
THE OIL AND GAS LAW REVIEW

EDITOR
CHRISTOPHER B STRONG

LAW BUSINESS RESEARCH

THE OIL AND GAS LAW REVIEW

Reproduced with permission from Law Business Research Ltd.

This article was first published in The Oil and Gas Law Review, 1st edition
(published in November 2013 – editor Christopher B Strong).

For further information please email
Adam.Sargent@lbresearch.com

THE OIL AND GAS LAW REVIEW

Editor
CHRISTOPHER B STRONG

LAW BUSINESS RESEARCH LTD

THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW

THE RESTRUCTURING REVIEW

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

THE DISPUTE RESOLUTION REVIEW

THE EMPLOYMENT LAW REVIEW

THE PUBLIC COMPETITION ENFORCEMENT REVIEW

THE BANKING REGULATION REVIEW

THE INTERNATIONAL ARBITRATION REVIEW

THE MERGER CONTROL REVIEW

THE TECHNOLOGY, MEDIA AND
TELECOMMUNICATIONS REVIEW

THE INWARD INVESTMENT AND
INTERNATIONAL TAXATION REVIEW

THE CORPORATE GOVERNANCE REVIEW

THE CORPORATE IMMIGRATION REVIEW

THE INTERNATIONAL INVESTIGATIONS REVIEW

THE PROJECTS AND CONSTRUCTION REVIEW

THE INTERNATIONAL CAPITAL MARKETS REVIEW

THE REAL ESTATE LAW REVIEW

THE PRIVATE EQUITY REVIEW

THE ENERGY REGULATION AND MARKETS REVIEW

THE INTELLECTUAL PROPERTY REVIEW

THE ASSET MANAGEMENT REVIEW

THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

THE MINING LAW REVIEW

THE EXECUTIVE REMUNERATION REVIEW

THE ANTI-BRIBERY AND ANTI-CORRUPTION REVIEW

THE CARTELS AND LENIENCY REVIEW

THE TAX DISPUTES AND LITIGATION REVIEW

THE LIFE SCIENCES LAW REVIEW

THE INSURANCE AND REINSURANCE LAW REVIEW

THE GOVERNMENT PROCUREMENT REVIEW

THE DOMINANCE AND MONOPOLIES REVIEW

THE AVIATION LAW REVIEW

THE FOREIGN INVESTMENT REGULATION REVIEW

THE ASSET TRACING AND RECOVERY REVIEW

THE INTERNATIONAL INSOLVENCY REVIEW

THE OIL AND GAS LAW REVIEW

www.TheLawReviews.co.uk

PUBLISHER
Gideon Robertson

BUSINESS DEVELOPMENT MANAGERS
Adam Sargent, Nick Barette

MARKETING MANAGERS
Katherine Jablonowska, Thomas Lee, James Spearing, Felicity Bown

PUBLISHING ASSISTANT
Lucy Brewer

MARKETING ASSISTANT
Chloe Mclauchlan

PRODUCTION COORDINATOR
Lydia Gerges

HEAD OF EDITORIAL PRODUCTION
Adam Myers

PRODUCTION EDITOR
Caroline Rawson

SUBEDITOR
Charlotte Stretch

EDITOR-IN-CHIEF
Callum Campbell

MANAGING DIRECTOR
Richard Davey

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK
© 2013 Law Business Research Ltd
www.TheLawReviews.co.uk

No photocopying: copyright licences do not apply.

The information provided in this publication is general and may not apply in a specific situation, nor does it necessarily represent the views of authors' firms or their clients.

Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided is accurate as of November 2013, be advised that this is a developing area.

Enquiries concerning reproduction should be sent to Law Business Research, at the address above. Enquiries concerning editorial content should be directed to the Publisher – gideon.roberton@lbresearch.com

ISBN 978-1-907606-87-8

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

BARRERA, SIQUEIROS Y TORRES LANDA, SC

BENNETT JONES LLP

BM MORRISON PARTNERS

CGA – COUTO, GRAÇA & ASSOCIADOS

CMS CAMERON MCKENNA

CUATRECASAS, GONÇALVES PEREIRA

GRANDALL LAW FIRM

KVALE ADVOKATFIRMA DA

LOYENS & LOEFF NV

MATTOS FILHO, VEIGA FILHO, MARREY JR E QUIROGA ADVOGADOS

MENA ASSOCIATES IN ASSOCIATION WITH AMERELLER LEGAL CONSULTANTS

MINTER ELLISON

MKONO & CO ADVOCATES

PILLSBURY WINTHROP SHAW PITTMAN LLP

RPS GROUP LTD

ŞENGÜLER & ŞENGÜLER LAW OFFICE

SUÁREZ ZAPATA & PARTNERS ABOGADOS SAS

UCHE NWOKEDI & CO

VINSON & ELKINS LLP

WEBBER WENTZEL IN ALLIANCE WITH LINKLATERS

WENGER & VIELI LTD

CONTENTS

Editor's Prefacevii
	<i>Christopher B Strong</i>
Chapter 1	AUSTRALIA.....1
	<i>Sam MacGibbon, Paul Wentworth and Sam Jaffray</i>
Chapter 2	AZERBAIJAN23
	<i>Aykhan I Asadov</i>
Chapter 3	BRAZIL33
	<i>Giovani Loss, Felipe Feres and Nilton Mattos</i>
Chapter 4	CANADA44
	<i>Donald E Greenfield, Vivek T A Warriar, Darcy Moch, Wally Braul, Milos Barutciski, Simon Foxcroft, Vasilis F L Pappas and Kim Kapesi-Miller</i>
Chapter 5	CHINA.....57
	<i>Weidong Wang and Tao Zhu</i>
Chapter 6	COLOMBIA.....68
	<i>José V Zapata</i>
Chapter 7	IRAQ80
	<i>Christopher B Strong</i>
Chapter 8	IRAQI KURDISTAN.....92
	<i>Daniel Heintel and Dablia Zamel</i>
Chapter 9	IRELAND.....106
	<i>James Massey</i>

Chapter 10	MEXICO	123
	<i>Carlos Ramos Miranda and Miguel Ángel Mateo Simón</i>	
Chapter 11	MOZAMBIQUE	134
	<i>Jorge Graça, Taciana Peão Lopes, Paulo Ferreira and Márcio Paulo</i>	
Chapter 12	NETHERLANDS	147
	<i>Elisabetta Aarts</i>	
Chapter 13	NIGERIA.....	170
	<i>Uche Nwokedi</i>	
Chapter 14	NORWAY	178
	<i>Yngve Bustnesli and Simen Skaar Kristoffersen</i>	
Chapter 15	PORTUGAL.....	189
	<i>Rui Mayer, Diogo Ortigão Ramos, Ana Isabel Marques and Bruno Neves de Sousa</i>	
Chapter 16	RUSSIA.....	202
	<i>Natalya Morozova and Rob Patterson</i>	
Chapter 17	SOUTH AFRICA.....	213
	<i>Manus Booysen, John Smelcer, Hennie Bester, Keith Veitch, Jonathan Veeran and Garyn Rapson</i>	
Chapter 18	SWITZERLAND	231
	<i>Andreas Huenerwadel and Beat Speck</i>	
Chapter 19	TANZANIA.....	243
	<i>Wilbert B Kapinga and Angela Thorns</i>	
Chapter 20	TURKEY	258
	<i>Jonathan W Blythe, Nihan Kisi and Esin Erkal</i>	
Chapter 21	UNITED KINGDOM.....	267
	<i>Penelope Warne and Norman Wisely</i>	

Chapter 22	UNITED STATES: CALIFORNIA280 <i>Robert A James</i>
Appendix 1	ABOUT THE AUTHORS..... 291
Appendix 2	CONTRIBUTING LAW FIRMS' CONTACT DETAILS.. 309

EDITOR'S PREFACE

I am very pleased to have been able to take part in this first edition of *The Oil and Gas Law Review*. This publication is intended to be a practical analysis of recent developments around the globe in this exciting industry. My hope is that it will serve as a valuable resource to attorneys in private practice, in in-house positions, in government service and in academia who are seeking to keep abreast of legal developments on the oil and gas front.

Input from leading oil and gas practitioners around the world has been gathered for *The Oil and Gas Law Review*. The publication is divided into 22 chapters, each addressing legal issues in a particular jurisdiction. Our goal in selecting these jurisdictions was to ensure that most of the major oil and gas producing regions were represented. Although the oil and gas business is a global one, laws and regulations vary significantly from jurisdiction to jurisdiction, and sometimes even between states or regions of a particular jurisdiction. For practitioners within the oil and gas industry, keeping up with global legal developments is a constant effort. By gathering recent and insightful information from the world's major oil and gas jurisdictions this book will be a major step in addressing this need.

Over the past several years, a number of major trends have emerged in the global oil and gas industry. The first and undoubtedly most important of these is the growing importance of unconventional resources to the global oil and gas industry. The 'shale boom' that started in North America and is slowly starting to spread to other parts of the world has upended the industry. The United States looks set to shortly becoming a net exporter of petroleum for the first time in decades, and other jurisdictions are seeking to emulate its success. At the same time, lawmakers and regulators, particularly those in jurisdictions that are unused to large-scale onshore exploration and production activities, are struggling with how best to address the inherent environmental issues. The struggle with how to effectively balance the benefits of increased domestic production of petroleum with the perceived environmental risks of 'fracking' will no doubt occupy the attention of lawmakers, regulators and lawyers for many years.

A second emerging trend is the opening (or reopening) of new jurisdictions to oil and gas exploration and production activities. Jurisdictions such as Tanzania and Mozambique, which just a few years ago received scant attention from international oil and gas companies, are now receiving significant attention, with major gas finds seemingly announced on a monthly basis. A similar situation is playing out in the Eastern Mediterranean, where discoveries in offshore Israel, Lebanon and Cyprus have the potential to transform both economies and regional politics. Iraq, closed to foreign investment during its years of economic sanctions, has re-emerged as one of the world's major oil provinces with both majors and independents investing billions of dollars in petroleum sector. Finally, decades after nationalising its oil industry, Mexico's new president has announced plans to allow private investment in its upstream sector. Each of these jurisdictions will have to craft a legal regime that strikes an appropriate balance between attracting foreign investment while at the same time ensuring that economic rents are retained by the state for the benefit of the people.

Finally, in a period of sustained high oil prices, resource nationalism is an issue in many parts of the world. Whether taking the form of windfall taxes, forced renegotiation of contractual terms agreed during a period of lower prices, or stronger measures, oil and gas investment remains an area fraught with political and legal risk as some producing jurisdictions seek to change the rules of the game mid-course in light of increased oil prices and other changed circumstances from the time an investment was originally made. Although impossible to avoid entirely, lawyers advising clients in the oil and gas business are constantly seeking to get a handle on political and legal risk so that they can advise their clients accordingly.

Each of the trends mentioned above, as well as a number of others that space has not permitted me to discuss, will no doubt attract considerable attention from lawmakers, regulators and attorneys in the coming year, and I hope that the readers of *The Oil and Gas Law Review* will find it to be a helpful resource in that regard. I am grateful to all of the contributing authors for their efforts and insights.

Christopher B Strong

Vinson & Elkins LLP

London

November 2013

Chapter 2

AZERBAIJAN

*Aykhan I Asadov*¹

I INTRODUCTION

Azerbaijan and its present capital city, Baku, as well as, more generally, the Absheron Peninsula, where Baku is located, have long been known for their oil and gas. Gas discharging from the subsurface blazing on the ground around Baku has historically attracted fire worshippers from around the world. Records from as early as the 9th century refer to fields in Azerbaijan, oil from which as well as products derived from the oil were used for the various needs of the time, including household and medicinal usage.

Baku became significant when the necessity for oil in quantities large enough to support developments in the aftermath of the industrial revolution arose. At the beginning of the 20th century, approximately half of the world's total oil output was produced in Azerbaijan. With the creation of the USSR, Baku's oil primarily served the internal needs of the huge country; 23.5 million tonnes of oil were extracted in 1941, which was 71.4 per cent of the USSR's total output for that year.

Oil has been and remains the driving force of the Azerbaijani economy. The oil industry features upstream, midstream and downstream segments. While the oil and gas industry was declining in Azerbaijan following the break-up of the Soviet Union, attraction of foreign investment into the upstream sector has enabled Azerbaijan to revive the industry as well as the economy of the country and, to a certain extent, of the entire region.

The 'major' oil contract was signed in 1994 between the Republic of Azerbaijan and foreign companies in the form of an oil production sharing agreement (PSA) for the giant (believed to be the largest oilfield in a jurisdiction outside OPEC) Azeri–Chirag–Guneshli (ACG) field. This was followed by a considerably large number (around 30) of

¹ Aykhan I Asadov is a managing partner at BM Morrison Partners.

other PSAs for both onshore and offshore developments ending up with another large gas and gas condensate discovery at Shahdeniz field in the Caspian Sea.

These discoveries have led to the development of major regional oil and gas pipelines.

One of the world's major projects, the Baku–Tbilisi–Ceyhan (BTC) oil pipeline, has been in operation since 2005. The pipeline is 1,768km long, running through the territories of Azerbaijan, Georgia and Turkey, and currently takes oil mostly from the Azerbaijani sector of the Caspian Sea to the terminal in Ceyhan on the Mediterranean Sea. There are other oil pipelines in Azerbaijan to Georgia and Russia.

The South Caucasus Pipeline (SCP) is a gas export pipeline that was put into operation in 2006 to enable export gas sales from Shahdeniz field and, except for the terminus point, runs parallel to the BTC pipeline. Other existing smaller gas pipelines of regional importance of Azerbaijan are the pipelines from Hacıqabul in Azerbaijan to the borders with Georgia, Russia and Iran.

While new upstream developments and pipeline constructions were run together with foreign companies, midstream (other than major export pipelines) and downstream segments of the Azerbaijani economy remain largely under the control of the government through State Oil Company of Azerbaijan Republic (SOCAR).

The majority of the current production (oil and gas alike) is based offshore in the Caspian Sea.

In 2012, Azerbaijan produced 42.9 million tonnes of oil as a commodity (including gas condensate), which is 5.5 per cent less than the 2011 total and 15.4 per cent less than a peak production of 50.7 million tonnes in 2010. The total oil production estimate for 2013 is 40.8 million tonnes. The country's proven crude oil and gas condensate reserves stand at 2 billion tonnes.

The oil-related infrastructure in Azerbaijan also includes a number of oil terminals located on the Caspian seashore, the Sanqacal oil terminal, a starting point of the BTC pipeline, a number of refineries, the oil marine tanker fleet, railways and a fleet of rail tank cars, as well as oil platforms and oil equipment factories. The existence of a developed oil transportation infrastructure allows Azerbaijan to play a role as a transit country for oil almost as important as its role as an oil-producing country.

Amid the decline in oil production, the natural gas reserves and production are of increasing importance. In 2012, Azerbaijan produced a record 17.2 million cubic metres of natural gas as a commodity, which is a 4.2 per cent increase over the production in 2011. The total gas production estimate for 2013 is 18.4 million cubic metres. Further increase, at times sharp, is projected as preparations for natural gas supplies to European customers are under way.

The country's proven natural gas reserves are 2.2 trillion cubic metres.

Large gas and condensate discoveries in the Caspian have forced Azerbaijan to start looking for sustainable markets for its gas sales. The long-awaited selection of the route for the Azerbaijani gas exports to Europe, narrowed down recently to the Nabucco West – TAP (Trans Adriatic Pipeline) dilemma, ended in June this year with TAP prevailing.

The TAP project would be supported with a new Trans Anatolia Natural Gas Pipeline (TANAP) to be built in Turkey to facilitate the stage two development of Shahdeniz. The TANAP is expected to start at the border between Georgia and Turkey

to cross Turkey westward and end up in Edirne. Azerbaijan's existing gas sales to Turkey are fulfilled through the SCP.

II LEGAL AND REGULATORY FRAMEWORK

i Domestic oil and gas legislation

Azerbaijan reinstated its statehood in 1991. The legal framework for the regulation of oil and gas issues in Azerbaijan as a state independent from the USSR was laid down with the adoption of Law No. 439-IQ on Subsoil dated 13 February 1998 (the Subsoil Law) and Law No. 541-IQ on Energy dated 24 November 1998 (the Energy Law). On 30 May 1996, Azerbaijan adopted Law No. 94-IQ on the Use of Energy Resources (the Energy Resources Law).

The Subsoil Law governs the exploration, use, protection, safety and supervision over the use of subsoil resources including, but not limited to, oil located both within Azerbaijan and on the Azerbaijani sector of the continental shelf of the Caspian Sea. The Code of the Azerbaijan Soviet Socialist Republic on Subsoil, dated 26 November 1976, which was repealed with the adoption of the Subsoil Law, specifically excluded oil and gas from the definition of subsoil resources.

While the Energy Law is intended to complete the legal framework for the use of subsoil resources, including oil and gas, the Energy Resources Law sets forth the social, economic and legal bases of state policy in the area of energy resource use.

On 28 March 2000, the president of Azerbaijan issued Decree No. 310 on measures to improve the issuance of special permits (licences) for certain types of business activities in Azerbaijan, as subsequently amended (the Decree). Under the Decree, the production and processing of oil, oil products, and natural gas can only be conducted by state enterprises and joint-stock companies in which the controlling stake belongs to the state.

Azerbaijan has a general (as opposed to a specific oil-related-activity policy) energy policy.

ii Regulation

Pursuant to the regulations of the Ministry of Industry and Energy approved by Presidential Decree No. 404 on 15 May 2006, this ministry participates in the preparation and implementation of state policy in the areas of the production, transportation, and processing of oil. Specifically, based on the instructions of the president, the ministry may prepare, negotiate, execute and oversee the implementation of PSAs and other agreements on behalf of the state with respect to the development of hydrocarbon reserves in Azerbaijan.

While the regulations of the Ministry of Industry and Energy suggest that the regulation of oil and gas matters is generally vested in this ministry, SOCAR continues to play an important (in fact, on most issues, a leading) role in such matters, especially in relation to the practical implementation of oil as well as gas projects.

The State Oil Fund of Azerbaijan Republic (SOFAR or, sometimes, SOFAZ) was established in 1999 to accumulate and manage Azerbaijani oil revenues.

There are several state authorities maintaining statistics on the production, export and import of oil in Azerbaijan. The State Statistics Committee of the Republic of Azerbaijan is the authority entitled by its regulations to maintain, keep and distribute statistics. The Ministry of Industry and Energy, the State Customs Committee, SOCAR, and SOFAZ maintain oil production, export and import statistics relevant to their duties and operations.

iii Treaties

Due to the considerable amount of foreign investment in the oil industry of Azerbaijan and the growing concerns of consumer states regarding energy security, Azerbaijan agreed to extend the regulation of its oil industry by a number of international agreements.

The Republic of Azerbaijan acceded without reservations, effective from 29 May 2000, to the UNCITRAL Convention on Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention 1958).

Similarly, Azerbaijan acceded to the Convention on Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention) and is a member of global and regional financial institutions, such as IBRD (World Bank), IDA (graduated from IDA lending in 2011), and IFC as well as the Islamic Development Bank and EBRD. Azerbaijan is an observer at the WTO and is a member of the Commonwealth of Independent States (CIS).

The country is a signatory and a contracting party to the Energy Charter Treaty and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects and is a member of the Energy Charter Conference. The development of regional transit oil transportation is supported by the European Union under the TACIS/TRACECA programme.

Azerbaijan has concluded around 40 bilateral investment treaties mostly with neighbouring countries as well as countries such as the United States, Germany and the United Kingdom.

Azerbaijan has concluded 43 treaties on the avoidance of double taxation with 40 currently in effect. Treaties of the former Soviet Union, including double taxation treaties, are not recognised except in specifically agreed cases.

Among the Azerbaijani double taxation treaties, there are treaties with popular 'onshore' jurisdictions (such as Luxembourg and the Netherlands).

Other tax treaties of Azerbaijan include tax compliance cooperation and mutual assistance agreements (also, multilateral within CIS), an agreement on cooperation and information exchange in combating tax evasion, agreements on principles of indirect taxation upon export and import of goods (works and services)/bilateral trade, and a cooperation agreement between tax authorities.

Considering that the majority of Azerbaijani oil and gas production is offshore, an issue of importance to Azerbaijan is the status of the Caspian Sea. Resulting from the issues of the status is the division of the Caspian surface and, more importantly as far as subsoil resources are concerned, of the seabed. While the seabed has been divided between Azerbaijan and Russia, Kazakhstan and Russia, and Azerbaijan and Kazakhstan, there is no agreement over water surface. Most recently, in 2010, the littoral states 'agreed to agree' national maritime zones to 24–25 nautical miles.

III LICENSING

Under the Subsoil Law, subsoil resources such as oil are the sole and exclusive property of the state of Azerbaijan. There is a legal distinction between surface rights and subsurface mineral rights.

Oil exploration and production generally falls under the regulation of the Ministry of Industry and Energy (although it has not been explicitly appointed as a licensing authority under the Subsoil Law). Under the Subsoil Law, no person or legal entity may engage in oil or gas exploration and production without a licence (an activity permit for a particular area). The Subsoil Law further provides that a production licence must be issued for a particular subsoil block and is the ultimate deed granting subsoil use rights to that block.

Under the Subsoil Law, an exploration licence can be issued for a term of up to five years and a production licence for up to 25 years. A combined exploration and production licence may be issued for up to 30 years. The licence term (exploration, production or combined) is extendible, subject to the subsoil user's compliance with the terms of the licence. An extension can be granted for a term agreed between the subsoil user and the licensing authority.

An existing licence holder has a pre-emptive right to obtain an extension.

The rights of exploration and development can be terminated in the following cases:

- a* expiration of a licence;
- b* waiver by a subsoil user of its rights – in this case, the subsoil user shall inform the state authority issuing the licence at least six months in advance; and
- c* in case of occurrence of circumstances depriving the licensee of the rights under the licence.

The right of exploration and development can also be limited or terminated early by the licensor in the following cases:

- a* occurrence of threat to life and health of people living and working in the areas of licensed activities;
- b* non-compliance with conditions determined in the licence;
- c* systematic violation of the rules of subsoil use;
- d* occurrence of force majeure (natural disasters, acts of war and others);
- e* in the event where subsoil user has not proceeded to licensed activities in specified volume within the time frame determined in the licence;
- f* liquidation of entity that was granted the right of subsoil use; and
- g* by the initiative of the holder of the licence.

In case of elimination of circumstances that caused early termination, the right of subsoil use can be fully re-established.

Unlike the Subsoil Law, the Energy Law provides that production rights for a specified block are granted exclusively on the basis of an 'energy contract'. Notwithstanding the regimes set forth in the Subsoil and Energy Laws, and underlining the strategic importance of oil to the country, most major oil deals in Azerbaijan have been and are approved by the country's legislature. In the absence of a PSA law and a law

on petroleum, every oil deal in the form of a PSA – the prevailing form of oil agreements in Azerbaijan – is approved into law prevailing over any other conflicting Azerbaijani law (arguably, except for the Constitution, acts adopted by public referendums and international agreements).

In practice, a memorandum of understanding for a particular field or block is entered into between SOCAR, an operator of the country's oil and gas reserves appointed by presidential decree, and an interested investor. Thereafter, following an accord on the basic commercial terms of the deal between SOCAR and the investor, the president of the Republic, head of the state and of its executive power, authorises a governmental agency (on most occasions SOCAR) to finalise negotiations over the field or block and execute the deal. The executed agreement is then presented to the legislature for approval into law and following this approval is signed by the president.

While a separate *corpus juris*, most PSAs have been concluded for similar terms as provided for in the Subsoil Law with regard to licences with a maximum term of 30 years.

Joint ventures with foreign partners were common in the Azerbaijani oil industry in the early and mid-1990s and reached four joint ventures in total. Another upstream venture in the form of a local entity was formed in 2008 to explore principally the Umid offshore structure. Joint ventures would generally be formed as an Azerbaijani legal entity, a separate taxpayer (instead of a pass-through entity as oil investors might expect).

Following the first approval of a PSA into law, most subsequent oil deals have been concluded as PSAs. One joint venture was subsequently converted into a PSA regime and the field unitised with a neighbouring field under a PSA regime. Some other remaining joint ventures are also expected to transfer to the PSA regime.

IV PRODUCTION RESTRICTIONS

No individual or legal entity can engage in oil exploration or production without a licence. Licences are awarded by tender, auction or, in exceptional cases, negotiation. Tenders can be open or closed, and licences under the Subsoil Law are available to foreign investors in the areas of exploration or production, or both.

An exploratory geological structure may be granted to several subsoil users (presumably for different minerals and resources).

As stated, under the Decree, production and processing of oil and gas can only be conducted by state enterprises and joint-stock companies, in which the controlling stake belongs to the state. It is arguable whether this limitation contradicts the Subsoil Law; as the licensing regime in the Subsoil Law or 'contract' regime in the Energy Law is not being implemented in practice, this contradiction has not been tested in courts. The 'ownership' limitation in the Decree does not extend to PSAs.

There are no limitations on export of oil or gas except that, annually, the state budget of Azerbaijan would typically require that, upon export of commodities made in Azerbaijan whose prices are regulated, 30 per cent of the difference between the contract (sale) price (less costs of export) and the in-country wholesale price be remitted to the state budget. Domestic prices for both crude oil and natural gas are regulated and, therefore, exporters acting under the general regime (as opposed to a PSA regime) would

be required to remit a percentage of the difference between the export and domestic prices to the budget.

When it comes to PSA contractors, they too might be restricted to export by the volumes that they, under a particular PSA, are required to sell locally. In fact, it is not unexpected that, as far as exports from Azerbaijan are concerned, SOCAR would be acting to consolidate such exports through its marketing arms, such consolidation potentially being a feasible option for small producers in Azerbaijan.

Domestic prices for crude oil, natural gas and oil products are established by decisions of the Tariff (Pricing) Council of the Republic of Azerbaijan.

To allow efficient use of the existing oil and gas infrastructure, the Law on the implementation of a special economic regime for oil and gas export operations provides for a preferential tax regime for the exportation of products and services for oil and gas operations from Azerbaijan by qualified contractors.

V ASSIGNMENTS OF INTERESTS

Under the Energy Law, a transfer of rights under an energy contract to third parties and signing of subsequent agreements can be made with a special permit from the Ministry of Industry and Energy and comes into force after registration. In the absence of such a special permit, a contractor would be liable either solely or jointly with the successor for non-fulfilment of contractual obligations by the successor.

Under the Subsoil Law, the right to use subsoil is transferred to another party in the case of a change of legal-organisational form or reorganisation of the business entity using subsoil. In case of a change of control by way of a company's separation or merger with another company, the new entity would be regarded the new holder of the licence.

Under a PSA, a transfer of interest (except for internal reorganisation) would typically require consent from the government represented by SOCAR. Arguably, SOCAR's consent does not exclude the need for other regulatory consents and compliance, including antimonopoly and tax, where applicable.

VI TAX

The Tax Code of Azerbaijan, effective 1 January 2001 (the Tax Code), stipulates a three-level tax system with the state taxes levied at the first level, taxes of the Nakhchivan Autonomous Republic within Azerbaijan at the second, and local and municipal taxes levied at the third level. The taxes applicable to oil and gas exploration and production are mostly the state taxes and include profits (corporate income) tax at 20 per cent (or simplified tax on proceeds), value added tax at 18 per cent, individual income tax, mining tax (royalty), excise, highway tax, property tax, land tax, and social taxes and charges.

Specifically, the Tax Code provides for royalties (mining tax) to apply to crude oil production at a rate of 26 per cent and to natural gas production at a rate of 20 per cent.

The tax regimes provided under PSAs are different from the generally applicable regime and differ individually. Generally, PSA tax regimes provide for lower withholding income tax rates, exemption from value added tax, and simplified reporting and accounting procedures. Contractors are obligated to make other tax-like payments in the

form of bonus payments and acreage fees that may vary depending on the capacities of each field and block granted under the PSA.

Most PSAs exempt contractors from the payment of the mining tax.

The tax paid by oil contractors can be included into the state's share of the profit oil production under a PSA.

The collection of taxes is administered by the Ministry of Taxes and its divisions. 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.

VII ENVIRONMENTAL IMPACT AND DECOMMISSIONING

The existing environmental rules and regulations (which may not always be publicly available) prescribe the limits of environmental pollution, the requirements for environmental monitoring and reporting, and applicable approvals and consents to be obtained. Administrative regulations establish the types of operation prohibited as part of general subsoil use.

Oil operations can be subject to mandatory insurance cover under PSAs, such as insurance of the contractor's liability:

- a* for loss, damage, injury arising from pollution of the environment and cost of wreckage removal and clean-up operations caused by an accident;
- b* for loss of or damage to property or bodily injury suffered by a third party; and
- c* to its employees.

Additionally, certain other types of insurance can be mandatory under a PSA, including those mandatory under generally applicable law. Such insurance includes, among others, medical insurance of respective employees, insurance of disability resulting from industrial accidents and occupational diseases, as well as the state social insurance.

The principal regulator in relation to environmental matters is the Ministry of Ecology and Natural Resources. The operation of facilities that are considered hazardous is also regulated by the Agency for Supervision of Safe Conduct of Works in Industry and Mining Supervision under the Ministry of Emergencies. Under PSAs, SOCAR acts on most occasions on behalf of the Republic also on environmental matters.

Penalties for the violation of environmental rules include administrative fines differing depending on the type of a violation. The state is entitled to recover damages from a subsoil user delinquent in environmental pollution.

Abandonment funds are typically established under PSAs to fund pursuant to a PSA abandonment of operations.

VIII FOREIGN INVESTMENT CONSIDERATIONS

i Establishment

Under the Subsoil Law, the right to engage in subsoil exploration and production can be granted to Azerbaijani citizens and entities as well as foreign individuals and legal entities.

Under Law No. 57 of the Republic of Azerbaijan on Protection of Foreign Investment dated 15 January 1992 (the Foreign Investment Law), foreign investors (foreign entities, governments, international organisations and individuals permanently residing outside Azerbaijan) can engage in any investment activity not prohibited by Azerbaijani law.

Under the Foreign Investment Law, foreign investment can take any of the following forms:

- a* participation in entities established with entities and citizens of the Republic of Azerbaijan on a shared basis;
- b* establishment of enterprises wholly-owned by foreign investors;
- c* purchase of enterprises, proprietary complexes, buildings, structures, shares in enterprises, other shares, bonds, securities, and certain other property which, under the laws of the Republic of Azerbaijan, can be owned by foreign investors;
- d* acquisition of rights to use land and other natural resources, and other proprietary rights; and
- e* conclusion of agreements with entities and citizens of the Republic of Azerbaijan providing for other forms of foreign investment.

Enterprises with foreign investment include joint ventures and enterprises wholly-owned by foreign investors. While not specifically mentioned in the Foreign Investment Law, foreign investors can also have branch and representative offices in Azerbaijan.

Under the general legal regime applicable outside PSAs, two principal requirements must be satisfied for a person to engage in oil and gas production: (1) under the Decree, a person must be a state enterprise or a joint-stock company, in which the controlling stake belongs to the state; and (2) a person must have the relevant licence under the Subsoil Law. As a practical matter, as most activities in oil and gas are fulfilled under PSAs, these principal requirements (specifically, (1) above) do not apply and foreign investors can freely choose among the forms of doing business in Azerbaijan (through an enterprise with foreign investment or directly through a branch and, in limited cases, representative office) to engage in oil and gas exploration and production.

ii Capital, labour and content restrictions

With liberalisation of the Azerbaijani foreign exchange (currency control) regime, there are no major restrictions on the movement of capital or access to foreign exchange.

Azerbaijan's currency control legislation distinguishes between 'residents' and 'non-residents', with residents including private individuals having a permanent place of residence in Azerbaijan and legal entities established in accordance with Azerbaijani law. Branches and representative offices of foreign entities established in Azerbaijan do not fall within the definition of a resident. Foreign exchange regulations are less restrictive for non-residents largely due to the fact that non-residents' bank accounts outside Azerbaijan are not regulated by the Azerbaijani currency control rules.

Employment in Azerbaijan is regulated by the Labour Code, effective 1 July 1999 (the Labour Code), and the Migration Code, effective 1 August 2013, along with other relevant laws and regulations. Foreign employees who are employed by enterprises operating in Azerbaijan are subject to Azerbaijani employment law, except for those

working in Azerbaijan on the basis of employment contracts concluded with a foreign employer in a foreign state.

Foreign nationals wishing to work in Azerbaijan are required to register at their place of residence and obtain a work permit through their employers. Work permits are issued by the State Migration Service. Work permits are not required if the foreign national is an individual entrepreneur or a sole proprietor and in certain other cases.

Under the Labour Code, employment discrimination in Azerbaijan based on citizenship, sex, race, religion, nationality and other factors not related to the professional skills of a person is prohibited. An employer's granting of privileges and benefits to women, invalids, persons under 18 years of age and other persons in need of social care is not considered discrimination.

iii Anti-corruption

Azerbaijan is an Extractive Industries Transparency Initiative (EITI) compliant country.

In general, Azerbaijani law prohibits provision of any benefits of any nature to public and equal-status servants for any actions or inactions that fall under the scope of their duties. A public servant cannot, during a year, accept in relation to the discharge of his or her office a gift (or gifts) with a cumulative value exceeding 55 manats; any gift of a value exceeding this threshold is deemed to belong to the office employing the servant.

IX CURRENT DEVELOPMENTS

The major highlight of recent developments in the Azerbaijani oil and gas sector is the increasing role of SOCAR, which is an active investor in and participant of projects both in Azerbaijan and outside. If, previously, SOCAR's role in regional projects (such as BTC and SCP) was aligned with the role of the Republic in ensuring political support from neighbouring countries to projects, currently, SOCAR actively promotes its projects as a commercial partner. On occasions, as is the case with TANAP, SOCAR acts in close cooperation with foreign counterparties (such as BOTAS and/or TPAO) in promoting the projects it is involved in.

Among such new major projects involving SOCAR are TANAP, TAP, construction of offshore drilling rig in the Caspian, and development of refineries in Azerbaijan and Turkey. While acting in these new projects, SOCAR relies heavily on the funding from SOFAZ.

Along with SOCAR's increasing role as an investor and a major project manager, SOCAR can also be considered as solidifying its position vis-à-vis the oil and gas assets in Azerbaijan. Reportedly, SOCAR considers alternatives to PSAs and, in doing so, might be relying upon risk service agreements.

In an attempt to locate new discoveries and deposits of oil and gas in Azerbaijan, in 2011, SOCAR and a foreign oil company reportedly signed an agreement to perform a joint study onshore Azerbaijan. The study is for secondary sediments in the northern regions of Azerbaijan. According to geologists, the secondary sediments could be lying at a depth of 10,000 metres.

Appendix 1

ABOUT THE AUTHORS

AYKHAN I ASADOV

BM Morrison Partners

Aykhan Asadov joined BM Morrison Partners in January 2013.

Aykhan has been practising law for more than 15 years, having started at one of the Big Four accountancy firms in Baku as a legal consultant. In 1997, he joined one of the international law firms at its Almaty office prior to transferring to the newly opened Baku office in April 1998. In 2009, Aykhan became the first local Azerbaijani partner in the same firm.

Aykhan advises on specific industry aspects of oil and gas, infrastructure, and mining projects, including acquisition and disposal of assets. He also advises on taxation (tax planning and structuring, value added tax/indirect taxation, and tax controversies for both foreign and domestic businesses operating in Azerbaijan and international tax considerations of companies with interests in Azerbaijan and local companies with interests outside Azerbaijan) and customs law.

Aykhan Asadov is recommended as a 'shrewd practitioner' for his trade and customs work in Azerbaijan by *Who's Who Legal 2011*. He is recognised as a 'leading lawyer/individual' in relevant areas of practice by *IFLR1000 2013*, *Chambers Global* and *The Legal 500 EMEA 2012*. He is ranked one of the world's leading practitioners by *The International Who's Who of Energy Lawyers 2013*.

BM MORRISON PARTNERS

Villa 9, English Yard

25A, Mammad Araz St

AZ1106, Baku

Azerbaijan

Tel: +994 12 497 19 14 / 15

Fax: +994 12 497 19 13

aasadov@bmlawaz.com

www.bmlawaz.com