

MGB Law Offices

State Oil Fund of the Republic of Azerbaijan
24, Neftchilar Avenue
AZ 1000, Baku
Azerbaijan

12 September 2013

Legal opinion including analysis of the New Extractive Industries Transparency Initiative Standard (EITI Standard) in light of the requirements of the legislation of the Republic of Azerbaijan

Dear Sirs

At your request, we have prepared this opinion in respect of the laws of the Republic of Azerbaijan in connection with the new EITI Standard to be implemented in the Republic of Azerbaijan.

1. In connection with the foregoing, we have examined EITI Standard. Words and expressions used in capitalised form in this opinion are defined in the body of this opinion.
2. In rendering the opinions set out below, we have relied upon the accuracy of the EITI Standard and we have assumed and have not independently verified:
 - (i) that there have been no variations or amendments to EITI Standard of which we have not had notice and which would otherwise cause us to qualify or vary the opinions contained herein.
 - (ii) The opinions set forth below are limited to the laws of the Republic of Azerbaijan as at the date hereof, and we express no opinion as to the future laws of the Republic of Azerbaijan or the laws of any jurisdiction other than the Republic of Azerbaijan.
3. Based upon the foregoing and subject to the qualifications set out in paragraph 4, we are of the opinion that

EITI Standard does not have any major provisions which would contradict to the legislation of the Republic of Azerbaijan.

We therefore confirm that

Part one of the EITI Standard including

-the EITI Principles,

-EITI Requirements,

-the Validation Guide

MGB Law Offices Limited
Apt. 28-30
11 Rasul Rza Street
Baku AZ 1000
Republic of Azerbaijan

Tel: + 994 12 493 2939/6669
Fax: + 994 12 498 7132
e-mail: office@mgb-law.com
www.mgb-law.com

Registered as a branch in Azerbaijan No 1700037141

MGB Law Offices Limited is a limited company registered in Scotland with registered number SC186552 and having its registered office at Princes Exchange, 1 Earl Grey Street, Edinburgh, EH3 9AQ

-the Protocol "Participation of civil society and

Part two (Governance and Management)

do not conflict with the requirements of the legislation of the Republic of Azerbaijan.

4. The opinions expressed in this letter are subject to the following qualifications:

4.1 Legal environment

- (i) Section 1.3 (b) of EITI Requirement 1 of EITI Standard states that *"the government must ensure that there is an enabling environment for company and civil society participation with regard to relevant laws, regulations and administrative rules ...in implementation of EITI"*.

Section 1.3 (f) (iv) of EITI Requirement of EITI Standard also defines that *"the government must consider establishing the legal basis of the group"*. We note that on 13 November 2003 the Cabinet of Ministers issued the Decree for establishment of EITI Commission to perform necessary actions in connection with joining to EITI. On 24 November 2004, EITI Commission, Companies' Group (local and foreign companies engaged in the extractive industries) and NGO's Group entered into the Memorandum of Understanding on Implementation of EITI in Azerbaijan ("Memorandum").

- (ii) If EITI Standard would become a part of the legislation, they would be considered as legally binding instrument for state agencies and/or commercial entities engaged in the extractive industries in Azerbaijan. For instance, Section 4.2 (a) of EITI Requirement 4 of EITI Standard states that *"all companies making material payments to the government are required to comprehensively disclose these payments in accordance with the agreed scope"* or *"all government entities receiving material revenues are required to comprehensively disclose these revenues in accordance with the agreed scope"*. If EITI Standard would not have the obligatory legal force, companies engaged in extractive industry would not have the statutory obligation to disclose the relevant information as required under EITI Requirements.

Recommendation: The Government may consider ratifying EITI Standard as an act of law or incorporating the major requirements of EITI Standard into the existing Azerbaijani legislation otherwise.

4.2 Beneficial ownership

- (iii) a) Amongst others, we note that Section 1.4 (f) of EITI Requirement 1, Sections 3.6 (c) and 3.11 of EITI Requirement 3 of EITI Standard refer to the *beneficial ownership* in Azerbaijan respectively stating that *"where state participation in the extractive industries gives rise to material revenue payments, the EITI Report must include disclosures from*

government and SOE(s) of their level of beneficial ownership in mining, oil and gas companies operating within the country's oil, gas and mining sector, including those held by SOE subsidiaries and joint ventures, and any changes in the level of ownership during the reporting period.” or “it is recommended that implementing countries maintain a publicly available register of beneficial owners of the corporate entity(ies)... ” or “it is required that the government and/or state owned enterprises disclose their level of beneficial ownership in oil, gas and mining companies operating within the country...”. It should be noted that the concept of beneficial ownership is not recognized under the Azeri law and no publicly available register of beneficial owners of corporate entities exist in Azerbaijan. , The state register of legal entities contains information about the registered owners of shares (participatory interests) in corporate entities rather than the beneficial owners of such entities. Thus, no public registers in Azerbaijan contains the information about beneficial ownership and, therefore, it is unlikely that such information can be provided by the government and/or state owned enterprises on the statutory basis. Moreover, under the Law on introducing amendments to the “Law on State Registration and Register of Legal Entities” dated 12 June 2012, access to the information on founders (shareholders) of legal entities has been restricted and such information is not further publicly available. Such information may be obtained by third parties only with the consent of the shareholders of such entities (except for the courts and court bailiffs, law enforcement agencies and advocates)¹

b) Section 3.11 (b) of EITI Requirement 3 of EITI Standard states that “*where such registers don’t exist or are incomplete, it is recommended that implementing countries request companies participating in the EITI process provide this information for inclusion in the EITI Report.*” Further, Section 3.11 (d) (iv) states that “*.. each entity within the venture should disclose its beneficial owner(s), unless it is publicly listed..* ”. Given the lack of concept of beneficial ownership and absence of any statutory obligations as to provision of the information about such ownership in Azerbaijan, disclosure of the beneficial owners would not be legally binding requirement for companies participating in EITI.

c) It should also be taken into account that in the near future disclosure of beneficial ownership may become a mandatory requirement of EITI. It is noted under Section 3.11 (b) of EITI Requirement 3 of EITI Standard that at the 22nd EITI Board meeting, it was agreed that EITI will in the future require disclosure of beneficial ownership. Subject to successful piloting, the EITI Board will develop detailed provisions with a view to make this a requirement from 1st January 2016.

Recommendation: For the purpose of compliance with EITI Standard and provision of transparency in respect of this particular issue, the government may consider introducing the basic concept of beneficial ownership into the Azerbaijani legislation and establish obligations of companies to disclose information about beneficial ownership to relevant state registries, likewise to introduce the amendments to the legislation permitting the

¹ Article 15.9 of the Law on State Registration and Register of Legal Entities dated 12 December 2003

special commission to obtain such information for the purposes of making reports under the EITI Standard.

4.3 *Disclosure of information relating to extractive industry*

- (iv) Section 3.3 EITI Requirement 3 of EITI Standard states that “*EITI Report should provide an overview of extractive industries, including significant exploration activities*”. If the Report contains the information on geological structure of subsoil; minerals; and other properties of subsoil contained in reports, maps and other materials, such information may be considered as the state owned information² and it may be obtained from the State Fund on Geological Information of the Ministry of Ecology and Natural Resources upon payment of certain state fees³. Furthermore, if the geological information falls into the category of the state secret, it may be used upon obtaining an approval of the relevant state authorities responsible for protection of such information⁴. Under Article 5.2.6. of the Law on State Secret dated 7 September 2004 information on volume of certain strategical minerals, volume of their production, import, export, and sale of such minerals, and information on state reserves shall be considered the state secret (for detailed information please refer to the paragraph (vi) below).
- (v) The information on extraction industries to be included into EITI Report may also fall within the scope of information classified as *environmental*. Under the Azeri law, information on conditions (status) of subsoil (including oil, gas and minerals) shall be considered environmental information⁵. Such information may be opened for public or restricted for public use.. Under the Classification of Types on Environmental information Access to which is restricted approved by the Decree No. 26 of the Cabinet of Ministers dated 15 February 2003, an access to environmental information may be restricted by the state authorities if such information relates to (i) secret activities of the state authorities; (ii) connected with the state security matters; (iii) refers to secret materials of the state authorities in respect of international affairs or protection of the country; or (iv) relates to matters which are considered by the court or law enforcement bodies. Likewise for provision of protection of environment, state authorities may restrict access to the following environmental information: a) the disclosure of which may create a danger for environment or damage it; b) information on geological research of subsoil; c) information on cartograms relating to geological research of subsoil, and so forth. In order to obtain the foregoing information an application shall be made to the state authority possessing such information.
- (vi) Section 3.4. of EITI Requirement 3 of EITI Standard states that “ *EITI Report must disclose, when available, information about contribution of the extractive industries to the economy*”....including “*size of extractive industries, .. exports from extractive*

² Article 32 of the Law on Subsoil dated 13 February 1998

³ Articles 2.1 and 2.3 of the Rules and Conditions on Use of Geological Information on Subsoil approved by the Decree No. 175 of the Cabinet of Ministers dated 8 November 1999

⁴ Article 3.2 of the Rules and Conditions on Use of Geological Information on Subsoil approved by the Decree No. 175 of the Cabinet of Ministers dated 8 November 1999

⁵ Article 1 of the Law on Obtaining Information on Environment dated 12 March 2002

industries... key regions/areas where production is concentrated". Section 3.5 of EITI Requirement 3 also states that "*EITI Report must disclose production data .. including total production and export volumes...*". It should be noted that the information on volume of certain strategic minerals, volume of their production, import, export, and sale of such minerals is considered the state secret⁶. We note that the List of Information which is considered as State Secret approved by the Presidential Decree No. 248 dated 3 June 2005 ("List") includes specific minerals to the list of objects falling under the category of state secret. Under the List, information on industrial reserves of strategic minerals (*rare metals included into the group of tantalum, niobium, beryllium, lithium, and itrium; uranium, thorium, quartz raw materials*) in subsoil, which are not produced under the contracts (international agreements) to which the Republic of Azerbaijan is a party shall be considered as the state secret and may be used upon obtaining consent of the Ministry of Economic Development, Ministry of Ecology and Natural Resources, Ministry of Emergency Situations and Ministry of Industry and Power Engineering.

Recommendation: The government may consider introducing the legislation (or amendments to the existing legislation) to the effect that the entities (including state authorities) which possess the necessary information on extractive industries would cooperate with the special commission by providing such information to the commission for the purposes of making reports under the EITI Standard. An enactment of such legislation would create the legal basis for the special commission to request the information on extractive industries to which the access is restricted and the state authorities would not unreasonably refrain from providing such information.

4.4 Register of licenses

- (vii) Section 3.9 (b) of EITI Requirement 3 of EITI Standard states that "*implementing countries are required to maintain a publicly available register or cadastre system(s)... regarding each of the licenses (i.e. license, title, permit or concession by which the government confers on a company(ies) or individual(s) rights to explore or exploit oil, gas and/or mineral resources) pertaining to companies covered in the EITI Report..*". Unified license register in Azerbaijan is conducted by the Ministry of Economic Development⁷ ("MED"). Under the Regulations on Conducting Unified License Register in Azerbaijan approved by the Order No. 68 of the MED dated 30 September 2002 ("Regulations") register of all licenses issued in Azerbaijan is publicly available.. On the other hand, the Regulations have been adopted in light of the above Presidential Decree No. 782 and it may therefore be inferred that the register of licenses conducted in accordance with the Regulations would include the information on licenses falling into the scope of the Presidential Decree No. 782 only (i.e. the licenses for sale of oil and gas products, for production, processing and utilization, and turnover of precious metals and stones (gold, silver, platinum, etc.)). To our knowledge, to date, the unified licence

⁶ Article 5.2.6. of the Law on State Secret dated 7 September 2004

⁷ Article 1.9 of Regulations on issuance of a special permit (license) to certain type of activities approved by the Presidential Decree No. 782 dated 2 September 2002

register does not contain the information on licenses issued with respect to exploration or exploitation of oil, gas and minerals.

Recommendation: It is recommended to introduce the implementing legislation as to inclusion of the information on licenses issued with respect to exploration or production of oil, gas and mineral resources into the unified register of licenses.

4.5 Disclosure of contracts

(viii) a) Section 3.12 of EITI Requirement 3 of EITI Standard states that *“implementing countries are encouraged to publicly disclose any contracts and licences that provide the terms attached to the exploitation of oil, gas and minerals...”*. Under Section 3.12 (c) the term contract means: *“the full text of any contract, concession, production-sharing agreement or other agreement granted by, or entered into by the government which provides the terms attached to the exploitation of oil, gas and mineral resources .. and full text of any alteration or amendment to such documents”*. Under the existing legislation, the parties to commercial contract are not restricted to release such contract to third party unless they are bound by the confidentiality clause in such contract. We note that existence of confidentiality clauses in contracts shall oblige the parties of the contracts to comply with such confidentiality clauses. Under the Azeri law, the party disclosing a commercial secret (i.e. information related to production, technological, management, finance or other activities of individuals or legal entities or disclosure without an owner’s consent of which may adversely affect its legal interests) to third parties in violation of the confidentiality clause shall be responsible before its counterparty⁸. Therefore under the EITI Standard, the text of any commercial contracts may be disclosed to third parties only by observing confidentiality clauses in contracts or upon consent of the parties of the contract.

b) We note that the texts of some of the production-sharing agreements (“PSA”) entered into by foreign companies and state enterprises are not officially published and may not be publicly available in Azerbaijan. Although there are no specific legislative restrictions for such publication, we may suggest that the texts of some PSAs are not made publicly available due to confidentiality of some of the terms of the PSAs. In practice, in order to obtain the text of a particular PSA, the special commission should request it from SOCAR or the contracting parties or operator acting under the PSA.

c) We note that under the number of PSAs, *“..the information and data of a technically, geologically or commercially sensitive nature acquired or obtained relating to petroleum operations and which is not in the public domain or otherwise legally in the possession of the relevant party ... shall be considered confidential and shall be kept confidential and not be disclosed to any person or entity not a Party to this Contract...”*. Therefore, the parties to the relevant PSA may refuse to disclose the information on exploitation of oil and gas minerals if they decide that information is considered as confidential under the PSAs.

⁸ Article 7 of the Law on Commercial Secret dated 4 December 2001

- (ix) Section 4.1 (c) of EITI Requirement 4 of EITI Standard states that “*where the sale of the state’s share of production or other revenues collected in-kind is material, the government, including state owned enterprises are required to disclose the volumes sold and revenues received*”. We note that disclosure of such information would be subject to confidentiality clauses in a particular sale and purchase agreements.

Section 4.1 (d) of EITI Requirement 4 of EITI Standard sets out that “*where the multi-stakeholder group concludes that these agreements (i.e. agreements involving the provision of goods and services, including loans, grants and infrastructure works, in full or partial exchange for oil, gas or mining exploration or production concessions or physically delivery of such commodities) are material, the multi-stakeholder group and the Independent Administrator (auditor) are required to ensure that the EITI Report addresses these agreements, providing a level of detail and transparency commensurate with the disclosure and reconciliation of other payments and revenues streams*.”. Again, addressing the agreements in the Report as envisaged in the above Section 4.1 (d) with the disclosure of payments and revenues would be subject to confidentiality clauses contained in such agreements, if any.

Recommendation: The government may consider making the amendments to the legislation to the effect that parties to commercial contracts entered into by the government in the field of exploitation of oil, gas and mineral resources would not unreasonably withheld their consent with respect to disclosure of such contracts to the special commission for the purposes of making reports under the EITI Standard.

4.6 Disclosure of revenues and payments

- (x) Section 4.1 (b) of EITI Requirement 4 of EITI Standard sets out the disclosure requirement for extractive industry revenues and disclosure of all material payments to government by oil, gas and mining companies, stating that “*the following revenue streams should be included: 1) the host government’s production entitlement; 2) national state-owned company production entitlement; 3) profit taxes; 4) royalties, 5) dividends; 6) bonuses, such as signature discovery and production bonuses; 7) license fees, rental fees, entry fees and other considerations for licenses and/or concessions; and 8) any other significant payments and material benefit to government*”. In principle, the legislation sets out no mandatory obligation for taxpayers (including state owned enterprises) to disclose their internal financial information to third parties, except for the relevant state authorities such as the Ministry of Taxes. Any information on taxpayers (including state owned enterprises) may be disclosed to third parties only with the written consent of taxpayers⁹.

Recommendation: The government may consider introducing the amendments to the legislation stipulating that all companies (including state owned enterprises) acting in the oil, gas and minerals industry would not unreasonably refrain from disclosure of the necessary information on their revenues and payments to the special commission if it is

⁹Article 30 of the Tax Code dated 11 July 2000

requested by the special commission for the purposes of making reports under the EITI Standard.

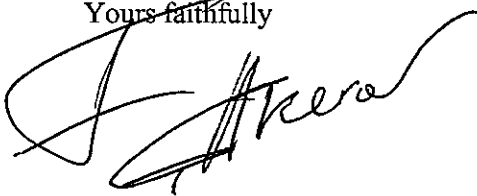
The information on use of resources of SOFAZ and annual report on actual use of its resources is published in official mass media per each year and the information on revenues and taxes can be found therein in general form only (including total figures on income and expenses).

5. This opinion letter :-

- a) is given to you in connection with EITI Standard only;
- b) is limited to the matters stated herein and does not extend to and is not to be read as extending by implication to any other matter in connection with the EITI Standard; and
- c) contains the entire opinion by us to you with respect to the EITI Standard contemplated herein and shall supersede all prior representations and opinions relating thereto, whether written, oral or implied from us to you.

6. We do not undertake to update, as of any future date, any of the opinions expressed in this letter.

Yours faithfully

A handwritten signature in black ink, appearing to read 'J. Akero', written over the typed name 'J. Akero'.

MGB Law Offices Limited