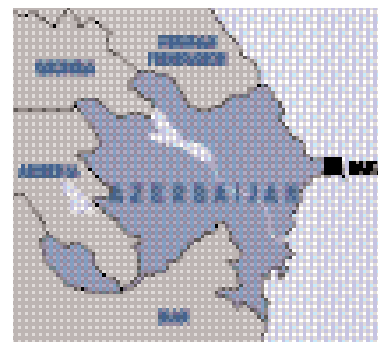


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Corporate governance and securities law reform in Azerbaijan

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The past year has seen a steady flow of legislation affecting the law relating to securities and corporate governance. The laws On Joint Stock Societies (1994) and On Securities (1998) have been repealed, and in part consolidated, with some major modifications, into the Civil Code 2000 (the Code). These amendments came into force on March 6 2004. Also, a new law, On Banks, came into force on March 30 2004 that included some special corporate governance provisions relating to banks.

Normally, legal entities formed in Azerbaijan take the form of either limited liability societies (LLS) or joint-stock societies (which can be open or closed) (JSS).

One important change (if that is what was intended) is that reference is now made to the *nominal value* of a share in an LLS. It always used to be the case that participants in an LLS did not have shares with nominal value but owned a percentage interest, or share, in the company. By ascribing a nominal value to LLS shares, it appears that the Code is aligning LLSs with JSSs. However, it is possible that this is a drafting error and it is too early to tell what will transpire in practice.

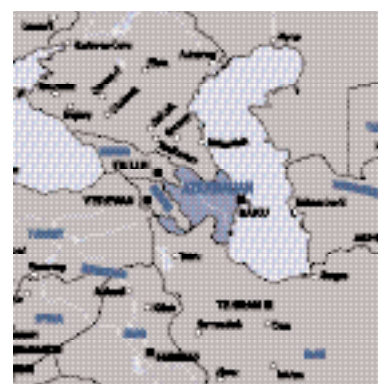
The amendments now do make clear that neither an LLS nor a JSS can pay a dividend where it is insolvent (or where the payment would make it insolvent). They also state that the par value of shares must be denominated in Azeri *manats*, and that an initial issue must be fully paid.

Corporate governance

Corporate governance in an LLS is left much as before (in addition to an executive board, it may have a supervisory board and audit committee). As usual, drafting imprecision has created the potential for conflict: for instance, participants are given the right to be elected to the governing bodies of the society. One issue that has been clarified, however, is that the chief executive's contract is signed by the chairman of the general meeting of participants appointing him or her.

As regards JSSs, some of the problems of holding inquorate shareholder meetings have been resolved. For instance, the reference to *60% of shareholders* has been amended to *60% of voting shares represented at the meeting*. The former rule was almost impossible to fulfil in companies with employee shareholders, generally privatized companies, which affected the success of privatization in general.

Lower quorum requirements also apply to adjourned meetings but, if a quorum still cannot be reached after two adjournments, the State Securities Committee must be informed and the general meeting (even if inquorate) can wind-up the JSS. Other possible difficulties in terms of corporate governance have been introduced: a shareholder can participate in a general meeting by proxy, or in writing (if permitted by the charter and



having clearly specified his or her voting preference), but both methods require notarization of the shareholder's signature.

The super-majority voting requirement for those important matters reserved to the shareholders of a JSS (for example, amendments to the charter, winding-up or reorganization) has been reduced, other than for banks, from three-quarters of votes present to two-thirds. And the creation of branches is no longer a matter that is subject to super-majority voting.

Notices of annual general meetings of open-type JSSs must be published in the press 45 days before the meeting, as well as notifying shareholders in writing. Closed-type JSSs are, as before, only required to notify shareholders in writing.

Importantly, resolutions of JSS general meetings must be notified to the shareholders within 15 days. Minutes must be signed by the chairman and secretary and sealed. The minutes must specify: (i) the time and place of the general meeting; (ii) the agenda; (iii) the number of voting shares represented at the meeting; (iv) the number of shareholders with voting rights taking part; (v) a summary of proceedings; (vi) the results of voting in respect of each issue put to the vote; and (vii) the precise text of each resolution passed.

The new provisions provide for methods of counting votes at general meetings in JSSs with more than 100 shareholders: a panel of at least three tellers is required. The tellers have to add a record of the vote to the minutes of the meeting.

Though it had previously been the case that the supervisory board should be elected by the general meeting, it is now provided that the term of a director (other than for banks) cannot exceed three years and can be terminated before the expiration of the term by a resolution of the general meeting. Supervisory board meetings must now be held on at least a quarterly basis (previously, no minimum requirement was specified), the chairman has a casting vote, and minutes of the meetings signed by the chairman must be maintained. Other key corporate governance provisions include:

- i) The supervisory board is also given authority to approve transactions in which a member of the executive board has a conflict of interest.
- ii) Both members of the supervisory and executive boards must disclose in the press any transaction by them with regard to the securities of the JSS before entering into such transaction.
- iii) No member of the executive board may own 20% or more of the JSS.
- iv) Executive board members may only hold positions in other organizations with the consent of the general meeting of the supervisory board.
- v) An audit committee (or internal auditor), elected by the general meeting for a term not exceeding three years, is a requirement for a JSS with more than 50 shareholders (previously, all JSSs were required to have an audit committee).

In relation to JSSs of an open type, a transaction that exceeds 25% of the net asset value of the company must now be approved by a general meeting of shareholders, and the method of disclosing details of such transactions, should be specified in the charter.

Nonetheless, many matters still need to be resolved. For example, a participant can withdraw from an LLS and, where the

use of property has been contributed in kind to the charter capital, this property can be demanded back; in JSSs, it is left to the general meeting to select the chairman of the supervisory board, which can only be done after the supervisory board has itself been elected; and the audit committee, although now given powers to demand documents from the company, it is now limited to carrying out audits with the approval of the general meeting or supervisory board.

Companies are permitted to consolidate or split shares, subject to procedures to be defined by the State Securities Committee. The ability to do this might make the administration of some companies easier, but experience in the former Soviet Union has shown that this power can be abused by a dominant shareholder at the expense of minority shareholders.

Security for real property not yet in being

A new type of security – a housing certificate – has been introduced. Such certificates are, in fact, guarantees for real property not yet constructed. The certificate is a security between a natural person and a legal person, and entitles the holder to require the issuer (normally, a developer) to transfer a building or apartment in respect of which the security has been purchased once the terms of issue of the security have been fulfilled. Housing certificates can be registrable or unregistrable securities, and it is left to the State Securities Committee to determine regulations for the issue, assignment and registration of housing certificates. No such regulations have yet been issued.

Futures and options

The Code now provides for derivatives, such as futures and options. However, beyond defining what these are, the Code is silent as to how these should be applied and leaves it to the State Securities Committee to provide the relevant regulations.

Securitization of mortgage-backed debt

The law now contains provisions allowing for the securitization of mortgage-backed debt. Mortgage or hypothecation certificates are registered securities confirming the existence of monetary and other obligations under a hypothecation agreement. Such mortgage certificates can be assigned by endorsement without the approval of the borrower or, if different, the owner of the mortgaged property, as long as the essence of the obligation is not affected.

Convertible bonds

Debt securities convertible into shares can be issued by JSSs of an open type only.

Preference shares

One final comment, relating to preference shares. These were, and continue to be, permitted. However, the right to vote by preference shareholders at shareholder meetings is strictly limited to issues concerning reorganization, liquidation, and certain charter amendments (unless, presumably, the charter grants other rights). This has the potential to create problems when determining the quorum for meetings at which preference shareholders have rights to vote. It does appear that preference

shareholders are not in reality equity holders, but instead own securities much more akin to loan stock. As such, one might ask if a preference shareholder has the right, as do other JSS shareholders, to require the executive to provide a copy of the shareholders' register.

Banking and finance

Recommended firms

Baker & McKenzie

Baker Botts

Ledingham Chalmers

Salans

Corporate and commercial

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Baker Botts

The Baku office of Baker Botts opened in 1998 to deal specifically with energy projects in the region. It still specializes in oil, gas and other areas of project finance.

At the time of writing, the firm was advising Caspian Energy Group UK on the conversion of the Shirvan Oil onshore joint venture into a production sharing agreement regime. Also under way are negotiations between several Azeri licensed banks (for example, Unibank) and the European Bank for Reconstruction and Development in relation to potential loans. These loans are for the purposes of on-lending to both small and medium-sized enterprises.

It is in project financing that Baker Botts really stands out from the crowd, however, recently acting as principal outside counsel to a consortium in the \$3.2 billion Shah Deniz natural gas pipeline from Azerbaijan to eastern Turkey. The firm was involved with the project at every level. It also advised on the \$3 billion Baku-Tblisi-Cayhan crude oil pipeline, and for this deal provided all documentation, host government agreements, and export credit and other political risk insurance advice to a consortium of partners.

Baker Botts' client list is impressive and includes Exxon, the Azerbaijan Gas Supply Company, BP and Lukoil. Mark Rowley is the firm's representation on the ground in Baku, while Kevin Dent – the partner in charge – is based in Washington. Associate Bakhtiyar Mammadov is recommended by his peers and seen as a rising star. He recently

advised on the conversion of the Shirvan Oil onshore joint venture into a production sharing agreement.

Key contact partner

Mark Rowley

Leading lawyer

Bakhtiyar Mammadov

Baker & McKenzie

Established in 1998, Baker & McKenzie's Baku office is the most recent addition to the firm's CIS network. It is managed by partner Daniel Matthews, who oversees a team of four lawyers. Matthews, although based in the Moscow office, is well regarded in Baku for his banking expertise. The firm has an impressive client list in this practice area, including ABN AMRO, BNP Paribas, the International Bank of Azerbaijan and the Royal Bank of Scotland.

The firm has also been busy with corporate and commercial work, recently advising on the privatization of Azal, the Azerbaijani state airline, and various aspects of aircraft finance. The client list for corporate and commercial work includes Transocean SedcoForex, Consolidated Contractors International Company, Statoil Apsheron, Siemens and Shell International.

Natik Mamedov is the firm's key M&A lawyer. He worked on the merger of M Bank and Trometchekbank, to form Techobank, and handled Baker & McKenzie's involvement in the Azal privatization, a deal completed in 2003.

Key contact partner

Daniel Matthews

Leading lawyer

Natik Mamadov

Ledingham Chalmers

Scottish firm Ledingham Chalmers was the first foreign firm to establish a presence in Baku. It began working in the region in 1992 while advising the consortium developing the Azeri-Chirag-Gunashli oil and gas fields in the Caspian Sea, and has since established a solid reputation for advising on Azerbaijani infrastructure projects.

The firm was involved in the Baku-Tblisi-Ceyhan pipeline deal, for which it conducted analysis of the regulatory regimes for oil and gas transportation, environmental protection, monopolies, currency control and licensing.

Ledingham Chalmers has also advised the Azerbaijan government on various matters, including the establishment of the Azeri Bar Association. This intimate knowledge of domestic law issues led to it advising international lending institutions and oil companies on the implications of laws and proposed legislation. The resident directors in the Baku

office are Ismail Askerov and Elchin Mammadov. Benjamin Paine is the office's associate, and is well regarded by the Azerbaijan legal market.

Key contact

Ismail Askerov

Leading lawyer

Benjamin Paine

Salans

Salans established an office in Azerbaijan in 1999 when the firm merged with the Wicklow Group. Wicklow's managing partner was Alum Bati, who is now a partner at Salans and has been described as "historically the number one" in Azerbaijan. He is one of a six-lawyer team in the Baku office, which is known for its extensive experience in banking work. Salans is the main general counsel to Koch Bank, and was involved in the privatization of the National Bank of Azerbaijan.

Key contact partner

Alum Bati

Leading lawyer

Alum Bati