communications Law also recognizes the right of foreign individuals and legal entities to own and operate networks and devices in Azerbaijan. Such devices must be jointly certified by the Ministry of Communications, the Azerbaijan State Standards Agency and their subordinate bodies, as well as accredited test laboratories.

¹⁸ Law No. 328-IQ of the Republic of Azerbaijan, *On Communications*, dated June 20, 1997.

Foreign capital inflow into the telecommunications industry has evolved primarily in the form of joint ventures with the entities subordinate to the Ministry of Communications, which acts both as an ultimate partner and supervising authority. Such joint ventures are engaged in the production of telecommunications equipment and operation of telecommunications facilities. However, under the Presidential Instructive Order *On the Privatization of Certain Enterprises and Facilities of the Ministry of Communications of the Republic of Azerbaijan*, dated March 29, 2001, the Government of Azerbaijan announced its intent to privatize the state-owned share of joint ventures in which the Ministry of Communications and its subordinate enterprises and institutions have participated.

Two cellular communication providers operate in Azerbaijan, the first of which started its activity in 1994. Both of them offer GSM standard. A number of cable TV providers and independent TV and radio channels operate in Azerbaijan.

The existing telephone network is being upgraded but significant problems remain. The provision of Internet services and communication has been developing at a rapid pace and at affordable tariffs.

15.4 Construction

15.4.1 Legislation

Pursuant to the Presidential Decree *On Measures to Eliminate Monopoly and Privatize the Construction Sector*, dated December 2, 1997, the state monopoly in the construction sector has been eliminated. Private persons may engage in construction activities.

The main laws regulating construction are the law *On the Basics of City Construction* dated June 11, 1999, and the Civil Code. Other legislation regulating construction includes: (i) legislative acts of a general nature such as property, land, safety, environmental protection, fire and sanitary regulations; (ii) construction rules, norms and standards; and (iii) legislative acts that regulate specific sectors where structures or facilities are constructed. The construction rules and standards of the USSR (GOST and SNIP) are still effective in Azerbaijan.

Pursuant to the Presidential Decree *On Implementation of the Law "On the Basics of City Construction"*, dated August 30, 1999, the Cabinet of Ministers is

obligated to adopt a number of regulations, including construction rules and standards, which are still pending.

15.4.2 Foreign Contractors

Foreigners and foreign legal entities may engage in construction works in Azerbaijan only together with Azerbaijani nationals or legal entities.

15.4.3 State Involvement

State involvement in the construction sector is extensive. Construction, reconstruction and design as well as issues relating to the location of a construction project require a feasibility study by the state. A number of state authorities, such as fire, environmental protection and sanitary agencies must issue their positive opinion on the proposed construction. Either municipalities or local state executive authorities, depending of the status of the land, issue decisions on allocation of land for the construction. Any construction, reconstruction or alterations require a state permit and approval of construction documents by state authorities. The State Committee of Construction and Architecture and local executive authorities within their competence grant such permits and approvals.

Apart from usual permits, construction works in certain areas, such as in cultural and historical reserves, require additional authorization of state authorities.

Construction is deemed to be completed and can be utilized only after a state inspection has been performed and a certificate has been issued confirming that all construction, safety, fire, sanitary, hygienic and other mandatory norms have been met.

The failure to observe construction regulations may create problems with registering the ownership right to the construction. The law *On Basics of City Construction* also provides for civil, financial, administrative and criminal liability for violation of construction legislation.

16. COURT SYSTEM IN AZERBAIJAN

16.1 Court System

The basic provisions regulating the structure and activities of the judiciary are stated briefly in the Constitution and more extensively in the Civil Procedure Code and the law *On Courts and Judges* (the “Courts Law”).¹⁹

The Azerbaijani system of courts of general jurisdiction incorporates four levels: (i) the Supreme Court of Azerbaijan; (ii) the Appellate Court; (iii) the Supreme Court of the Nakhchivan Autonomous Republic; and (iv) the local district (city) courts as well as a specialized court which hears cases involving serious crimes. In addition, the Courts Law provides for courts of specialized jurisdiction including the state Economic Court, the Economic Court for Cases Arising out of International Agreements and military tribunals. The Constitutional Court established in late 1998 is regulated by a separate body of laws and is not a part of the court system regulated by the Courts Law.

District (city) courts and the serious crime court are courts of original jurisdiction. Judgments are subject to review by higher courts. The serious crimes court is a single court that, as its name suggests, has jurisdiction to try serious crimes. However, it has no jurisdiction over serious crimes which are subject to the Nakhchivan court system.

The Nakhchivan Supreme Court exercises control over the Nakhchivan district courts and functions as a court of appeal for their decisions. It is also a court of original jurisdiction for serious crimes.

The Appellate Court is a court of appeal for all original jurisdiction courts including the Nakhchivan Supreme Court (but not Nakhchivan district courts).

The Supreme Court is the highest court in Azerbaijan. It acts as a court of appeals with regard to cases heard by the lower courts. Supreme Court cases are heard by the relevant (civil, criminal, military, economic, and administrative) appellate collegia. The Supreme Court is headed by the Chairman and the Plenum of the Supreme Court, the highest administrative body in the Supreme Court.

¹⁹ Law No. 310-IQ of the Republic of Azerbaijan, *On Courts and Judges*, dated June 10, 1997.

While the Courts Law provided for significant change in the court system and for its restructuring, the state lacks adequate financial resources to implement the reforms. Consequently, the Courts Law is not being thoroughly implemented and the court system is still in the process of transformation. As a result, the government started to implement the above-outlined court structure only in June 1999 when Presidential Decree No. 140, *On the Organization of the Courts of the Republic of Azerbaijan and their Activity*, was issued. Before that Azerbaijan had a three level court system inherited from the Soviet Union: district, Baku city court/Nakhchivan Supreme Court and the Supreme Court of the Republic of Azerbaijan.

16.2 Judges

Judges of the district and other lower level courts are appointed by the president upon the recommendation of the Judicial Council under the President. The Judicial Council's recommendations are based on examinations and on interviews that it conducts with the nominees.

The judges of the Azerbaijan Supreme Court and Economic Courts are appointed by the National Assembly upon recommendations by the President. While the judges of the Azerbaijan Supreme Court, the Economic Courts and the Appellate Court are appointed to office for a ten-year term, all other judges are appointed for a five-year term.

16.3 International Arbitration

Foreign investors may rely on provisions of the Foreign Investment Law to govern dispute resolution pursuant to which investment disputes may be resolved either by Azerbaijan courts or in accordance with the dispute resolution procedures agreed to by the parties. This may include international arbitration at a forum selected by agreement.

International arbitration in Azerbaijan is conducted in accordance with the rules prescribed by the Law of the Republic of Azerbaijan *On International Arbitration*. Under these rules, parties may select independent arbitrators of any nationality, the proceeding may be conducted in any language chosen by the parties, the applicable material (except for the matters that must exclusively be resolved under Azerbaijani laws) and procedural law may be chosen by the parties, and, in general, parties may stipulate other terms of the arbitration. If no such terms were stipulated by the parties, voids can be filled by the Economic Court of the Republic of Azerbaijan. In addition, international

commercial disputes may be heard by the Economic Court of the Republic of Azerbaijan for the Cases Arising from International Agreements. This state court has been established for the purpose of hearing cases arising specifically from commercial agreements with foreign counterparts.

Azerbaijan has acceded to the *Convention On the Recognition and Enforcement of Foreign Arbitral Awards* of June 10, 1958. Azerbaijan also ratified the *European Convention On Foreign Commercial Arbitration* of April 21, 1961.

16.4 Enforcement of Foreign Judgments and Court Assignments

Procedures for enforcement of foreign judgments in Azerbaijan are established by the newly adopted Civil Procedure Code of the Republic of Azerbaijan and generally require that foreign judgments be enforced in Azerbaijan based on the principle of reciprocity. These procedures, however, are as yet untested, making enforcement somewhat unpredictable. In addition, Azerbaijan has entered into several bilateral treaties (principally with neighboring states) to facilitate the enforcement of foreign judgments. It is a party to the CIS *Convention On Mutual Legal Assistance*²⁰. However, Azerbaijan is not a party to any multilateral international treaties on the enforcement of foreign court judgments.

²⁰ Resolution of the National Assembly of the Republic of Azerbaijan No. 1098, *On the Republic of Azerbaijan Joining the Convention of CIS Countries on Legal Relationships and Legal Assistance on Civil, Family and Criminal Cases* dated September 1, 1995. The CIS Convention is dated January 22, 1993.

NOTES

WORLDWIDE

Europe and Middle East

Almaty	Cairo	Paris
Amsterdam	Dusseldorf	Prague
Antwerp	Frankfurt/Main	Riyadh
Bahrain	Geneva	Rome
Baku	Kyiv	Stockholm
Barcelona	London	St. Petersburg
Berlin	Madrid	Vienna
Bologna	Milan	Warsaw
Brussels	Moscow	Zurich
Budapest	Munich	

Asia Pacific

Bangkok	Jakarta	Singapore
Beijing	Kuala Lumpur	Sydney
Hanoi	Manila	Taipei
Ho Chi Minh City	Melbourne	Tokyo
Hong Kong	Shanghai	

North and South America

Bogota	Juarez	San Francisco
Brasilia	Mexico City	Santiago
Buenos Aires	Miami	Sao Paulo
Calgary	Monterrey	Tijuana
Caracas	New York	Toronto
Chicago	Palo Alto	Valencia
Dallas	Porto Alegre	Washington, D.C.
Guadalajara	Rio de Janeiro	
Houston	San Diego	

CIS

Moscow (Contact: Paul Melling)

Sadovaya Plaza, 11th Fl.
7 Dolgorukovskaya Street
Moscow, Russia 127006
Tel: (7 095) 787 27 00, Fax: (7 095) 787 27 01
moscow.office@bakernet.com

St. Petersburg (Contact: Maxim Kalinin)

57 Bolshaya Morskaya Street
St. Petersburg, Russia 190000
Tel: (7 812) 303 90 00, (7 812) 325 83 08, Fax: (7 812) 325 60 13
spb.office@bakernet.com

Kyiv (Contact: James T. Hitch, III)

Millennium Business Centre, 5th Fl.
12a Volodymyrska Street
Kyiv, Ukraine 01025
Tel: (380 44) 490 70 70, Fax: (380 44) 490 67 87
kyiv_info@bakernet.com

Almaty (Contact: Curtis Masters)

Samal Towers, Samal 2, 97 Zholdasbekov Street
Almaty, Kazakhstan 480099
Tel: (7 3272) 50 99 45, Fax: (7 3272) 58 40 00
almaty.info@bakernet.com

Baku (Contact: Daniel Matthews)

The Landmark Building, 96 Nizami Street
Baku, Azerbaijan AZ1000
Tel: (99 412) 97 18 01, Fax: (99 412) 97 18 05
baku.info@bakernet.com

The CIS Practice

Moscow Office

Sadovaya Plaza, 11th Floor

7 Dolgorukovskaya Street

Moscow 103006 Russia

Tel.: (7 095) 787-2700

Fax: (7 095) 787-2701

moscow.office@bakernet.com

St. Petersburg Office

57 Bolshaya Morskaya Street

St. Petersburg

190000 Russia

Tel.: (7 812) 325-8308

Fax: (7 812) 325-6013

spb.office@bakernet.com

Kyiv Office

Millenium Business Center, 5th Floor

12a Volodymyrska Street

Kyiv 01025 Ukraine

Tel.: (380 44) 490-7070

Fax: (380 44) 490-6787

kyiv_info@bakernet.com

Almaty Office

Samal Towers

Samal-2, 14th Floor

97 Zholdasbekov Street

Almaty 480099 Kazakhstan

Tel.: (7 3272) 50-99-45

Fax: (7 3272) 58-40-00

almaty.info@bakernet.com

Baku Office

The Landmark Building

96 Nizami Street

Baku 370010

Azerbaijan

Tel.: (9 9412) 97-18-01

Fax: (9 9412) 97-18-05

baku.info@bakernet.com