

Azerbaijan

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Azerbaijan's lending market and regime

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In this article we look at some of the developments in the market and the legal regime relating to cross-border lending transactions in Azerbaijan.

Market developments

Azerbaijan has seen a pronounced increase in cross-border lending over the past few years. Until recently the lending market was dominated by international financial institutions like the European Bank for Reconstruction and Development and the International Finance Corporation. The exposure brought to Azerbaijan by the \$2.7 billion financing of the Baku-Tbilisi-Ceyhan main export pipeline (BTC) appears to have provided a significant impetus to lending by international banks.

Since BTC significant transactions have included the following unsecured financings:

- \$56 million syndicated loan to International Bank of Azerbaijan (2004).
- \$750 million pre-export financing to Azerbaijan (ACG) – AzACG, a subsidiary of the State Oil Company (2005).
- \$175 million to the State Oil Company of the Azerbaijan Republic (2006).

The financing products sought by Azerbaijani borrowers are slowly becoming more sophisticated. Banks, faced in 2007 with sharp, but much needed, increases in their minimum regulatory capital, have been looking at attracting subordinated loans, which may constitute up to 50% of regulatory capital.

Financings to date have been entirely by way of loan; unlike its neighbours, the Russian Federation and Kazakhstan, Azerbaijan has not yet seen any eurobond issues. This is expected to change in the very near future. The International Bank of Azerbaijan has announced its intention to

issue eurobonds during 2007. Bond issues to date have been limited to domestic offerings on the Baku Stock Exchange.

Legal regime for lending

Azerbaijan has a relatively light regulatory regime for cross-border lending compared with other jurisdictions in the region. Foreign loan agreements do not need to be registered or notarized and, generally, no translation of the agreement is required.

Withholding tax is still an issue and unlike some of its neighbours, none of Azerbaijan's double tax treaties provide for an exemption from withholding tax on interest payments. Treaties invariably provide that the rate of withholding may not exceed 10%, which is also the current rate under the Tax Code.

Judgments of foreign courts will generally not be recognised and enforced in Azerbaijan and lenders frequently provide for the option to arbitrate any disputes (Azerbaijan ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards) and/or litigate in other jurisdictions.

English and New York law are the most common choices of governing law, although lenders should note that if lending under New York law using a promissory note, promissory notes issued by an Azerbaijani corporate must be registered with the State Securities Committee and comply with its regulations as to content.

Security matters

Security agreements in respect of assets in Azerbaijan are generally best governed by the law of Azerbaijan, the use of foreign law security being to date untested in the courts. Predictably, all security over real estate must be governed by local law.

The philosophy behind the realization of security is that the pledgor should be able to realise the best possible price for the collateral and thus all pledges (other than those for money or money's worth) are required to be realized through public auction, rather than the security holder's taking possession of the collateral.

Security assignments are not currently expressly recognized as a form of security under Azerbaijani law. Lenders face risks variously of adverse tax treatment or losing their collateral on bankruptcy of the security provider. In the absence of any clarification in the law or established court practice, lenders should consider assignment only as part of a cocktail of other security instruments.

A change in the law in early 2007 saw the abolition of the Law on Pledge, such that the only source of law is now the Civil Code. This resolved a number of uncertainties caused by the simultaneous existence of the two laws and simplifies the list of required contents in security documents.

With a number of major potential borrowers being state entities, lenders should note that new requirements for the issuing of government guarantees for loans to state entities were introduced in early 2006. Among the requirements is that any credit agreement be subject to the supremacy of Azerbaijani law, a provision unlikely to be acceptable to most foreign lenders. The approval process for issuing guarantees can last over three months.

Prospects

Despite recent increased activity and maturity in the lending market in Azerbaijan, it remains to be seen how current growth will develop. Significant eligible borrowers are still relatively few and generally limited to state-owned entities, banks and a small handful of industrials. If, as is hoped, Azerbaijan's new-found oil wealth can stimulate growth across its various economic sectors, we can look forward to a promising market in the near- to mid-term.

Financial and corporate

Recommended firms

Tier 1

Baker & McKenzie
McGrigors

Tier 2

OMNI Consultants
Salans

Tier 3

BM Law
Michael Wilson & Partners

After the Azerbaijan Republic gained state independence, one of the priorities of its foreign economic policy was relations with international financial-credit and economic structures. And in 2007, it has continued its interaction with bodies like the International Monetary Fund, World Bank, European Bank for Reconstruction and Development (EBRD) and the Islam Development Bank.

In the last 12 months, Azerbaijan has seen a surge in financing work, as a result of an increase in international financial investment. French and South Korean banks like Société Générale and the Shinhan Bank have become increasingly active in the region.

Secondly, commercial banks have also shown interest and the capital markets are set to emerge. M&A deals are also getting more sophisticated. Another field of growth is the insurance sector, and some observers say firms will be seeing a lot of insurance-related work in the near future.

Baker & McKenzie and McGrigors continue to dominate the market and with no other international firm interested in setting up operations in Baku, the two have carved themselves a niche in the country and in the region. However, 2006 and 2007 saw Omni Consultants make more of an impact in the corporate and commercial market by advising clients like the State Oil Company of the Azerbaijan Republic and McDonald's.

Baker & McKenzie

According to a rival, Baker & McKenzie is deservedly in the first tier and has had another successful year. The increased activity in bank acquisitions by foreign investors has had a direct impact on the firm's Baku operations and it has played a leading role in the majority of these transactions, generally representing the buyer.

Daniel Matthews, who is the main partner of the Baku office, is liked by both peers and clients and is regarded as a reputable lawyer. "Daniel is a nice guy; he has had a great stint running the firm so far," said a competitor.

"He has also done well to sell the firm's brand in this part of the world."

As one would expect, the oil and gas sector remains strong in Azerbaijan. In one of the largest acquisitions in the past year, the firm advised the State Oil Company of the Azerbaijan Republic in its \$239 million takeover of the Kulevi oil terminal in Georgia.

Meanwhile, the firm acted for BayernLB, Calyon and UniCredit as the mandated lead arrangers of a \$140 million syndicated loan to the International Bank of Azerbaijan. It also advised BNP Paribas as the lender in a \$50 million loan to the International Bank of Azerbaijan in a separate transaction. On the capital markets side, the firm advised the International Bank of Azerbaijan in a \$100 million subordinated debt offering arranged by JP Morgan and UBS.

There was also an interest in private-equity players in the market. An example of this was when Baker & McKenzie advised Kazimir Partners Investment Fund in connection with its equity investment in Texnikabank.

According to a client, Baker & McKenzie "provides better advice than most of its competitors and is quite aggressive". The client added: "In all, it is an efficient and helpful firm and is fast in its work. I can't really complain."

Outside the oil and gas and banking sectors, the firm acted for Holcim, one of the world's largest cement producers in connection with EBRD's \$10 million equity investment in Holcim's Azerbaijani subsidiary, Garadagh. Additionally, it continues to represent Azertel, the majority shareholder in Azerbaijan's largest mobile telephone service provider, in connection with the ongoing privatization of the state's share of Azercell.

Baker & McKenzie is now advising potential buyers in three proposed acquisitions in Azerbaijani production sharing agreements which are expected to close by the end of 2007.

Leading lawyers

Natik Mamedov
Daniel Matthews

McGrigors

McGrigors also received the nod from its rivals and clients and continues to be one of the top firms in the country. Among the deals, it acted for an American bank in a \$100 million subordinated loan to an Azerbaijani bank and represented arrangers in a \$305 million syndicated loan to a borrower from the state sector.

Elchin Mammadov was noted to be a "fine personality" by a competitor. "I like working with him. He is always open to dialogue,

unlike some other lawyers," he added. Ismail Askerov also attracted praise and together with Benjamin Paine, McGrigors has a "well-rounded practice".

Traditionally known for its expertise in the oil and gas sector, the firm has engaged in a lot of banking work, which is growing rapidly. For example, it recently advised a development bank in its acquisition of a minority stake in an industrial company. Another transaction saw it acting for an international financial institution in relation to the increase in capital of a local bank and consequent amendments to the shareholders' agreement.

McGrigors' regular clients include EBRD, the International Finance Corporation, Bayerische Hypo- und Vereinsbank, ExxonMobil, Anglo Asian Mining and Otis Lifts.

Some of the practice's other innovative work included acting for a European bank in the \$135 million refinancing of an oil company in Azerbaijan and advising an international oil company on its real-estate rights in relation to a major development.

Leading lawyers

Ismail Askerov
Elchin Mammadov
Benjamin Paine

OMNI Consultants

While in the last year the firm has been predominantly occupied with financial work, both for lenders and borrowers, M&A activity is also on the up. The firm has three partners and six associates and is well placed to act on the buyers' side of transactions.

The firm participated in the largest financing deal in the country in 2006. It advised the State Oil Company of the Azerbaijan Republic (Socar) in its \$480 million refinancing of a loan and carry arrangements extended to its subsidiaries under Shah Deniz and the SCP projects. It was involved in all the stages of the deal and issued a legal opinion in favour of a consortium led by ABN Amro and Société Générale. It is also representing Socar in raising finance secured by the crude oil from the Azeri Chirag Gunesgli oil field with a value of \$800 million.

Another innovative project finance transaction it is working on involves the financing of an upgrade and expansion of a motorway by Shinhan Bank, one of South Korea's leading financial institutions.

A client reported that partners Roman Alloyarov and Ismail Zargarli "play to each others strengths". The two of them worked together for the EBRD in a \$4.5 million secured loan to Taj, an independent bottling company, for an expansion of its existing

capacities. It guided the same client in an acquisition of an equity stake and a secured loan to Unileasing to extend its lease portfolio. It also advised VTB Europe Bank as a sole arranger and facility agent in one of the first syndicated loans to local banks.

Finally, the firm acted for McDonald's Azerbaijan in a \$6 million real-estate development project involving the construction of an upscale shopping centre in the heart of Baku. Some of the regular banks it works for include the Black Sea Trade and Development Bank, Standard Bank and the Micro Finance Bank of Azerbaijan.

Leading lawyers

Roman Alloyarov
Jeyhun Bayramov
Ismail Zargarli

deals involving clients like Czech Export Bank, Raiffeisenbank, Société Générale and Credit Suisse.

Salans

Salans has been active since 1990 and formally opened its Baku office in 1999, when the Wicklow Group, the first foreign law firm to be licensed in Azerbaijan, became an integral part of its worldwide practice.

The firm was recently struck a blow by the departure of the "exceptional" Alum Bati, but has the talent to fill the vacuum: Bati's role was assumed by James Hogan, who has practised in the region for more than 18 years. Its team consists of five full-time lawyers, all of whom speak fluent English and Azeri.

Recent work includes advising a foreign bank in obtaining a banking licence and conducting the associated legal due diligence.

In other deals, the firm acted on the privatization of an Azeri bank and it also advised a large aircraft leasing company on the leasing and registration of an aircraft to the Azerbaijan national carrier.

Lastly, it also does a lot of work in the energy and oil and gas sectors and has worked on a series of oil and gas pipeline projects in the country over the last five years.

Leading lawyers

James Hogan

Other notable firms

Michael Wilson & Partners remains in tier three and according to a peer is "still establishing itself in the market". **BM Law**, which has been on the market since 1993, was spotted often on the market in the last year. Its founder Jamal Baghirov served as Chairman of the State Law Office in Baku for 10 years and he has experience serving as Azerbaijan counsel to big names such as AzEuroTel, Lukoil, Turkish Petroleum, British Airways, Lufthansa and HSBC. It recently worked on