

MEMORANDUM

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International Swaps & Derivatives
Association

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Subject: Informal Country Update – Republic of Azerbaijan

This memorandum provides general responses to questions from the International Swaps & Derivatives Association (“**ISDA**”) about over the counter (“**OTC**”) transactions with derivative financial instruments in relation to the law of the Republic of Azerbaijan.

We should note from outset that, currently, Azerbaijani law provides for very limited regulation of derivative financial instruments, which remains largely untested in practice or by the courts. At the moment, there are few specific pieces of legislation which would regulate derivative financial instruments in Azerbaijan, encompassing a few provisions in the Azerbaijani Civil Code¹, the Securities Market Law,² and several regulations promulgated by the Regulator^{3,4}.

Discussions in this Memorandum represent our best judgement of how we believe they would apply based on the provisions of the relevant legislation.

¹ *Civil Code of the Republic of Azerbaijan*, approved by Law No. 779-IQ, dated 28 December 1999, (the “**Civil Code**”)

² Law of the Republic of Azerbaijan “*On Securities Market*” No. 1284-IVQ, dated 15 May 2015 (the “**Securities Market Law**”)

³ The State Securities Committee (or the SSC), the Financial Markets Supervision Authority (or FIMSA) or the Central Bank of Azerbaijan (or the CBA), depending upon the time period

By way of background, the SSC, among other governmental authorities, was reorganised into FIMSA, which was established further to the Presidential Decree “*On Establishing the Financial Markets Supervision Chamber of the Republic of Azerbaijan Public Legal Entity*” No. 760, dated 3 February 2016

FIMSA subsequently was abolished and all of its authorities were transferred to the CBA by the Presidential Decree “*On Improving the Regulation and Supervision in the Financial Services Market*” No. 1616, dated 28 November 2019

⁴ Derivative financial instruments concluded or circulated in the territory of Alat Free Economic Zone will be regulated within the framework of the Law of the Republic of Azerbaijan “*Alat Free Economic Zone*” No. 1143-VQ, dated 18 May 2018. These regulations are yet to be developed

1 QUESTIONS

1.1 Do OTC derivatives transactions face an enforceability problem (e.g. due to anti-wagering provisions, etc. under local law)?

Azerbaijani law does contain anti-wagering provisions, which deprives claims arising from games or bets of judicial protection⁵, because games and bets are considered to be agreements without any commercial purpose, as parties gain a profit or suffer a loss depending on uncertainty and/or chance.⁶

However, Azerbaijani law now expressly excludes derivative financial instruments⁷ from the application of Azerbaijani anti-wagering provisions.

1.2 Are there any issues with foreign law governed contracts (mainly English law and New York law) when used for cross-border transactions into your jurisdiction? For example, some countries may restrict the use of foreign law and language documents when it comes to contracting with local public law or state entities.

While Azerbaijani law⁸ allows parties to choose the law that would govern their relationships if there exists a so-called *foreign element*,⁹ the applicability of such foreign law is limited to certain contractual matters, such as the determination of the rights and obligations of the parties to a contract; the validity, interpretation and termination of the contract (including the consequences thereof); the performance of, failure to perform, or improper performance of obligations under a contract (including consequences thereof); as well as the assignment of rights and obligations under a contract.¹⁰

Even in the event of a proper choice of foreign law, foreign legal norms contradicting the Constitution of the Republic of Azerbaijan and legal acts adopted by the referendum are inadmissible in Azerbaijan. In addition, imperative legal norms of the Azerbaijani law regulating certain relations will apply regardless of contractual provisions with respect to the governing law.¹¹

Azerbaijani court may refer to and apply Azerbaijani law regardless of the parties' choice of governing law if:

- the court fails in its efforts to determine the content of the foreign law chosen by the parties; or
- such efforts require significant expenditure and neither party is able to provide the necessary documentation to support its claim or objection with reference to such foreign law.¹²

⁵ Civil Code, Article 1084

⁶ Civil Code, Article 1083

⁷ The concept of a *derivative financial instrument* was introduced into the Civil Code in 2015 and is defined as a contract to buy, sell, or swap underlying assets. Securities, foreign exchange, interest spots, profitability, derivative financial instruments, commodities, financial indices, credit risk, etc. may serve as underlying assets. Currently, the Civil Code provides for three types of derivative financial instruments – futures, options, and swaps

⁸ Law of the Republic of Azerbaijan “*On International Private Law*” No. 889-IQ, dated 6 June 2000 (the “**International Private Law**”), Article 1.2

⁹ Common examples generally deemed to establish the existence of a foreign element are, where:

- (i) one of the parties to a legal relationship is a foreigner, a foreign legal entity, or a foreign state;
- (ii) property that is the subject of the legal relationship is located in a foreign country; and/or
- (iii) events as a result of which the civil relationship in question was created, altered, or terminated, took place in a foreign country (e.g. execution or performance of a contract, occurrence of an insurance event, injury, etc.)

¹⁰ International Private Law, Article 24

¹¹ International Private Law, Articles 4 and 5

¹² International Private Law, Article 2.2

The choice of law provision in a contract would be considered invalid under Azerbaijani law if it were made with a purpose to evade application of imperative legal norms of a jurisdiction having ties with such a contract.¹³

The analysis provided in Section 1.2 of this Memorandum would generally be the same with respect to any Azerbaijani counterparty, subject to the following comments in relation to the Central Bank of Azerbaijan.

1.2.1 Central Bank

The International Private Law, which codifies international private law principles in Azerbaijan, applies to civil law transactions with a foreign element concluded by individuals and legal entities. The application of the International Private Law also extends to civil law transactions with a foreign element involving the State¹⁴, where their nature is not connected with the exercise of sovereign functions—a factor that is to be determined based on the legal nature of and reasons for such transactions.

Because the Central Bank is a public law entity in charge of implementing, *inter alia*, monetary policy and acting, in certain circumstances, as a financial agent of the State¹⁵, civil law transactions with a foreign element concluded by it would be outside of the scope of the International Private Law, provided that the transactions in question were related to the exercise of sovereign functions by the Central Bank. (While the law does not provide a definition of what constitutes a sovereign function, traditionally, regulatory and rulemaking functions are regarded as sovereign (i.e. unique to the State), as opposed to an activity in which a private party could also engage.)

1.3 Are there provisions (of a statutory, customary, common law, etc. nature) in local law that provide for the enforceability of close-out netting? Is close-out netting defined in addition to set-off under local law? Does local law allow netting in accordance with the terms of the underlying contract (e.g. the 2002 ISDA Master Agreement)?

Currently, there are limited provisions in Azerbaijani law that provide for the enforceability of close-out netting, as local law differentiates between the concepts of netting among clearing members and payment set-off, as described below.

1.3.1 Netting

The concept of *netting* is defined in the Securities Market Law as the conversion of claims and obligations arising from transfer orders sent (or received) by clearing members to (or from) other clearing members into a single net claim or obligation.¹⁶

All transfer orders submitted to the post-trading system are irrevocable and must be executed, provided that they were submitted prior to a declaration of the bankruptcy of a clearing member. The transfer orders submitted to the post-trading system on or after the date of the declaration of a clearing member as bankrupt may be executed only if the clearinghouse or the central counterparty proves that they did not know or could not have known about these circumstances.¹⁷

The results of netting are final, even if transactions that are executed before the declaration of a clearing

¹³ International Private Law, Article 24.4

¹⁴ International Private Law, Article 16

¹⁵ Law of the Republic of Azerbaijan “On the Central Bank of the Republic of Azerbaijan” No. 802-IIQ, dated 10 December 2004, Articles 2.1, 5.0.1, and 19

¹⁶ Securities Market Law, Article 1.0.21

¹⁷ Securities Market Law, Articles 56.2 and 56.3

member as bankrupt have been suspended.¹⁸

1.3.2 Set-off prior to the initiation of bankruptcy proceedings

Azerbaijani law recognises the concept of a payment set-off, by which an obligation is deemed satisfied in full or in part by way of a set-off against a counter claim where such counter claim has already matured or will mature at demand or there is no indicated term of maturity. A declaration of one party shall be sufficient for the set-off.¹⁹

For a set-off to be valid the claims that are being set-off must be mutual (i.e., the two persons must be a creditor and a debtor vis-à-vis each other) and they must mature before or at the time of the set-off or there should be no indicated term of maturity or they will mature on demand.

Payment set-off is prohibited, *inter alia*, in the following circumstances:

- if the parties have agreed not to set-off any obligations;
- if the claim relates to property which is not alienable or is a residence;
- if, at the demand of a party, the statute of limitations must be applied in respect of the claim and such statute of limitations has already expired;
- if the claim is one owned by the Republic of Azerbaijan or its municipalities, except where the claim of set-off by the other party is against an agency in favour of which the obligation was discharged;
- in other circumstances specified in the law or a contract.²⁰

Although, to our knowledge, these matters have never been tested in Azerbaijani courts, we believe that netting in accordance with the terms of the 2002 ISDA Master Agreement would be upheld to the extent that such claims have arisen and have been settled prior to the initiation of bankruptcy proceedings; however, for the sake of completeness we note that such netting may be challenged on the grounds set out in the Azerbaijani bankruptcy law, as described below.

1.3.3 Set-off following the initiation of the bankruptcy proceedings

Azerbaijani law sets forth three distinct insolvency and bankruptcy regimes—(a) a regime largely established under the Insolvency and Bankruptcy Law²¹, which applies to all commercial and non-commercial legal entities (except for, *inter alia*, banks and public law entities, including the Central Bank of Azerbaijan), as well as individual entrepreneurs; (b) a regime established under the Banking Law²², which applies only to banks and branches of foreign banks operating in Azerbaijan, and (c) a regime for public law entities (consisting of a single provision in the Public Entities Law²³ that public law entities may be not declared bankrupt).

¹⁸ Securities Market Law, Article 56.4

¹⁹ Civil Code, Articles 540 and 543

²⁰ Civil Code, Article 545

²¹ Law of the Republic of Azerbaijan “*On Insolvency and Bankruptcy*” No. 326-IQ, dated 13 June 1997 (the “**Insolvency and Bankruptcy Law**”), paragraph 2, Article 2

Certain specific provisions of the Law of the Republic of Azerbaijan “*On Investment Funds*” No. 1101-IIIQ, dated 22 October 2010 and of the Law of the Republic of Azerbaijan “*On Insurance Activity*” No. 519-IIIQ, dated 25 December 2007, are also taken into account in the context of the bankruptcies of joint stock investment funds and insurance companies, respectively

²² Law of the Republic of Azerbaijan “*On Banks*” No. 590-IIQ, dated 16 January 2004 (the “**Banking Law**”), Article 60

²³ Law of the Republic of Azerbaijan “*On Public Law Entities*” No. 97-VQ, dated 29 December 2015 (the “**Public Entities Law**”), Article 5.1

(a) Corporate counterparties

Generally, claims against Azerbaijani counterparties in the context of bankruptcy proceedings may be set-off, to the extent that such claims have arisen prior to the initiation of bankruptcy proceedings.²⁴

Namely, where in the course of bankruptcy proceedings it is revealed that the counterparty has or will have unpaid liabilities (including contingent liabilities) arising out of transactions concluded before the initiation of bankruptcy proceedings vis-à-vis another person and such other person²⁵ has existing, current or contingent liability, or debt, to the counterparty, then the relevant mutual obligations (debt and liabilities) are set-off against each other, provided that they:

- existed prior to the initiation of bankruptcy proceedings; and
- are expressed in monetary terms or have money equivalent, or where the money equivalent cannot be discerned with certainty, they are approximated by the bankruptcy administrator.

Therefore, in case of the bankruptcy of a local counterparty to a derivative financial instrument, the calculation of the net amount should be possible, as long as obligations (debt and liabilities) arose prior to the initiation of bankruptcy proceedings. (Payment set-off is specifically prohibited in relation to any obligations (debt and liabilities) that arose after the initiation of bankruptcy proceedings.²⁶)

Furthermore, even if the automatic early termination occurs and the automatic early termination amount is paid before the initiation of bankruptcy proceedings, there is still a risk of invalidation of such payment and of the automatic early termination itself by the bankruptcy administrator based on the following claw-back provisions.

(i) *Claw-back*

In addition to the grounds set forth in Azerbaijani law of general application, under the Insolvency and Bankruptcy Law the bankruptcy administrator has the right to apply to court to invalidate transactions concluded by a local counterparty, where:²⁷

- the transfer of rights or the creation of pledge or mortgage rights by the counterparty over its assets had occurred during the counterparty's insolvency;
- the counterparty concluded a transaction within six months prior to the initiation of the bankruptcy proceedings, whereby a creditor's ranking in the statutory order of priority has improved vis-à-vis other creditors;
- a *related party* creditor or security interest holder received the counterparty's assets (or security interest over assets) within one-year prior to the initiation of the bankruptcy proceedings;
- transactions were concluded by the counterparty for a value that is lower than the market value, causing counterparty's insolvency.

In our view, the above will likely constitute the primary grounds the bankruptcy administrator will consider in connection with any attempt to invalidate a transaction. The invalidation would likely be assessed on a case-by-case basis, by reviewing each asset transfer of the counterparty. Therefore, there is a risk that the

²⁴ Law on Bankruptcy and Insolvency, Article 17 and paragraph 5 of Article 52—While a counterparty may not dispose of any part of its assets or conclude any new transactions without the permission of the court or the bankruptcy administrator appointed to deal with its assets (Article 17 of the Insolvency and Bankruptcy Law), in our view the right to the set-off continues to apply and is not prejudiced by the provisions of Article 17

²⁵ This *other person* may not be a shareholder (member) of the local counterparty (Law on Bankruptcy and Insolvency, paragraph 6, Article 52)

²⁶ Law on Bankruptcy and Insolvency, Article 17 and subparagraph (c), paragraph 5, Article 52

²⁷ Law on Bankruptcy and Insolvency, Article 55

administrator could treat each Transaction under the 2002 ISDA Master Agreement as a separate agreement (i.e. engage in “cherry picking”).

(b) Banks

It is possible that the close-out netting provisions of the 2002 ISDA Master Agreement may be unenforceable in Azerbaijan in the case of the insolvency of a bank for the reasons specified below.

Once the bankruptcy proceedings have been initiated, the bank’s management is removed and the liquidator is appointed solely to manage the insolvent bank’s assets.²⁸ The liquidator is responsible for creating registries of accepted and rejected creditors’ claims. The accepted claims thereafter are satisfied in the statutory order of priority upon approval by the court. Any set-off of such claims must also follow the statutory order of priority.²⁹

Given the broad authority of the liquidator to manage the insolvent bank’s assets, it is possible that the liquidator will try to recover the outstanding receivables of the insolvent bank, including those under the 2002 ISDA Master Agreement. This essentially means that the liquidators have substantial discretion to “cherry pick” the outstanding transactions entered into under the 2002 ISDA Master Agreement.

Notwithstanding the foregoing, the Banking Law states that any settlements processed through payment systems which, under the rules of such payment systems, are final and irrevocable, as well as any payment made in respect of securities in the event that a bank is declared insolvent, remain effective for such bank and third parties, provided that:

- such payments are irrevocable before a court decision declaring the bank insolvent is effective; and
- the liquidator cannot prove that the operator of such payment system was aware of a court decision declaring the bank insolvent before such payments and settlements became final and irrevocable under the rules of the said payment systems.³⁰

(i) *Claw-back under bank resolution regime*

There are no specific restrictions in relation to the ability to set-off mutual claims under the bank resolution regime set forth in the Banking Law.

Further, while the Banking Law does not contain claw-back provisions equivalent to those of mentioned in Section 1.3.3(a)(i) of this Memorandum in the context of the bankruptcy of a bank, similar powers are granted to the temporary administrator under the bank resolution regime.

²⁸ Banking Law, Article 71.3

²⁹ Banking Law, Articles 78 and 82

Upon the bankruptcy of a local bank, funds available to meet unsecured claims are applied in the following order of priority:

- (i) claims commenced by the deposit insurance fund for physical persons’ under its right of subrogation
- (ii) bankruptcy costs
- (iii) claims of employees for bodily injuries and claims in respect of the death of employees
- (iv) claims of existing and former employees relating to the payment of salaries, allowances and pensions due for the period 6 months prior to the court judgement on bankruptcy
- (v) expenses of any temporary administrator incurred in the process of management and financial recovery of the bank
- (vi) taxes and social insurance payments falling due during the period beginning one year before the bank was declared bankrupt
- (vii) other unsecured claims
- (viii) claims under subordinated loans in terms of the regulations of the Central Bank of Azerbaijan; and
- (ix) claims of the bank’s shareholders

³⁰ Banking Law, Article 73.1

Namely, a temporary administrator may avoid contractual obligations that caused the deterioration of the financial status of the bank as a result of the conclusion of contracts, including loan agreements, on terms that are manifestly contrary to the interests of the bank within the context of the banks' resolution regime.³¹

Further, it may invalidate the following transactions³² concluded within two-years prior to the appointment of a temporary administrator:

- alienation or grant of use rights over the bank's assets on terms and for value that is significantly lower than market conditions and value;
- granting waivers under credit agreements that are unavailable under normal market conditions;
- conclusion of contracts for the purpose of seizing the bank's assets;
- conclusion of transactions with payments and assets by the bank whereby certain creditors receive privileges or benefits;
- conclusion of contracts with parties related to the bank that violate the requirements of legislation or threaten the interests of depositors and creditors of the bank;
- acquisition of assets, goods, and services at prices significantly inflated prices;
- inflation of the value of property serving as collateral for loans.³³

(c) Public law entities

Azerbaijani public law entities, including the Central Bank of Azerbaijan, may not be declared bankrupt.³⁴

1.4 In case there are netting provisions under local law, do they apply to all types of counterparties, e.g. financial institutions, corporates (commodity trading firms, utilities, manufacturers, etc.), SPVs, public law entities (municipalities, central bank, development banks, etc.)?

Netting provisions under the Securities Market Law apply to clearing members only (i.e. investment companies and local banks).³⁵ Azerbaijani general payment set-off provisions apply to all types of counterparties, with the exception of set-off claims owned by the Republic of Azerbaijan and municipalities³⁶ (please see the relevant discussion in Section 1.3.2 of this Memorandum).

Different rules would apply in the post-bankruptcy phase. Please see the relevant discussion in Section 1.3.3 of this Memorandum.

1.5 Is the scope of eligible transactions restricted in any way, e.g. to certain products (rates, currencies, equities, credit, etc.)? What about commodity products (gas, coal, oil, metal, agricultural, etc.) and “new” products (emissions allowances, freight rates, weather variables, etc.)? Is there a different treatment for financially settles transactions as opposed to physically settles ones (i.e. where the underlying product is delivered)?

At the moment, there is no specific piece of legislation which would regulate derivative financial instruments in Azerbaijan, except for a few provisions in the Civil Code and several regulations promulgated by the Regulator. The concept of *eligible transactions* as it pertains to the enforceability of close-out netting under derivative financial instruments in the context of bankruptcy proceedings is yet to be introduced into

³¹ Banking Law, Article 57-2.3.5

³² Banking Law, Article 57-3.3

³³ Banking Law, Article 57-3.2

³⁴ Public Entities Law, Article 5.1

Insolvency and Bankruptcy Law, paragraph 2, Article 2

³⁵ Securities Market Law, Articles 1.0.21 and 53.1

³⁶ Civil Code, Article 545.0.6

Azerbaijani law. (Please take note of Section 2 (*Looking Ahead*) of this Memorandum for further information.)

Nevertheless, we should note that the existing regulations seems to only envisage physically settled futures, options, and swaps.

1.6 Are financial collateral arrangements governed by foreign law recognized under local law? In particular, would title transfer and security interest arrangements (under English and New York law) be enforceable (e.g. ISDA credit support documentation)?

In general and subject to the comments below, Azerbaijani law recognises collateral arrangements governed by foreign law, so long as there exists a so-called *foreign element*. Indeed, a provision of the Civil Code, which provides that performance of obligations may be secured, *inter alia*, in the manner provided by a contract between the parties³⁷, was the subject of a decision of the Constitutional Court of Azerbaijan. Although this was not the central issue in the case, the Court essentially reaffirmed the right of parties based on the freedom of contract principle to agree between themselves upon an arrangement to secure performance of obligations.³⁸

1.6.1 Title transfer

Because Azerbaijani law does not specifically envisage a title transfer as a separate type of security, there is a risk that an Azerbaijani court may attempt to re-characterise a title transfer to be a pledge.

There might be several implications of such a re-characterization, including a requirement that the collateral be sold at a public auction in the event of default, unless the collateral is moveable property (including cash). Additionally, in relation to collateral located in Azerbaijan, a security interest in relation to such collateral would only be valid upon its due perfection under Azerbaijani law (e.g. registration of a pledge of Azerbaijani securities with the National Depository Centre of Azerbaijan (or NDC)).

Further, while publicising a security interest over moveable property (including cash) with the Registry of Secured Transactions with Moveable Property does not affect its validity, the failure to publicise in the manner specified under the law will affect the priority of security interest holders' claims over the collateral.

1.6.2 Financial pledge

Azerbaijani law also provides for a special type of pledge—a financial pledge. A pledge agreement is considered to pertain to a *financial pledge* where:

- it is entered into for the purpose of securing performance of financial obligations in a regulated market;
- the collateral under such pledge agreement is money or securities traded on a regulated market or derivative financial instruments;
- the pledgee (pledger) is the Central Bank of Azerbaijan, a central depository (i.e. the NDC), a bank, an insurance company or an investment company; and
- the obligation secured by the said pledge is used only for carrying out purchase and sale transactions in a regulated market.³⁹

Where the collateral consists of securities or derivative financial instruments traded on a regulated market, a financial pledge is concluded through the NDC system and perfected by its instant registration with the NDC.

³⁷ Civil Code, Article 460.1

³⁸ Ruling of the Constitutional Court of the Republic of Azerbaijan on the Interpretation of Certain Provisions of Article 460.1 of the Civil Code of the Republic of Azerbaijan, dated 14 July 2015

³⁹ Civil Code, Article 1078-23.18

If the obligor fails to perform (i.e. the NDC has not received a notice of performance on the maturity date), the title to the underlying securities or derivative financial instruments traded on a regulated market is transferred to the pledgee by the NDC, provided that the financial pledge agreement provides for such transfer.⁴⁰

1.7 Any other issues under local law (e.g. conflict of law rules; jurisdiction issues (e.g. arbitration recommended))?

1.7.1 Foreign Judgements

Judgements of foreign courts technically may be recognised and enforced in Azerbaijan, where:

- such decisions are not contrary to the legislation and the legal order of Azerbaijan; and
- there is reciprocity in the enforcement and recognition of court decisions between Azerbaijan and the relevant foreign state.⁴¹

In practice, however, the enforcement of a foreign court judgement by an Azerbaijani court may occur only pursuant to the conditions of a bilateral judicial assistance treaty in force between Azerbaijan and the foreign state in which the judgement was rendered and subject to the exclusive jurisdiction of the Supreme Court of Azerbaijan.⁴²

There are a number of grounds under which the Supreme Court may refuse the recognition of a foreign court, including, *inter alia*, where Azerbaijani courts have exclusive jurisdiction over certain matters.

1.7.2 International Arbitral Awards

Contractual parties may generally agree to submit a dispute to international commercial arbitration⁴³, if at least one party to the agreement from which the dispute arises is a foreign person or an enterprise with foreign investment.

Azerbaijan is a party to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “**New York Convention**”).⁴⁴ For this reason, the inclusion of an international arbitration clause is highly recommended, as an Azerbaijani court (subject to the conditions noted below) would be required to recognise and enforce an international arbitral award issued in accordance with the New York Convention without re-examination or re-litigation.

The grounds enumerated in the International Arbitration Law for the refusal by a local court to recognise and enforce the international arbitral award largely replicate those set out in the New York Convention, but they are not (by virtue of the minor language differences between the two documents) completely identical to them. To the extent that the International Arbitration Law proposes grounds for refusal or grounds for a claim that are not set out in the New York Convention, the relevant provisions of the International Arbitration Law would

⁴⁰ SSC Rules “*On the Registration, Termination and Enforcement of a Pledge of Securities*” No. 9-q, dated 3 February 2016, Article 4

⁴¹ *Civil Procedure Code of the Republic of Azerbaijan*, approved by the Law No. 780-IQ, dated 28 December 1999 (the “**Civil Procedure Code**”), Article 462

⁴² Civil Procedure Code, Article 464

⁴³ Law of the Republic of Azerbaijan “*On the Protection of Foreign Investment*” No. 57, dated 15 January 1992, Article 42

Law of the Republic of Azerbaijan “*On International Arbitration*” No. 757-IQ, dated 18 November 1999 (the “**International Arbitration Law**”), Article 3

⁴⁴ Law of the Republic of Azerbaijan “*On Accession to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards*” No. 734-IQ, dated 9 November 1999

not be enforced by the courts of Azerbaijan by operation of the supremacy clause in the Constitution of the Republic of Azerbaijan.⁴⁵

1.7.3 *International Centre for the Settlement of Investment Disputes*

Even in the absence of an agreement to arbitrate, in a dispute between a foreign investor and an Azerbaijani state-owned or controlled entity, international arbitration is usually possible on the basis of the standard provisions of a bilateral investment treaty concluded between Azerbaijan and the foreign state, where the foreign investor is located. Most of the bilateral investment treaties in force allow any dispute “relating to investments” between Azerbaijan and “companies of the other Contracting Party” to be submitted to arbitration under the auspices of the International Centre for the Settlement of Investment Disputes (“ICSID”).

ICSID arbitration is considered by many to be a particularly effective means of dispute resolution for the settlement of investors’ disputes against States. This is because an ICSID award may not be challenged before the courts of the country in which the award was rendered, or before the courts of any State party to the ICSID Convention before which enforcement of the award is sought. The Contracting States to the ICSID Convention have agreed to recognise resulting awards as binding and to “enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State”.⁴⁶ The only possible manner in which to challenge an ICSID award is through an annulment action before an ad hoc ICSID Committee that is constituted at the request of the challenging party⁴⁷, pursuant to the limited (principally procedural) annulment grounds set forth in the ICSID Arbitration Rules.

1.7.4 *Process Agent*

There is no concept of irrevocable authorization (or appointment) under Azerbaijani Law, as a principal is entitled to revoke his authorization at any time. The New York Convention, to which Azerbaijan is a signatory, provides that a signatory state may refuse to enforce an arbitral award if “the party against whom the award is made was not given proper notice (as a general rule, this implies either delivery in person or delivery by a registered or other type of a recorded mail) of the appointment of the arbitrator or of the arbitral proceedings or was otherwise unable to present his case.” If process were served upon a local counterparty via an agent outside of Azerbaijan, a local court might refuse to enforce an arbitral award against such local counterparty if the court determines that it did not receive adequate notice of the arbitral hearings.

1.7.5 *Interest Calculations*

The payment of compound interest technically is not permitted¹⁶ under the Azerbaijani law, and, therefore provisions for compound interest may not be enforced by local courts. While, in practice, most international agreements provide for compound interest, these provisions remain untested.

1.7.6 *Foreign Exchange Controls*

Azerbaijani monetary regulations establish certain restrictions on remittances of funds outside of Azerbaijan, including in foreign currency. Azerbaijani residents and non-residents are expressly permitted to remit funds outside of Azerbaijan, *inter alia*, for the purposes of, investing in the shares of foreign entities or the acquisition of other securities by foreign issuers, and for the payment of arbitral awards.⁴⁸ However, since

⁴⁵ According to Article 477 of the Civil Procedure Code, the New York Convention expressly applies to the recognition and enforcement of foreign arbitral awards in addition to the provisions reflected in the Civil Procedure Code

⁴⁶ ICSID Convention, Article 54(1)

⁴⁷ ICSID Convention, Article 52

⁴⁸ Rules “On Conducting Foreign Currency Transactions by Residents and Non-Residents in the Republic of Azerbaijan” approved by the Resolution No. 45/1 of the Central Bank of the Republic of Azerbaijan, dated 28 November 2016, Articles 4.3.13.1 and 4.3.13.2

derivative financial instruments are no longer classified as securities under Azerbaijani law, remittances of foreign currency funds outside of Azerbaijan under derivative financial instruments are not currently expressly permitted.

1.7.7 Foreign Bank Account

If the security provider is an Azerbaijani counterparty and the cash collateral is to be held in a foreign bank account opened in the name of such entity, such Azerbaijani entity must notify the Ministry of Taxes about the opening of this bank account. The obligation is imposed upon a local counterparty and is not in itself cause the invalidation of the security interest.

1.7.8 Public Procurement Rules

Specific procurement will apply to state organisations and institutions, as well as to legal entities with state ownership of at least 30 percent.

The local state procurement requirements are set forth in the Public Procurement Law⁴⁹, which prescribes a mandatory procedure to be followed by state entities and organisations (agencies), as well as any other entities and organisations of which the state owns 30 percent or more of the shares in the charter capital, when procuring goods (works and services) using state funds.

The Public Procurement Law defines *state funds* as: (i) funds from the state budget of the Republic of Azerbaijan; (ii) loans extended, grants accorded and foreign aid provided under an international agreement entered into by the State; (iii) off budget funds of organisations financed from the state budget; and (iv) other funds which are attributable to state funds under the applicable law.

1.7.9 Sovereign immunity

Although the concept of sovereign immunity is recognised among the prevailing principles of international law, Azerbaijan does not have any specific legislation on sovereign immunity. For this reason, the circumstances under which sovereign immunity may be asserted or waived, as well as the applicable procedure for such a waiver, are not well settled.

Even though Azerbaijan is a member state of the Council of Europe, it has not acceded to the European Convention on State Immunity, which entered into force on 11 June 1976.⁵⁰ Nor has it signed onto the United Nations Convention on Jurisdictional Immunities of States and Their Property, dated 2 December 2004.

Generally, the view of many practitioners is that sovereign immunity can be waived either expressly or, presumably, by conduct (e.g., by actual submission to proceedings in a local court). It appears, however, that in the absence of a law governing sovereign immunity, such waiver cannot necessarily be implied from the fact that a given activity is commercial in nature.⁵¹ It is unclear how Azerbaijani courts would view an arbitration clause in a contract concluded with a state entity on the issue of a waiver of immunity by such state entity.⁵²

⁴⁹ Law of the Republic of Azerbaijan “*On Public Procurement*”, No. 245-IQ, dated 27 December 2001 (the “**Public Procurement Law**”).

⁵⁰ According to information posted on [the official website of the Council of Europe](#), retrieved on or around the date of this Memorandum

⁵¹ Although not directly on point, Article 16 of the International Private Law states that its provisions will apply to civil law transactions of the state if they are not connected with the performance of sovereign functions. The character of legal transactions entered into by the state “shall be determined based on its legal nature and reasons”

⁵² To its credit, we should note that, unlike certain other countries in the former Soviet Union, to date Azerbaijan has not attempted to re-negotiate or unilaterally amend its contractual obligations under, for instance, the numerous production sharing agreements or export pipeline agreements concluded more than a decade ago with foreign oil and gas companies

On balance, however, we have represented several major foreign financial institutions in loan transactions with state entities of Azerbaijan that were backed by state guarantees and included waiver of immunity by the guarantor (i.e. the Republic of Azerbaijan) from jurisdiction, attachment, and execution to which it is or may become entitled.

1.7.10 Use of Azerbaijani Language

Although there is no express requirement to enter into commercial contracts in the Azerbaijani language, the state language of the Republic of Azerbaijan, notarized translations of the all foreign language documents will be required in the event that any proceedings are instigated in the Azerbaijani courts.

1 LOOKING AHEAD

We have been aware of the ongoing efforts by the Regulator since mid-2018 to analyse and modernise current legal framework related to regulating the derivative financial instruments. Reportedly, these efforts are aimed at qualifying Azerbaijan as a netting jurisdiction and will include legal reform, introducing a definition of and clarifying the scope of eligible transactions, expanding the pool of potential underlying assets, disapplying certain provisions of the general commercial law and insolvency laws, as well as introducing new types of financial collateral arrangements.

While the timing of these reforms remains uncertain, the counsel believes there is a good chance that significant reforms will be enacted in the course of 2020.

2 RELIANCE

While this memorandum may be shared with ISDA members, it does not in any manner constitute legal advice with respect to any matter stated herein and may not be relied upon for such purposes. ISDA and its members are advised to seek appropriate legal advice before entering into any transaction related to matters discussed in this memorandum.

For further information and advice on the application of the law of the Republic of Azerbaijan to derivative financial instruments, please contact Ulvia Zeynalova-Bockin (Counsel) by email at Ulvia.Zeynalova-Bockin@dentons.com.

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We hope that the above is useful. Should you have any questions or comments, please do not hesitate to contact us.