

Oil and Gas Regulation in Azerbaijan

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This article is about the general structure of petroleum ownership and regulation in Azerbaijan, and it is prepared inspired and on the basis of experience of professional lawyers from the best law firms in Azerbaijan.

Azerbaijan has created one of the most stable oil and gas regimes in the world. In 1994, the very first offshore Production Sharing Agreement (hereinafter the “PSA”) in Azerbaijan was signed for the Azeri-Chirag-Guneshli oilfields. In other countries, special laws regulate PSA contracts or the overall oil and gas industry, thus defining the legal conditions that PSAs must follow within the country’s existing legal framework.

1. REGULATORY BODIES

1.1. There is no independent public regulator for the oil and gas sector. Nevertheless, the Ministry of Energy and the State Oil Company of Azerbaijan Republic (hereinafter the “SOCAR”) carry out the functions of the regulator.

The Ministry of Energy of the Republic of Azerbaijan operates energy transactions in accordance with its Regulations approved by the Decree No. 575 of the President of the Republic of Azerbaijan and other relevant laws and presidential acts. The Ministry of Energy must supervise, and is entitled to issue special permits for exploration, exploitation, production, processing, storage, transportation, distribution and use of energy materials and products, including oil and natural gas. The Ministry of Energy is the central executive authority, which exercises state policy and regulation in the area of energy.

SOCAR is actively engaged in literally all

energy-related transactions as an implementing institution. Unlike the Ministry of Energy, which acts as a high-level regulator, SOCAR is the “commercial arm” of the State, having the prime responsibility, and possessing the requisite resources, to supervise and implement the projects in the energy sector. Acting as a sole representative of the government, SOCAR’s main objective is the implementation of exploration, discovery, preparation and development of both on- and offshore oil and gas fields, the transportation, processing and sale of oil, gas, condensate and products obtained from them, the stable and sustainable satisfaction of consumers’ demand for energy resources and provision of other works and services.

1.2. Other regulatory authorities:

Ministry of Emergency Situations 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.

Ministry of the Labour and Social Protection of Population 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.

Ministry of Ecology and Natural Resources supervised the compliance of oil and gas activities with environmental regulations and standards.

2. LAWS AND REGULATIONS

2.1. The legal system of Azerbaijan is based on a civil law system and, therefore, the country’s law is codified. There is, however, no

unified petroleum law regulating the oil and gas industry. Instead, the petroleum industry is governed by various laws enacted by the Parliament, as well as miscellaneous decrees, rules and regulations passed by the President, the Cabinet of Ministers, the Ministry of Energy and other relevant government bodies.

Main laws on the development, use and disposal of energy sources, including oil and gas, are:

1. Law on Use of Energy Resources dated 30 May 1996 (hereinafter the “Energy Resources Law”);
2. Law on Energy dated 24 November 1998 (hereinafter the “Energy Law”);
3. Law on Subsoil dated 13 February 1998 (hereinafter the “Subsoil Law”); and
4. Law on Gas Supply dated 30 June 1998.

Most provisions of the Energy Resources Law are of declaratory nature – they do not contain specific requirements with respect to the development of reservoirs. In particular, the Energy Law proclaims the government’s intention to achieve the efficient use of natural resources. The Energy Law contains more specific provisions, and governs “energy contracts”. The agreements on exploration, development and use of natural resources, such as oil and gas, are considered energy contracts. Under the Energy Law, energy contracts are awarded on competitive basis or as a result of negotiations.

The Subsoil Law defines “subsoil” as part of the land, which is located below the surface and consists of, among other things, natural and energy resources (such as oil and gas). Any natural resources below the surface of land belong to the government of Azerbaijan. The Subsoil Law defines “use” of subsoil. In particular, extraction of mineral resources is considered the use of subsoil. In order to use subsoil a legal or natural person must obtain a license from the government. The Subsoil Law allows for allocation of subsoil through negotiations with the government, although the law does not set out the procedure in more detail.

2.2. Two basic regulatory regimes 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 regime established by specific

PSAs.

Taking into consideration above-mentioned, under the Energy Law, the right to extract and develop energy resources may be granted according to ‘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. These contracts are in essence services contracts executed between the contractor and the Ministry of Energy or SOCAR.

The most common method of granting rights to develop oil and gas fields is by means of individually negotiated PSA. Approximately 25 PSAs have been signed during the last 20 years. It should be noted that Azerbaijan does not have a dedicated law governing PSAs. The Subsoil Law and the Energy Law are not sufficiently comprehensive to enable the regulation of most PSAs. Therefore, PSAs are usually negotiated and agreed separately. PSAs are entered into between number of large and multinational energy companies. Azerbaijan participates in oil and gas related PSAs through SOCAR. Most PSAs contain provisions governing in detail, among other things, each party’s interest (or share) in the project, the procedure for exploration of oil and gas reserves, formation of decision-making committees, procedure and criteria for making decisions in those committees, formation and functioning of operating companies. Besides regulating these contractual matters, PSAs also regulate issues of taxation of proceeds from oil and gas operations in the context of PSAs as well as import and exports of products. PSAs also regulate other matters that are normally within the ambit of regulations of general application.

3. RIGHTS TO OIL AND GAS

On the one hand, PSAs function both as the enabling commercial concession granting the subsoil use rights and as a rather comprehensive set of rules regulating almost all aspects of petroleum extraction and development. On the other hand, the Subsoil Law and the Energy Law set out separate rules on subsoil licensing.

Under the Subsoil Law, the right to engage in subsoil exploration and extraction activities may be granted pursuant to a special permit (licence) to Azerbaijani citizens and entities as well as to foreign individuals and legal entities. No person or legal entity may engage in oil exploration or production without a licence. Licences are awarded by tender, auction or, in exceptional cases, negotiation. Tenders may be open or closed, and licences under the Subsoil Law are available to foreign investors in the areas of exploration or production or both.

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).

4. TAX REGIME

The tax regimes provided under specific PSAs are specific to each project and differ from the general tax regime. Generally, PSA tax regimes provide for:

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

As a rule, PSAs provide total exemption from a number of taxes. Pursuant to the Azeri-Chirag-Guneshli PSA, for example, all foreign oil companies (hereinafter the “FOC”) are entitled to full and complete exemption from all taxes (existing or future) in respect of their hydrocarbon activities except for the flat profit tax. In addition, FOCs are entitled to repatriate their profits freely outside Azerbaijan without payment of any branch remittance tax on profit, interest, fees or charges with respect to any debt, royalty, lease payment or management fee. In other words, the flat profit tax of 25% fully satisfies FOCs’ tax liability in respect of their hydrocarbon activity under the PSA.

Similarly, FOCs engaged in hydrocarbon activity under the PSAs are also exempt with credit (0% rate) from VAT on all: (1) goods, works, and services supplied to or by them, (2) their exports of petroleum, and (3) imports of goods, works and services acquired by them.

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Xülasə

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Резюме

В данной статье нашло свое отражение отношения, связанные с энергетическими сделками, органы регулирующие данные отношения, режимы энергетических транзакций и т.п. в Азербайджанской Республике. Здесь также имеет место информация об энергетических контрактах, соглашениях о разделе продукции и других контрактах, в том числе о лицензиях для занятия энергетической деятельностью, а также о специальной налоговой политике в отношении данных контрактов.