

Oil and gas regulation in Azerbaijan: overview

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DOMESTIC SECTOR

1. Describe the domestic sector and policy for onshore and offshore oil and gas, including liquefied natural gas (LNG) and unconventional/shale oil and gas.

Domestic industrial production

The oil and gas extraction industry has been the main sector of the national economy of the Republic of Azerbaijan since its independence from the USSR in 1991. Located on the western coast of the Caspian Sea, Azerbaijan is one of the world's pioneers in oil and gas field development, with the first oil well drilled mechanically in 1846. More than 50% of the world's oil production originated from Azerbaijan by 1901. In addition, the world's first offshore oil field platform, Neft Dashlary (Oily Rocks), was developed in 1949 in the shallow waters of the Caspian Sea which are located in the territorial waters of Azerbaijan.

After gaining independence from the USSR, Azerbaijan successfully continued developing its oil and gas reserves and attracted considerable foreign direct investments into the industry. As of early 2014, crude oil reserves were estimated to be 7 billion barrels and natural gas production was estimated at 35 trillion cubic feet. In the last ten years, the volume of oil production nearly tripled, reaching 881,000 barrels per day in 2013. The natural gas production increased fivefold during this period, reaching 29.4 billion cubic meters in 2013. Most of the hydrocarbon output comes from the BP-operated oil fields of Azeri, Chirag and Gunashly, and from the gas and condensate field of Shah Deniz located in the Caspian Sea.

The import/export market

Most of the oil and gas production in Azerbaijan is export-oriented. According to the available statistical data, 37.7 million tons of oil (out of 44.7 million tons of oil produced) was exported from Azerbaijan in 2013. With the development of the Shah Deniz field, Azerbaijan has become one of the major gas exporters in the region with more than 8.5 billion cubic meters of natural gas exported in 2014. The main natural gas exporters are the State Oil Company of the Republic of Azerbaijan (SOCAR) and the BP-led consortium of international energy companies.

Azerbaijan has diversified its oil and gas export routes in the last ten years and aims to transform Azerbaijan into a major energy corridor through which energy resources of Central Asia will be transported to European consumers. Currently, oil and condensate exports are carried out through the three following pipelines:

- South Caucasus pipeline (692 km) since 2006.
- Baku-Tbilisi-Ceyhan pipeline (1,768 km) since 2006.
- Baku-Novorossiysk pipeline (1,330 km) since 1997.

These exports are made to European and Asian countries, including Ukraine, Turkey, India, as well as Italy and Israel which are the biggest importers of Azerbaijani crude oil. Exported crude

oil mainly consists of Azeri Light and Azeri BTC grades of Azerbaijani crude oil.

Natural gas is exported to:

- Georgia and Turkey through the South Caucasus pipeline (Baku-Tbilisi-Erzurum Pipeline).
- Russia through the Gazi-Mahomed-Mozdok pipeline.
- Iran through the Baku-Astara pipeline in the framework of the swap arrangement aimed at the delivery of natural gas to the Autonomous Republic of Nakhichevan.

Azerbaijan plans to increase its export of natural gas to 25 billion cubic meters by 2019 and expand its exports to the EU with the development of the second stage of the Shah Deniz project. As part of this project, the consortium of international energy companies plans to build the Trans-Anatolian pipeline (TANAP) passing through Turkish territory and the Trans-Adriatic pipeline which will be connected to TANAP and deliver natural gas to Italy through Greece and Albania.

According to official records, Azerbaijan did not import oil or natural gas in recent years.

Domestic market structure

The domestic upstream oil and gas market is dominated by SOCAR. SOCAR has statutory exclusive rights for the development and production of oil and natural gas in Azerbaijan. SOCAR is an integrated energy company active in all segments of the domestic oil and gas industry. However, its output from upstream oil and gas developments did not exceed 25% of the total national oil and gas production in 2013. SOCAR also owns and operates the only oil refinery and gas refinery in the country, and manages the domestic oil and gas pipeline system in Azerbaijan. A major part of the oil produced in Azerbaijan is being marketed by SOCAR Trading, a subsidiary of SOCAR.

Although privatisation of these segments of the oil and gas industry is not in the foreseeable plan of the government, SOCAR has actively engaged in joint ventures with local and foreign private investors for providing domestic oil and gas industry services.

International energy companies participate in the development of oil and gas fields together with SOCAR's subsidiaries, primarily under production sharing agreements (PSAs) signed with the government represented by SOCAR. Since its independence from the USSR in 1991, the government has executed about 30 PSAs, with 15 of these agreements currently in effect.

The government's profit share from the implementation of the oil and gas agreements is accumulated in the State Oil Fund of the Republic of Azerbaijan (SOFAZ) established in 2000. SOFAZ also manages this revenue and funds the shares of the state in several major infrastructures, as well as midstream and downstream projects in the region.

Government policy objectives

The Government of Azerbaijan has been active in establishing a favourable investment environment for foreign investors, which has



resulted in billions of dollars of direct investments in the Azerbaijan oil and gas industry. According to official data, more than US\$5 billion of foreign direct investment was made into the oil and gas sector in 2014. In addition, the government has been investing in the industry through the use of state funds.

The main objectives of the government in this area set out in the State Programme for the Development of Fuel and Energy Sector (2005 to 2015) and approved by the Presidential Order No. 635 dated 14 February 2005 are as follows:

- Determining the minimum directions of the development of the fuel and energy complex of the Republic of Azerbaijan in accordance with modern requirements.
- Carrying out relevant scientific, technical and organisational measures to increase the efficiency of the industry.
- Ensuring the implementation of advanced technological measures for the production, processing, transportation, storage, accounting and consumption of energy resources.
- Establishing a fair competition environment in the fuel/energy sector.
- Attracting more investments for the development of the fuel/energy complex.
- Ensuring ecological security in the fuel/energy complex.
- Ensuring the due payments of consumed fuel/energy resources (that is, electric energy and natural gas).

Current market trends

With the upcoming final investment decision regarding the development of the second stage of the Shah Deniz gas field project, Azerbaijan is close to opening a new gas corridor to Europe and becoming one of the major gas exporters to European markets. In line with this development, the government and SOCAR are keen to explore and develop new offshore natural gas structures. Absheron, Umid and Babek natural gas fields are considered to be promising discoveries which will allow the long-term supply of natural gas to Europe and Turkey.

SOCAR, together with multinational energy corporations such as BP, has started the exploration of new oil and gas fields in the shallow waters of the Azerbaijani Caspian Sea. In addition, there are some activities planned in connection with the exploration and development of shale oil and gas reserves in Azerbaijan.

SOCAR has been successfully transforming itself into a modern multinational oil corporation. In recent years, it has started to play a more active and effective role in oil and gas operations, not only in the state-controlled sector of the oil and gas industry, but also in the private sector, in particular in operations and marketing activities under PSAs (*see above, Domestic market structure*).

In addition to upstream developments, the government has also focused in recent years on:

- Developing the oil and gas processing and petrochemical industries.
- Building a competitive national oil and gas processing industry in Azerbaijan.

2. What percentage of domestic energy needs is met by oil and gas?

According to the latest statistical data available in 2014, about 42% of domestic energy consumption is met by natural gas, while oil products represent 38% of energy consumption. The production of electricity depends heavily on the consumption of natural gas. In 2012, 89% of electricity was generated using natural gas. LNG is not used for domestic energy consumption.

3. Are there specific government policies and/or incentives in place to encourage the exploration and production of unconventional/shale gas and/or oil?

There are no specific government policies, regulations or incentives to encourage the exploration and production of unconventional/shale gas and oil.

REGULATION

Regulatory bodies

4. Who regulates the extraction of oil and gas?

The Ministry of Energy

There is no independent public regulator for the oil and gas sector. The functions of regulator are carried out by the Ministry of Energy in accordance with its Regulations approved by the Decree No. 575 of the President of the Republic of Azerbaijan dated 6 September 2001 and other relevant laws and presidential acts. The Ministry of Energy must supervise, and is entitled to issue special permits for, the exploration, exploitation, production, processing, storage, transportation, distribution and use of energy materials and products, including oil and natural gas (*Law on Energy of the Republic of Azerbaijan and Presidential Decree No.512 dated 17 November 1996*). In addition, on authorisation of the President of Azerbaijan, the Ministry of Energy can prepare and negotiate draft agreements for the production of hydrocarbon resources, (such as production sharing agreements (PSAs)), sign such agreements on behalf of the government and supervise their implementation.

State Oil Company of the Republic of Azerbaijan (SOCAR)

SOCAR plays an active role in representing the interests of the state in the oil and gas sector. Through the preparation, negotiation and implementation of the vast majority of PSAs, SOCAR has been acting as a sole representative of the government, contributing substantially to the regulation of foreign oil and gas companies' activities in Azerbaijan. In addition, SOCAR actively participates in the policy-making activities of the government in the oil and gas sector.

Other state authorities

Other ministries and state bodies indirectly regulate the oil and gas industry in Azerbaijan, including the:

- **Ministry of Emergency Situations.** This ministry has authority for ensuring technical safety at potentially hazardous oil and gas operations. It issues licences for certain activities in the oil and gas industry, in particular for the installation and operation of natural gas facilities and the construction of drilling facilities. It also carries out the certification of installations and equipment used in potentially hazardous objects in the oil and gas industry.
- **Ministry of the Labour and Social Protection of Population.** This ministry has the general responsibility of ensuring compliance with the requirements regarding the health and protection of labour by employers engaged in oil and gas activities (*see Question 15*).
- **Ministry of Ecology and Natural Resources.** This ministry supervised the compliance of oil and gas activities with environmental regulations and standards.

See box, *The regulatory authorities*.

The regulatory regime

5. Describe the regulatory regime that applies to onshore and offshore oil and gas exploration and production, including the key legislation and features of the regime.

A number of laws regulating oil and gas extraction activities have been adopted since the first years of independence. In the absence of codification, there are some inconsistencies in the development and implementation of these laws. Some of the key laws regulating the upstream oil and gas activities are:

- Law on Use of Energy Resources dated 30 May 1996.
- Law on Energy dated 24 November 1998 (Energy Law).
- Law on Subsoil dated 13 February 1998.
- Law on Gas Supply dated 30 June 1998.

There are two basic regulatory regimes that apply to oil and gas exploration and production in Azerbaijan:

- Regulatory regime established under the Law on Energy and implemented through energy contracts.
- Ad hoc regimes established by specific production sharing agreements (PSAs).

Energy contracts

The Energy Law regulates the exploration, extraction, distribution, transportation and storage of oil and gas in Azerbaijan. To engage in these activities, individuals and legal entities must obtain a special permit and enter into an energy contract with the Ministry of Energy or SOCAR. The Energy Law contains provisions on the:

- General mechanisms for the conclusion of energy contracts.
- General features for the different types of energy contracts.
- Rights and obligations of the contractors entering into energy contracts.

Parties engaged in oil and gas operations in accordance with the Energy Law must also comply with all other relevant laws and regulations of Azerbaijan applicable to these operations.

The Law on Subsoil is another notable law. Although the Subsoil Law specifies that it does not apply to the use of subsoil in connection with energy resources (such as oil and natural gas), the Energy Law refers to its provisions in certain cases, in particular in relation to the use of land for the activities regulated by the Energy Law.

PSAs

The execution of the first PSA for the Azeri, Chirag and Gunashli offshore oil fields (ACG PSA) laid the foundation of a new regulatory regime. After its execution, the ACG PSA was approved by the National Assembly of Azerbaijan (*Milli Majlis*) and given force of law. This practice has since been followed for all major onshore and offshore oil and gas field developments. As a general rule, all PSAs executed by the State Oil Company of the Republic of Azerbaijan (SOCAR) on behalf of the government are enacted as laws after being executed.

Each PSA is executed by the foreign energy companies, a SOCAR affiliate and the government, usually represented by SOCAR. Each PSA sets out an ad hoc regulatory regime for oil and gas operations carried out on the specific field developed under the PSA. In particular, the PSA regulates:

- Ownership of oil and gas and assets.
- Health, safety and environmental compliance.
- Taxation.

- Import/export operations.
- Profit sharing mechanisms.

The Energy Law, which generally applies to upstream oil and gas activities, does not apply to these operations. However, in recent years, the state regulatory bodies have sought to ensure that the provisions of PSAs do not conflict with other relevant national laws (*see Questions 12 and 13*).

Other

Under the Law on Protection of Foreign Investment dated 15 January 1992, rights to explore and produce minerals in Azerbaijan are granted to foreign investors under concession agreements concluded with the Cabinet of Ministers and approved by the Supreme Counsel (now the National Assembly). However, there are no known precedents of application of this law.

RIGHTS TO OIL AND GAS

Ownership

6. How are rights to oil and gas held, and who holds those rights?

Under the Constitution of the Republic of Azerbaijan dated 12 November 1995, natural resources belong to the state of Azerbaijan, without prejudice to the rights and interests of any individuals or legal entities. The Subsoil Law and Energy Law also provide for the state's exclusive rights of ownership over oil and gas resources.

Rights over land do not entail subsoil rights over oil and gas reserves found below the land. The transfer of ownership of oil and gas from the state to private parties is only possible after their extraction.

Nature of oil and gas rights

7. What are the key features of the leases, licences or concessions which are issued under the regulatory regime? Can these rights be leased by the right-holder?

Energy contracts

Rights for the exploration, development and production of oil and gas can be granted in accordance with the specific type of energy contract (*Law on Energy dated 24 November 1998 (Energy Law)*). These contracts are in essence services contracts executed between the contractor and the Ministry of Energy or State Oil Company of the Republic of Azerbaijan (SOCAR) (*see Question 5, Energy contracts*).

Rights under an energy contract must be registered with the Ministry of Energy. Contractors must also obtain special permits for engaging in energy activities (including the exploration, development and production of oil and gas) (*Energy Law*). The Ministry of Energy has authority to issue such permits (*Presidential Decree No. 512 dated 17 November 1996*). However, no specific rules for the issuance of special permits have been adopted to date.

The provisions pertaining to the protection of environment of contracts for the use of natural resources become effective after approval by the Ministry of Environment and Natural Resources (*Law on Protection of Environment dated 8 June 1999*).

Exploration contracts (a type of energy contract) are executed for an initial period of two years, renewable for one additional year. The execution of such contracts does not guarantee exclusive exploration rights over the specified area. It also does not provide pre-emptive rights for the development and production of oil and gas. All data and results of the exploration works must be submitted to the Ministry of Energy.

Development and production contracts regulate the rights and obligations of the contractor and the relevant state authority (that is, the Ministry of Energy or SOCAR) regarding the development and production activities. The development works can be carried out during a period agreed between the contractor and the state, which cannot exceed eight years. Development works must be realised in accordance with the master work programme agreed under the contract. There is no limitation on the production period (*Energy Law*). The Ministry of Energy approves individual production work programmes for each discovery.

Some licensing requirements apply to certain business activities associated with oil and gas operations, such as the (*Presidential Decree No.782 on Improvement of Rules on Issuance of Special Consent (Licences) for Some Types of Activities, dated 2 September 2002*):

- Sale of oil and gas products.
- Installation and operation of facilities for liquid and natural gas.
- Mining and drilling works.
- Transportation of dangerous goods (including oil, certain oil products and gas) by vehicles, by sea or on land.

Production sharing agreements (PSAs)

PSAs grant contractors the sole and exclusive right to conduct upstream oil and gas operations in the area specified in the PSA. PSAs also determine the participatory interests of the contractors and specific conditions and terms under which the operations must be conducted. PSAs typically define the:

- Warranties and general rights and obligations of the parties.
- Scope of the works.
- Procedures and rules for the management and implementation of the oil and gas operations.

The terms of PSAs vary, although they typically last about 30 years. This period can be extended with the consent of SOCAR.

Fees

General fees. Contractors must pay specific licence fees for engaging in licensable oil and gas activities as determined by the *Presidential Decree No. 782 On Improvement of Rules on Issuance of Special Consent (Licences) for Some Types of Activities, dated 2 September 2002*. The fees may range from AZN150 to AZN11,000.

The contractors and SOCAR must also pay taxes in accordance with the tax regime established by the Tax Code of the Republic of Azerbaijan for non-PSA oil and gas activities (*see Question 10, General tax regime*).

PSAs. Development programmes approved under individual PSAs regulate the size and terms of the investments by the contractors. Certain PSAs require contractors to pay bonuses to the government. These bonuses may be conditional on the occurrence of specific events such as the PSA becoming effective, approval of the development programme or the production of oil or gas reaching certain levels.

In addition, contractors must pay taxes in accordance with the individual tax regime established under the PSA (*see Question 10, Production sharing agreements (PSAs) and host government agreements (HGAs)*).

Liability

Energy contracts. Contractors engaged in upstream oil and gas activities are liable for violation of the terms of the contract and legislation regulating such activities. The owners of the facilities and equipment used for oil and gas operations are liable for damages caused to the environment and persons' health during their use, unless the owner is not the actual user of such facilities

and equipment and proves that damages were caused by the fault of the actual user (*Energy Law*).

Parties are not liable for damages caused by force majeure events.

For more detailed information on liability in connection with health, safety and environmental compliance, see *Question 15*.

PSAs. Contractors are generally only liable to SOCAR and/or any governmental authority for loss or damage arising from their wilful misconduct or the wilful misconduct of their respective employees, sub-contractors and sub-contractors' employees acting in the performance of oil and gas operations. A joint operating agreement signed between the contractors regulates the allocation of liability between the operator and contractors that are not involved in daily operations.

Restrictions

The Energy Law does not set out any restrictions for obtaining licences or entering into energy contracts for private local and foreign companies and individuals. However, there are certain restrictions set out by the president. The production and processing of oil, oil products and natural gas can only be conducted by state enterprises and joint stock companies with a controlling state shareholding (*Decree No. 310 on Measures to Improve Issuance of Special Permit (Licence) for Certain Types of Business Activities in the Republic of Azerbaijan*). Enterprises and organisations (for example, SOCAR) established by a presidential decree to engage in a business funded by the state (and in other cases specified by law) can engage in such business without obtaining a licence (*section 2*).

In addition, contractors must return the area located outside the disclosed commercial discovery to the state (*Energy Law*).

Contractors producing oil or gas under energy contracts must also sell a certain portion of their production at world market prices to the state on request for domestic consumption needs (*Energy Law*).

8. How are such leases, licences or concessions awarded?

Energy contracts

Energy contracts are awarded to contractors through tenders or direct negotiations. To date, no specific regulations on the organisation and implementation of such tenders and negotiations have been adopted.

Production sharing agreements (PSAs)

As a general rule, PSAs are awarded to contractors through direct negotiations with the State Oil Company of the Republic of Azerbaijan (SOCAR). Under the Charter of SOCAR approved by the Presidential Decree No. 844 dated 24 January 2003, SOCAR can only engage in direct negotiations with contractors after being duly authorised by a specific act of the President.

Transfer of rights

9. How are oil and gas rights transferred? Are there any restrictions on the disposal of interests?

Energy contracts

Rights granted under energy contracts can be transferred to third parties with the consent of the Ministry of Energy. A transfer is effective after registration with the Ministry. If consent is not granted, the original contractor remains severally and jointly liable for its obligations under the energy contract.

Production sharing agreements (PSAs)

The contractor's right to transfer its interests under the PSA is contractually agreed and reflected in the PSA. As a general rule,

the contractor can assign all or part of its rights and obligations under the PSA to:

- Third parties, with the prior approval of the State Oil Company of the Republic of Azerbaijan (SOCAR).
- Its affiliates without approval, provided that the assignees:
 - have the technical and financial ability to fulfil the responsibilities and obligations under the PSA; and
 - accept all terms and conditions of the PSA.

Unless the approval of SOCAR is sought and granted, a contractor assigning its rights and obligations to its affiliate remains liable for its obligations under the PSA.

TAX

10. What payments, such as taxes or royalties, are payable by oil and gas interest holders to the government?

General tax regime

The taxes applicable to individuals and legal entities engaged in oil and gas exploration, production and transportation activities include:

- Profits (corporate income) tax at 20% (for legal entities).
- Value added tax (VAT) at 18%.
- Individual income tax (for physical persons) is payable as follows:
 - a 14% tax is paid on monthly taxable income up to ANZ2,500, and AZN350 and 25% is paid if the monthly taxable income exceeds ANZ2,500; and
 - a 14% tax is paid on annual taxable income up to ANZ30,000, and AZN4,200 and a 25% tax is paid if the annual taxable income exceeds AZN30,000.
- Mining tax (royalty) on the wholesale price of crude oil and natural gas at:
 - 26% for crude oil; and
 - 20% for natural gas.

In addition, participants to oil and gas activities may be subject to:

- Excise.
- Highway tax.
- Property tax.
- Land tax.
- Social taxes and charges.

Production sharing agreements (PSAs) and host government agreements (HGAs)

The tax regimes provided under specific PSAs and HGAs (*see Question 13, Host government agreements (HGAs)*) are specific to each project and differ from the general tax regime (*see above, General tax regime*). Generally, PSA and HGA tax regimes provide for:

- Fixed withholding income tax rates.
- Exemption from VAT.
- Simplified reporting and accounting procedures.

PSAs may provide for other or additional taxes and levies, such as acreage fees. Generally, tax paid by oil and gas contractors under PSAs can be included into the state's share of profit derived from oil and gas production.

11. Does the government derive any other economic benefits from oil and gas exploration and production?

The government derives economic benefits from oil and gas exploration and production through general fees and bonuses (*see Question 7, Fees*).

12. What taxes and duties apply on import and export of oil and gas?

The following taxes and customs fees apply to imports of oil and gas (*Tax Code dated 11 July 2000; Customs Code dated 24 June 2017*):

- Customs duties. Ad valorem import tariffs range from 0 to 15% (*Decision No.161 of the Cabinet of Minister dated 22 December 2003*).
- Value Added Tax (VAT) at 18%.
- Customs levies.

PSA and HGA tax regimes (*see Question 10, Production sharing agreements (PSAs) and host government agreements (HGAs)*) provide exemptions from import customs duties and VAT under specified conditions.

Oil and gas exports are exempt from customs duties and VAT.

TRANSPORTATION BY PIPELINE

13. What regulatory requirements apply to the construction and operation of pipelines?

General requirements

The right to develop and operate master energy transportation systems, including trunk pipelines, is granted to individuals and legal entities by execution of an energy contract with the Ministry of Energy or the State Oil Company of the Republic of Azerbaijan (SOCAR) (*Law on Energy dated 24 November 1998 (Energy Law)*). The general selection and special permit requirements for the execution of energy contracts apply (*see Questions 5, Energy contracts and 7, Energy contracts*).

The requirements for the provision of gas transportation services by pipelines are set out in the Law on Gas Supply and are similar to those under the Energy Law.

The energy contract may also grant:

- The right to build and operate auxiliary infrastructures (for example, for storage).
- Ownership over such infrastructures.
- The right to transfer the use of infrastructures.

The contract is signed for a term of 20 years and can be renewed for ten more years.

Agreements on the export and import of third party gas by pipeline become effective from their approval by the Cabinet of Ministers (*Law on Gas Supply*).

Host government agreements (HGAs)

The government has signed HGAs with a consortium of international oil and gas companies for the construction and operation of the pipelines to be used for the export of oil or gas resources developed together with these companies. HGAs grant certain absolute and unrestricted rights to investors in connection with the construction and operation of the pipelines and set the

schedules and standards applicable to the construction and investment obligations of the contractors. HGAs also include undertakings of the government to:

- Provide the necessary support for the construction of the pipelines.
- Guarantee the stability of the regulatory and fiscal regimes that apply to pipeline operations.

HGAs are enacted as laws of Azerbaijan, in the same way as production sharing agreements (PSAs) (see *Question 5, PSAs*).

The first HGA was signed on 17 October 2000 in respect of the Baku-Tbilisi-Ceyhan oil pipeline, which is a landmark pipeline that transports oil from the Azeri, Chirag and Gunashli fields. Another HGA was signed on 14 February 2002 in respect of the South Caucasus gas pipeline (SCP) which was built for the export of gas from the Shah Deniz field.

14. Is there a system of third party access to pipelines and other infrastructure?

Energy agreements on master energy transportation systems must take into consideration competition among the producer of energy materials (including oil and gas and their products) (*Law on Energy dated 24 November 1998 (Energy Law)*). Third party access must be granted if the pipeline is operated on an exclusive basis. The oil and gas producer operating the pipeline on an exclusive basis must grant unused pipeline capacity to interested third parties. However, transportation of the third party's oil or gas must not hinder the transportation of oil and gas owned by the pipeline owner/operator. To date, no regulations have been issued for the implementation of these requirements, which impedes their application in practice.

All major pipeline owners and operators are listed as natural monopolists (*Decision No.189 of the Cabinet of Ministers of the Republic of Azerbaijan dated 19 July 2013*). Their activities are controlled and regulated by the government in accordance with the Law on Natural Monopolies.

The activities on the South Caucasus gas pipeline (SCP) are exempt from the requirements of competition, anti-trust and natural monopoly laws (*Article 4.1, SCP host government agreement (HGA)*).

HEALTH, SAFETY AND THE ENVIRONMENT

Health and safety

15. Describe the health and safety regime that applies to oil and gas exploration and extraction, and transportation by pipeline.

General health and safety regime

There are various laws and other normative acts that regulate the health and safety requirements applying to upstream and midstream oil and gas activities. The main laws are the:

- **Law on Technical Safety of the Republic of Azerbaijan, dated 8 June 1999.** This law defines oil and gas production facilities and trunk pipelines for the transportation of oil and gas as potentially hazardous production facilities. It imposes certain obligations on individuals and legal entities exploiting such facilities. These persons have to comply with all legislation, legal acts, standards, requirements and orders related to the exploitation of these facilities. In addition, project documents for the construction and reconstruction of oil and gas production facilities and trunk pipelines, and equipment and installations used at these facilities, are subject to technical safety examinations by the Ministry of Emergency Situations.

Users of such facilities are liable by default for any accident or incident taking place on the facilities.

- **Law on Protection of the Environment of the Republic of Azerbaijan, dated 2 November 1999.** This law aims to ensure environmental safety, prevent negative impact of business and other activities on nature and protect biodiversity. It sets out the rights and obligations of state authorities and businesses, and environmental requirements regarding the use of natural resources and the development, construction and exploitation of energy and transportation facilities (see *Questions 17 and 18*).
- **Labour Code, dated 1 February 1999.** The Labour Code regulates the occupational health and safety regime in the workplace. It provides that the owner of the enterprise and employer are directly responsible for compliance with occupational health and safety rules and regulations. Owners and contractors (as employers) of upstream or midstream facilities may be held liable for:
 - violations of these rules; and
 - injuries of employees resulting from non-compliance with the rules.

The safety requirements applying to the exploitation and repair of trunk pipelines are set out in the Technical Safety Rules for Trunk Pipelines approved by Decree No.39 dated 28 July 2010 of the Ministry of Energy.

For more information on the government bodies responsible for the regulation and supervision of compliance with health and safety requirements, see *Question 4, Other state authorities*.

Host government agreements (HGAs)

HGAs for pipeline development (see *Question 13, Host government agreement (HGAs)*) establish standalone health and safety requirements that are independent from the general regime (see *above, General health and safety regime*). Under HGAs, participants to the pipeline projects must comply with the health and safety standards that are customary in international petroleum transportation projects.

Production sharing agreements (PSAs)

Most PSAs establish specific health and environmental standards. Contractors must develop jointly with the State Oil Company of the Republic of Azerbaijan (SOCAR) and the Ministry of Environment and Natural Resources safety and environmental protection standards and practices to regulate operations by taking into account both the:

- International petroleum industry standards.
- Existing Azerbaijan safety and environmental legislation.

Contractors must comply with general Azerbaijani laws and regulations on public health, safety and environment, to the extent that such laws and regulations are no more stringent than international standards.

Environmental impact assessments (EIAs)

16. Is an EIA required before extracting or processing onshore or offshore oil and gas?

On receipt of an application to enter into an energy contract, the Ministry of Energy or the State Oil Company of the Republic of Azerbaijan (SOCAR) must arrange an environmental impact assessment (EIA) of the operations over the relevant territory (*Law on Energy dated 24 November 1998 (Energy Law)*). The EIA must be completed by independent experts (*Energy Law*).

The EIA is also mandatory for production sharing agreements (PSAs). The terms of the EIA are agreed with the government as part of the development programme and serve as a basis for

developing the environmental protection standards applicable to the specific upstream project (see *Question 15, Production sharing agreements (PSAs)*). As a general rule, EIAs under PSAs are completed by independent international consultants.

17. What are the different stages of the EIA?

Costs associated with the EIAs are covered by the applicant to the energy contract. There are no statutory period limitations for the implementation of EIAs. However, an EIA must be completed before the commencement of the activities.

EIA reports are subject to an environmental examination conducted by the Ministry of Environment and Natural Resources (*Law on Protection of Environment*).

The conclusions of EIAs conducted under production sharing agreements (PSAs) must be acceptable to the State Oil Company of the Republic of Azerbaijan (SOCAR).

Procedures for the implementation of EIAs are not regulated. It is therefore not possible to provide specific information on the different stages and timelines of EIAs.

Environmental permits

18. Is there a permit regime for environmental damage or emissions produced during the extraction or processing of oil and gas?

Individual entrepreneurs and companies engaged in the upstream and midstream oil and gas sector are subject to a variety of environmental requirements that relate to:

- Air emissions.
- Water use and disposal.
- Waste management.
- Type of impact on the environment.

The main law in this field is the Law on Protection of Environment.

Businesses must secure the following approvals and permits before commencing oil and gas operations (*Law on Protection of Environment*):

- Positive opinion of the Ministry of Environment and Natural Resources issued as a result of the environmental impact assessment (EIA) (see *Question 16*).
- Environmental examination conducted by the Ministry of Environment and Natural Resources (see *Question 17*).
- Environmental passport and passport of hazardous wastes approved by the Ministry of Environment and Natural Resources. These passports set out the allowed levels of impact on the environment and amount of waste disposals.

Environmental concerns

19. Are there any specific government policies and/or incentives aimed at meeting the environmental concerns associated with the exploration and production of oil and gas, particularly unconventional/shale oil and/or gas? Are there other non-environmental concerns which inhibit the development of the sector?

Government policies are reflected in the general environmental laws and regulations which apply to all industry sectors, including the production of oil and gas.

Waste

20. What are the regulations on the disposal of waste products resulting from oil or gas extraction or processing?

The Law on Industrial and Household Wastes dated 30 June 1998 provides a general framework for the management, processing, transportation and disposal of waste products produced by all industries. Specific obligations of oil and gas producers regarding waste products management and disposal are set out in the Law on Energy dated 24 November 1998 (Energy Law).

The Ministry of Ecology and Natural Resources also has authority to issue permits for the disposal of hazardous waste and drain waste water. These permits prescribe the maximum amount of hazardous waste that can be disposed of and waste water that can be drained into water basins.

Oil and gas producing and processing enterprises are prohibited from draining production waste into the general sewage system (*Decree No.122 dated 13 July 2000 of the Cabinet of Ministers of the Republic of Azerbaijan*). Azerbaijani law and various industry standards also contain various requirements on placing drilling wells in certain locations (for example, water basins, roads, settlements, nature reserves, historical monuments and telecommunication lines and equipment).

Flares and vents

21. Are flare and vent regulations in place?

The emission of harmful substances into the air from stationary sources require a special permit issued by the Ministry of Ecology and Natural Resources (*Law on Protection of Atmospheric Air of 27 March 2001*). The special permit must set out the level of permissible emissions and the mitigating measures that the permit holder must take. Emissions (or other impacts on atmospheric air) produced without a special permit, and violations of the conditions of a special permit, may result in restrictions, suspension or termination of the activities. Flaring without using purification equipment is prohibited.

Most production sharing agreements (PSAs) allow contractors to flare or vent natural gas in any of the following events:

- Emergencies.
- Equipment malfunctions.
- Repairs or maintenance of any facility.
- The State Oil Company's (SOCAR's) failure to take delivery of natural gas.

Decommissioning

22. What are the decommissioning obligations and liabilities that arise?

The contractors must transfer the installations and equipment to the state or new contractors free of charge in accordance with the energy contract (*Law on Energy dated 24 November 1998 (Energy Law)*). The energy contract must include a rehabilitation plan approved by the State Oil Company of the Republic of Azerbaijan (SOCAR) or the Ministry of Energy, which the contractor must implement before the contract's expiration. The contractor must also establish a rehabilitation fund to finance the works. The contractor can only remove or dispose of its fixed assets after completion of the rehabilitation works.

Production sharing agreements (PSAs) regulate the decommissioning obligations of contractors in more detail. They

contain provisions on the abandonment fund that contractors must establish to finance the abandonment of fixed assets used for oil and gas operations and set the rules on contractors' contributions to this fund. SOCAR and contractors must both approve the abandonment plan.

SALE AND TRADE

23. How is trade in oil and gas usually completed?

There are separate wholesale and consumer markets. Although there are no statutory limitations, wholesale and retail sales of oil and gas largely remain under the control of the State Oil Company of the Republic of Azerbaijan (SOCAR) and are regulated by the government. In recent years, the government has been considering liberalising and privatising the retail oil and gas market.

The general export regime applies to the export of oil and gas that is not produced under production sharing agreements (PSAs). Oil and gas produced under PSAs are exempt from foreign trade regulations that prohibit, limit and restrict import and export, and country of origin rules.

24. Are oil and gas prices regulated?

A contractor can freely determine market prices, unless the legislation provides otherwise (*Law on Energy dated 24 November 1998 (Energy Law)*). However, oil and natural gas are included in the list of goods, services and works that are subject to price regulation by the government (*Decree No.178 of the Cabinet of Minister dated 28 September 2005*). The Tariff Council is responsible for price regulation in Azerbaijan. The Council regulates prices for the:

- Domestic wholesale and retail sales of oil, oil products and gas.
- Services relating to the transportation of oil and natural gas through pipelines.
- Services for the storage and distribution of natural gas.

Prices of oil and gas sold in foreign markets are not regulated.

ENFORCEMENT OF REGULATION

25. What are the regulator's enforcement powers?

Orders

The Ministry of Energy can adopt mandatory rules that apply to the oil and gas industry, in accordance with the Law on Energy dated 24 November 1998 (Energy Law). In addition, the Ministry can issue specific orders to oil and gas producers for the implementation and enforcement of relevant legislation.

Fines and penalties

The Ministry of Energy can impose administrative sanctions in cases of violations of oil and gas legislation. It can also suspend the special permits and licences issued to businesses engaged in oil and gas activities.

In addition, the Ministry can impose fines for failure to comply with obligations set out in the relevant laws (*Code of Administrative Violations dated 11 July 2000*).

26. Is there a right of appeal against the regulator's decisions?

The regulators' decisions that do not comply with substantive or procedural requirements can be contested before the administrative-economic court or a district (city) court, depending on the issue and affected parties. Appeals must be made within 30 days from the date of official notification of the decision to the appellant.

REFORM

27. Are there plans for changes to the legal and regulatory framework?

There are currently no foreseeable plans for changes to the legal and regulatory framework.

THE REGULATORY AUTHORITIES

Ministry of Energy of the Republic of Azerbaijan

Address. Baku, Uzeyir Hajibeyov str. 84, Government House, AZ1000

T +994 12 598 16 53/54/55

F +994 12 598 16 78

E minenergy@minenergy.gov.az

W www.minenergy.gov.az

Main responsibilities.

- Participates in the formalisation of state policy and ensures the implementation of such policy.
- Ensures the implementation of measures related to the efficient use of energy resources and the protection of state interests in this field.
- Ensures the development of the energy sector.
- Regulates the energy sector.

Ministry of Emergency Situations of the Republic of Azerbaijan

Address. AZ1073, Baku city, M. Mushfig str., block 501

T +994 12 512 00 61

F +994 12 512 00 46

E info@fhn.gov.az

W www.fhn.gov.az

Main responsibilities.

- Develops state policy and regulations in matters related to civil defence, the protection of population and territories from emergency cases, fire safety, safety of people in water basins, technical safety in industry and mining works and construction, avoidance of emergency cases resulting from the accidental flow of oil and gas products.
- Carries out normative regulation and control/inspection functions.

Ministry of Ecology and Natural Resources of the Republic of Azerbaijan

Address. Baku city, B. Aghayev str., 100 (A)

T +994 12 538 04 81; +994 12 538 85 08; +994 12 538 13 35; +994 12 539 18 63

F +994 12 492 59 07

E ecologiya.nazirliyi@eco.gov.az

W www.eco.gov.az

Main responsibilities.

- Develops the state policy regarding the exploration, use, rehabilitation and protection of natural resources, the provision of ecological safety and the protection of biological diversification.
- Implements the state policy on the use of waters biological resources, their protection and enhancement.
- Develops the state policy on the geological exploration and protection of subsoil and the efficient use of mineral raw material resources.
- Develops and implements relevant national action programmes on ecology and the use of natural, geological and mineral resources.

Ministry of Health of the Republic of Azerbaijan

Address. Baku city, AZ 1022 ac. M. Mirgasimov str. 1A

T +994 12 441 26 03; 9103 (hotline)

F +994 12 493 06 95

E office@health.gov.az

W www.health.gov.az

Main responsibilities.

- Participates in the formalisation of a unified health state policy and ensures the implementation of such policy.
- Develops various programmes and ensures their implementation.

ONLINE RESOURCES

Ministry of Justice of the Republic of Azerbaijan

W www.e-qanun.az

Description. This website is maintained by the Ministry of Justice which maintains the state register of the Republic's legal acts.

Ministry of Taxes of the Republic of Azerbaijan

W www.taxes.gov.az

Description. This website is maintained by the Ministry of Taxes and includes normative and legal acts regulating taxation that are of particular importance for businesses. English translations are unofficial and are not binding on the state authorities. This website does not include all laws referred to in this article.

Ministry of Energy of the Republic of Azerbaijan

W www.minenergy.gov.az

Description. This website is maintained by the Ministry of Energy and includes normative and legal acts regulating the exploration, development, production and use of energy resources.

Practical Law Contributor profiles



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Baku office

Professional qualifications. Azerbaijan, Lawyer

Areas of practice. Upstream, midstream and downstream oil and gas; power; mining and natural resources; infrastructure; anti-trust and competition.

Non-professional qualifications. LLM, University of New Hampshire, School of Law; Bachelor of Law, Baku State University.

Recent transactions

- Advising an international oil and gas company in connection with the acquisition of a participatory interest in one of the major hydrocarbon offshore field development projects in Azerbaijan.
- Advising an oil and gas company on local law and regulations applying to the shale oil and gas development in Azerbaijan and related contractual aspects.
- Advising a global energy services company on local law and transactional aspects of the establishment of a strategic alliance with an Azerbaijani oil company and the performance of works under the Shah Deniz PSA Stage 2.
- Advising an international oil and gas services company on customs, environmental compliance and asset ownership regimes applicable to subcontractors operating in Azerbaijan under the EDPSAs.

Languages. Azerbaijani, English, Russian, Turkish, basic German

Professional associations/memberships. Association of the International Petroleum Negotiators.

Publications. Adjunct professor of law at the Baku State University; lectures on the Energy Law-related topics.

Baku office

Professional qualifications. Azerbaijan, Lawyer

Areas of practice. Energy, mining and infrastructure; real estate; tax.

Non-professional qualifications. LLM in Commercial Law, Baku State University; Bachelor of Law with distinction, Baku State University.

Recent transactions

- Advising a global energy services company on local law and transactional aspects of the establishment of a strategic alliance with an Azerbaijani oil company and the performance of works under the Shah Deniz PSA Stage 2.
- Advising a global energy services company on various matters as an in-house lawyer during a three-month secondment.
- Assisting a foreign oil company in the negotiation and execution of a joint study agreement for initial studies and exploration of hydrocarbon resources in Azerbaijan.
- Advising a foreign oil company in connection with the establishment of its branch offices in Azerbaijan.

Languages. Azerbaijani, English, Russian, basic German