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by

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Abstract

This Country Note includes an overview of the current FDI regime in the Republic of Azerbaijan by highlighting the existing relevant political background with energy transition as its center goal, respective regulatory framework, and expected reforms. Considering the energy transition, the Note demonstrates recent foreign investments in the renewable energy sector and the state policy to establish a more favourable FDI regime through removing bureaucratic barriers, promoting transparency starting from the pre-investment period, and granting more incentives. In that regard, “The Law on Investment Activities” adopted on June 22, 2022, is deemed as a “new beginning” and the Note analyses the new Law in comparison with the regulatory regime provided under the relevant previous laws. In order to shed light on the expected developments, the Note also gives special regard to “The Socio-economic development strategy for 2022-2026 of the Republic of Azerbaijan”, approved with the Presidential Order on July 22, 2002, which provides among others the clear checkpoints for the attraction of FDI and requires a customized regulatory framework for that purpose. The Note also touches on the “The Law on Public-Private Partnership” adopted on December 9, 2022, and covers the general regime defined under that Law with respect to FDI.

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Safar Safarli received his LL.B. degree from Baku State University Faculty of Law (LL.B. degree with honours) and his LL.M. degree from Uppsala University (Master Programme in Investment Treaty Arbitration). During his study periods, he was awarded Presidential, Visby, and other scholarships, and also the Swedish Institute postgraduate grant for pursuing an internship at the "DER Juridik AB" law firm in Stockholm. He has strong enthusiasm for the research of international investment law and dispute settlement topics. Mr. Safarli's interest in those spheres can be observed through his papers such as "Assistance of an Arbitral Tribunal in the Amicable Settlement of a Dispute under the Prague Rules: Potential Practical Problems" and LL.M. thesis on "Enforcement of provisional measures rendered under Article 47 of the ICSID Convention: A state's prerogative?". Currently, he is pursuing a Ph.D. in Public International Law at Baku State University. Mr. Safarli also works as a Chief Legal Specialist at the Economic Zones Development Agency under the Ministry of Economy of the Republic of Azerbaijan.

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1. Political Background – Energy Transition

For the last few years, the Government of the Republic of Azerbaijan (“the Government”) has been mostly focusing on attracting foreign direct investment (“FDI”) to strategic spheres of the economy with the purpose of reducing oil/gas dependency and diversifying its economy. In the first half of 2023, oil and gas products accounted for 90.13% of Azerbaijan’s total export revenue.¹ For diminishing that “*unsustainable rate*” the Government has targeted the following sectors for attracting investment: energy, transportation, agriculture, tourism, information, and communication technology.² Accordingly, several policy documents setting ambitious targets and creating a framework to encourage investment in low-carbon, climate-resilient development have been prepared.³

As a result, several foreign investors have embarked on renewable energy projects. Among others, ACWA Power (a company established in Saudi Arabia) has signed an agreement with the Government to build, own and operate a 240 MW wind farm.⁴ Masdar (a company established in the United Arab Emirates) has also started the construction project of a 230 MW solar power plant in Garadagh district, in order to diversify the country's energy mix.⁵ In fact, this attraction process seems to continue further since the “Socio-economic development strategy for 2022 – 2026 of the Republic of Azerbaijan”⁶ (“the Strategy”) has set some targets

¹ Official website of the State Customs Committee of the Republic of Azerbaijan (accessed on July 31, 2023).

² U.S. Department of State, ‘*Azerbaijan Investment Climate Statement 2015*’ (2015), 4; see also [U.S. Department of State, ‘Azerbaijan Investment Climate Statement 2020’](#) and [U.S. Department of State, ‘Azerbaijan Investment Climate Statement 2020’](#) (accessed on July 31, 2023).

³ EaPGreen Partnership for Environment and Growth, ‘*Scaling up Green Investments and Finance in Azerbaijan*’ (2018), 7.

⁴ <https://www.acwapower.com/en/projects/azerbaijan-wind-ipp/> (accessed on July 31, 2023).

⁵ <https://www.lloydsbanktrade.com/en/market-potential/azerbaijan/investment> (accessed on July 31, 2023).

⁶ ‘*Socio-economic development strategy for 2022-2026 of the Republic of Azerbaijan*’ (2022), https://static.president.az/upload/Files/2022/07/22/5478ed13955fb35f0715325d7f76a8ea_3699216.pdf (translated from Azerbaijani, accessed on July 31, 2023), 28.

for the Government including the attraction of FDI, especially from six companies represented in Forbes and Fortune 500, to the non-oil/gas industry of the country.

For the abovementioned purpose, the Government has continuous attempts to create a more favourable business environment. Outcomes of those attempts include non-application of requirements which may act as a barrier for FDI such as obtaining a permit for foreign investment, a license for foreign exchange transactions related to capital movements, as well as restrictions on foreign exchange, on the amount of foreign capital in companies, on technology transfer and ownership, on the repatriation of profits.⁷ In order to further encourage FDI, the Government has also established industrial parks in which investors are exempted from main taxes (corporate income, property, land, VAT) and customs duties for consecutive ten years starting from registration as a resident of an industrial park. Moreover, the President of the Republic of Azerbaijan approved the Decree on Additional Measures to Promote Investment⁸ dated 18 January 2016, endorsing regulations on stimulating investment in Azerbaijan using investment certificates. An investment certificate grants individuals and legal entities tax and customs privileges and can be obtained by confirming payment of at least 10% of the statutory minimum investment under the investment project and submitting a business plan along with a copy of a taxpayer registration certificate.⁹

Regarding the application of FDI screening *post* and *ante* registration, authority for registering representative offices of foreign businesses and the creation of business entities with foreign ownership has been transferred to the State Tax Service based on the so-called “one-stop-shop” principle that mostly simplifies the registration process and reduces waiting times.¹⁰ There are no additional procedures required of a foreign-owned company establishing a subsidiary in the country, other than the requirement to provide an apostille or notarized and translated copy of the incorporation documents and charter of the parent company abroad.

⁷ <https://azerbaijan.az/en/information/410> (accessed on July 31, 2023).

⁸ The Decree on Additional Measures to Promote Investment of the President of the Republic of Azerbaijan, January 18, 2016.

⁹ Baker & McKenzie - CIS, Limited, ‘*Doing Business in Azerbaijan 2018*’ (2018), 10.

¹⁰ U.S. Department of State, ‘*Azerbaijan Investment Climate Statement 2015*’ (2015), 5.

Even a foreign-owned company does not need to get an investment approval to establish itself in Azerbaijan.¹¹

2. Overview of relevant legal framework – New Law and New Beginnings

The FDI relations are regulated by several international treaties and domestic legal acts in Azerbaijan. The Republic has signed 52 bilateral investment treaties, 44 of which are currently in force.¹² Azerbaijan also ratified the Energy Charter Treaty on December 2, 1997.¹³ The approach of domestic legislation to bilateral and multilateral investment treaties is also specific by recognizing the supremacy of international treaties over domestic legal acts (except for the Constitution and acts adopted by referendum).¹⁴

Regarding the domestic legal acts, 2022 can be considered a fresh start for FDI regulation in Azerbaijan. Until 22 June 2022, the legislative framework regulating FDI relations was including two main laws:

- The Law on Protection of Foreign Investments dated January 15, 1992 (“the LPFI”);
- The Law on Investment Activity dated January 13, 1995 (“the LIA”).

On June 22, 2022, the new Law on Investment Activities (“the New Law”) was adopted according to which the LPFI and LIA were repealed. The New Law combines the abovementioned two laws under one framework and contains some progressive norms which intend to catch up with international trends in the sphere of FDI. In fact, there are also some other acts regulating the participation of FDI in specific sectors of the Azerbaijani economy such as “The Law on Investment Funds” (dated October 22, 2010), “The Law on Privatization of State Property” (dated May 16, 2000) and “The Decree on Approval of Second Program for Privatization of State Property of the Republic of Azerbaijan” (dated August 10, 2000). However, the New Law is the most important act defining the strategy, priorities, and state policy in the sphere of FDI, and according to its Article 5.2 the main directions of state policy in the field of investment activity include:

¹¹ U.S. Department of State, ‘*Azerbaijan Investment Climate Statement 2015*’ (2015), 5.

¹² <https://investmentpolicy.unctad.org/international-investment-agreements/countries/13/azerbaijan> (accessed on July 31, 2023).

¹³ <https://www.energycharter.org/who-we-are/members-observers/countries/azerbaijan/> (accessed on July 31, 2023).

¹⁴ The Constitution of the Republic of Azerbaijan, November 12, 1995, Article 151.

- *“formation of a favourable investment climate, including the strengthening of a free competitive environment;*
- *protection of the rights and legitimate interests of investors, as well as investments;*
- *creation of equal opportunities for investors in the implementation of investment activities;*
- *ensuring the stability of the conditions for the implementation of investment activities;*
- *privatization, restructuring, and rehabilitation of state property;*
- *support for investment projects in priority economic sectors;*
- *digitization and provision to investors of services related to the implementation of investment activities, based on the 'single-window' principle.”*

That being the case it becomes plausible to dig deep into the New Law, compare it with LPFI and LIA, and thus find out what really is “new”. The New Law gives a broad definition to the concept of “*investment*” as “*pecuniary means invested on business activity objects, securities, other property, also property rights and other rights having pecuniary value with the purpose of receiving profit*”. However, the LIA chose to list allowed types of investments rather than using the broad definition which is in favor of investors if a dispute arises in the future. Moreover, under Articles 4, 5, and 7 the New Law incorporates the principles, purposes, priorities, and directions of state regulation in the sphere of investment activity which gives an overview to potential foreign investors about the probable future investment environment of the country and the expectation of the Government from FDI. In comparison with the LPFI, which only defined the “*national treatment*” regime, the New Law also added the “*most favoured nation*” as a regime provided for the foreign investors.

Furthermore, the New Law has an updated approach toward the payment of compensation in case of expropriation. It prescribes the valuation date of investment as “*the time immediately before the expropriation was taken or became public knowledge, whichever is earlier*”, however, the LPFI was using the date of the decision for expropriation as the valuation date under Article 12. Additionally, instead of using the famous “*adequate, prompt and effective compensation*” wording (so-called “*Hull formula*”) with vague meaning, the New Law defines that the compensation shall amount to fair market value, be paid without delay, and in freely convertible currency.

Regarding dispute resolution the New Law favours the concept of “*exhaustion of local remedies*” under Article 15.2 which reads as follows:

“Unless any other mechanism is agreed for the resolution of the dispute and after the local remedies defined under the Civil Procedural Code of the Republic of Azerbaijan are exhausted the foreign investor may refer a dispute on investment activity between the foreign investor and the Republic of Azerbaijan to international arbitration.”

The New Law differs also in its approach to FDI screening. According to the LPFI, the legislative acts of the Azerbaijan Republic might determine territories whereon the activity of the enterprise with foreign investments is restricted or prohibited for the objectives of defence, national security, and protection of the environment and population. On the other hand, the New Law limits itself to just stating that *“by taking the requirements of applicable domestic legislation, investments in all business objects are allowed”*. Undoubtedly, this kind of vague wording might open room for different interpretations, especially for restrictive ones since the law does not specify potential grounds for screening or any mechanism to reveal them.

Indeed, the New Law also carries some other gaps and issues. First of all, regarding the definition of “foreign investor” the New Law is not compatible with the relevant domestic legal framework. Pursuant to Article 1.0.9 of the Law on Privatization *“legal entities of the Republic of Azerbaijan in which the share of foreign investment exceeds 50% of authorized capital are recognized as foreign investors”* and with that inclusion, the law uses the concept of *“foreign control”*. Although, on the other hand, the New Law disregards that concept and gives a definition of foreign investors as *“the foreign citizens, stateless persons, foreign legal entities, including their branches and representative offices, international organizations and foreign states engaging in investment activity”*. In this case, local legal entities with foreign control are considered foreign investors under the Law on Privatization, but not under the New Law.

Moreover, the LPFI had defined that *“if the subsequent legislation of the Azerbaijan Republic worsens investment conditions, the legislation existing at the time of implementation of investments is applied to foreign investments within the following ten years”*. The New Law, however, under Article 18.2 prescribes that *“more favourable conditions provided for foreign investors under the LPFI and LIA shall remain in force within the following ten years”*. Evidently, the previous stabilization clause aimed to protect foreign investors from possible changes in legislation and give them assurance in order to sustain initial investment conditions for the next ten years starting from the implementation of each foreign investment. However, the New Law refuses to provide that open-ended assurance and shields the foreign investor only from the adverse changes in the conditions provided only under the LPFI and LIA, and also limits the duration of stabilization to ten years after the New Law entered into force. It means the New

Law shall protect specific more favourable conditions for foreign investors only until 22 June 2032.

3. Development to follow – What can we expect?

Progress in the relevant domestic legal framework which intends to adapt to international standards and ensure growing FDI inflow is underway. One of those legal developments is about the adoption of “The Law on Public-Private Partnership” which had been defined as a target under the “Strategy”.¹⁵ Adopted on December 9, 2022, the purpose of the law is the establishment of a legislative framework favourable to privately financed infrastructure projects through defining the procedure for the selection of private partners and conclusion of partnership contracts. The law includes state support, guarantees, compensations, broad scope of other incentives during the term of the partnership and defines attraction of FDI as one of the purposes of the state policy in the sphere of public-private partnership under Article 6.1.4.

Other forthcoming developments influencing FDI can also be extracted from the “Strategy” according to with additional 10 draft laws regulating investment activities are expected to be prepared by the end of 2026.¹⁶ Moreover, the “Strategy” also determines the establishment of a legal framework for the insurance of investment which can also be considered as an upcoming progress in favour of foreign investors.¹⁷

¹⁵ ‘Socio-economic development strategy for 2022-2026 of the Republic of Azerbaijan’ (2022), https://static.president.az/upload/Files/2022/07/22/5478ed13955fb35f0715325d7f76a8ea_3699216.pdf (translated from Azerbaijani, accessed on July 31, 2023), 28.

¹⁶ ‘Socio-economic development strategy for 2022-2026 of the Republic of Azerbaijan’ (2022), https://static.president.az/upload/Files/2022/07/22/5478ed13955fb35f0715325d7f76a8ea_3699216.pdf (translated from Azerbaijani, accessed on July 24, 2023), 28.

¹⁷ ‘Socio-economic development strategy for 2022-2026 of the Republic of Azerbaijan’ (2022), https://static.president.az/upload/Files/2022/07/22/5478ed13955fb35f0715325d7f76a8ea_3699216.pdf (translated from Azerbaijani, accessed on July 24, 2023), 45.

Annex 1: Relevant laws, ordinances, regulatory guidelines

- The Constitution of the Republic of Azerbaijan, November 12, 1995
- Law on Protection of Foreign Investment, January 15, 1992
- Law on Investment Activities, January 13, 1995
- Law On Privatization of State Property, May 16, 2000
- Law on Investment Funds, October 22, 2010
- Law on Investment Activities, June 22, 2022
- Law on Public-Private Partnership, December 9, 2022
- Decree on Approval of Second Program for Privatization of State Property of the Republic of Azerbaijan August 10, 2000
- Decree on Additional Measures to Promote Investment of the President of the Republic of Azerbaijan, January 18, 2016

Annex 2: Relevant administrative and court cases

There have not been any relevant administrative and/or court cases in Azerbaijan.

Annex 3: Relevant literature

- Azerbaijan, Energy Charter, <https://www.energycharter.org/who-we-are/members-observers/countries/azerbaijan/>
- Azerbaijan Wind IPP, <https://www.acwapower.com/en/projects/azerbaijan-wind-ipp/>
- Baker & McKenzie - CIS, Limited, (2018) "Doing Business in Azerbaijan 2018"
- EaPGreen Partnership for Environment and Growth, (2018), "Scaling up Green Investments and Finance in Azerbaijan", <https://wedocs.unep.org/handle/20.500.11822/37044?show=full>
- Foreign direct investment (FDI) in Azerbaijan, "Socio-economic development strategy for 2022-2026 of the Republic of Azerbaijan" (2022), https://static.president.az/upload/Files/2022/07/22/5478ed13955fb35f0715325d7f76a8ea_3699_216.pdf
- <https://www.lloydsbanktrade.com/en/market-potential/azerbaijan/investment>
- Investment Environment, <https://azerbaijan.az/en/information/410>

- <https://investmentpolicy.unctad.org/international-investment-agreements/countries/13/azerbaijan>
- [Official website of the State Customs Committee of the Republic of Azerbaijan](#)
- U.S. Department of State, (2015), "Azerbaijan Investment Climate Statement 2015"
- U.S. Department of State, (2020), "Azerbaijan Investment Climate Statement 2020"
- U.S. Department of State, (2022), "Azerbaijan Investment Climate Statement 2022"

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