# Legal Risks and Preventive Mechanisms of Chinese Enterprises' Energy Investments in Azerbaijan

Zhonghong BAI, Tingting Qiu

**Abstract:** With the continued development of the economy and strong policy support, especially the Belt and Road Initiative, the scale of overseas investment by Chinese enterprises is continuously increasing, with the energy industry becoming an important investment area. In recent years, Chinese companies have gradually increased their investments in Azerbaijan's energy sector, especially in the oil, gas and energy infrastructure sectors. However, these investment projects often affect the key sectors of the host country, which are actually related to the national economy and the livelihood of the people in the host country. The absence of comprehensive environmental and social impact assessments (ESIAs) has heightened legal risks for Chinese enterprises in overseas energy investments. Additionally, environmental concerns in host countries have become major obstacles to large-scale energy projects. In view of this, when expanding investment in the Azerbaijani energy sector, Chinese enterprises should thoroughly understand the investment environment in Azerbaijan, improve legal due diligence, strengthen risk management, emphasize the environmental awareness of enterprises when investing, and establish good relations with the government and society.

**Key words:** Energy investment, Azerbaijan, legal risks, preventive mechanism

## 1. Introduction

In recent years, Chinese companies have gradually increased their investments in the Azerbaijani energy sector, particularly in oil, gas and energy infrastructure. In 2002, Chinese companies' oil and gas investment in Azerbaijan began to develop, mainly in the upstream sector, and the scale of cooperation was small (Han & Chang, 2020).

The Belt and Road Initiative has fostered increased investment opportunities for Chinese enterprises in Azerbaijan, particularly in the energy sector. From 2013 to 2022, China's non-financial direct investment in countries along the "Belt and Road" increased at an average annual rate of 5.8%, and cumulative investment in the energy sector accounted for about 40% of China's total investment in countries jointly developing the "Belt and Road" (China Energy Media Group Co.,Ltd, 2023). Driven by the "Belt and Road" initiative, the scale of oil and gas investment by Chinese companies in Azerbaijan has expanded, the level of cooperation has gradually deepened and the industrial chain has been continuously improved. In 2017, PetroChina and Azerbaijan State Oil signed a cooperation agreement on the Oil and Gas Processing and Petrochemical Complex (OGPC) project, the largest project signed between the two countries to date. In 2018, CNPC and the State Oil Company of Azerbaijan reached an agreement to establish a joint offshore oil and gas exploration and production company, further enhancing the oil and gas investment chain of Chinese companies in Azerbaijan.

The purpose of this paper is to analyze the legal risks that Chinese companies face when investing in the Azerbaijani energy sector and to propose appropriate countermeasures. The in-depth study will provide Chinese companies with guidance for their investment decisions in

Azerbaijan, help them better manage the legal risks, and ensure the smooth operation and long-term stable development of investment projects.

## 2. The Investment Climate in Azerbaijan

### 2.1 Investment Attractiveness

Azerbaijan's investment attractiveness mainly stems from its rich hydrocarbon resources, continuously optimized investment environment, continuously growing market demand, as well as its advantageous geographical location connecting Europe and Asia and relatively complete transportation infrastructure. In recent years, Azerbaijan has been actively integrating into the global wave of digitalization and green development, especially in the development of new energy sources, the digital reform of government affairs and the digital empowerment of traditional industries. The relevant areas are still in the early stages of development at present, but have shown great investment potential.

Azerbaijan regards attracting foreign investment as a key driver of economic growth and applies national treatment to foreign investment in principle, offering preferential policies especially for major energy projects, large-scale production-oriented projects and long-term contracting/hosting projects. There are basically no special incentives for small and medium-sized foreign enterprises and individual investors. However, efforts have been made by the Azerbaijani government to enhance the development environment for SMEs in recent years, and has endeavored to enhance the country's level of innovative development through the formulation of policies and the provision of concessions. According to the Azerbaijan Small and Medium Enterprises Development Agency, the number of SMEs in Azerbaijan has grown to 356,000 over the past four years, an increase of 45 percent. Among them, the share of SMEs in the output value of the non-hydrocarbon industry has increased from 23.5% to 26.6%, and their share in non-hydrocarbon exports has grown significantly from 23.3% to 59.8% (InvestGo[30], 2024).

Azerbaijan has demonstrated significant progress in international competitiveness. According to the Global Competitiveness Report published by the World Economic Forum in 2019, Azerbaijan was ranked 58th, up 11 places from 2018. The World Bank's Doing Business Report released in 2020 ranked Azerbaijan 34th, down nine places from 2019. In the Global Innovation Index published by the World Intellectual Property Organization in 2023, Azerbaijan was ranked 89th out of 132 countries and territories in the composite index, up four places from the previous year. (Dutta,S. et al, 2023)

Overall, Azerbaijan offers a market full of opportunities for investors with its rich natural resources, improving investment climate, and focus on digitalization and green development. Despite certain risks and challenges, with sound planning and risk management, investors can find sizable investment opportunities in Azerbaijan's transforming economy.

### 2.2 Legal Framework

Azerbaijan's energy sector, particularly the oil and gas industry, is governed by a complex legal framework that includes both domestic legislation and international treaties. The

30 The "InvestGo" website is a public service platform constructed and operated by the Department of Foreign Investment and Economic Cooperation of the Ministry of Commerce of China.

following is an overview of the key laws and regulations that investors need to be aware of when considering investments in Azerbaijan's energy sector.

*Law on Subsoil*: The Act stipulates that underground resources belong to the Republic of Azerbaijan and that the Government has ultimate ownership. However, the Act also respects the rights of individuals and legal entities to use and develop them. In other words, although the ownership of underground resources is vested in the Government, private companies may be granted the right to develop and utilize these resources under legal authorization. These exploitation rights are usually granted through the granting of licenses or the signing of contracts. In addition, the Act regulates the licensing system for oil and gas exploration and production. Exploration licenses are valid for a maximum of 5 years, production licenses for a maximum of 25 years, and combined exploration and production licenses for a maximum of 30 years. Licenses may be extended by mutual agreement.

*Law on Energy*: The Act provides the legal background for the generation, transmission, distribution and sale of electricity and thermal energy and aims to ensure the rational use of energy resources and environmental protection. The Ministry of Energy is responsible for the licensing and regulation of these activities, ensuring that all energy projects comply with national regulations and policies. It also requires operators in the electricity and heat sectors to take measures to achieve sustainable use of resources and reduce environmental impacts.

*Law on Utilization of Energy Resources*: The Act covers the policy, legal, economic and social bases in the field of energy resource use in Azerbaijan and establishes requirements for the certification and standardization of energy-consuming equipment and facilities. It ensures that Azerbaijani products and services in the energy sector meet the standards and certification requirements set by the State.

*Law on Combined Heat and Power Generation*: The Act provides the legal framework for the design, construction and operation of power plants, including independent power plants. There are no restrictions on the purchase of electricity produced by small power plants. Any natural person or legal entity has the right to construct, renovate and operate a power plant, subject to obtaining the necessary permits from the Ministry of Energy. The law also specifically states that electricity produced by small power plants can be sold freely without restrictions. This has also helped to promote the diversification of Azerbaijan's electricity market and support the development of renewable energy sources.

*Law on Renewable Energy*: Azerbaijan adopted the law "*On the Use of Renewable Energy Sources in the Production of Electricity*," No. 339-VIQ, dated May 31, 2021 (*Law on Renewable Energy*), that created a regulatory framework for renewables and established support mechanisms and competitive bidding processes for renewable energy projects. The law aims to promote the use of renewable energy in electricity production, facilitate the country's green energy transition, and offer clear legal protection and policy support to investors.

*The Energy Charter Treaty (ECT)* is a multilateral international investment treaty designed to promote investment, trade and cooperation in the energy sector by establishing a stable and transparent legal framework. In terms of investment protection, the ECT provides a wide range of protection measures for foreign investors, including fair and equitable treatment, national treatment, and most-favored-nation (MFN) treatment, etc., to ensure that investors enjoy treatment in the host country that is no less favorable than that accorded to their own or third-country investors, thereby avoiding discriminatory treatment. In terms of dispute resolution mechanisms, ECT has also set up a strong international dispute resolution mechanism that allows investors to initiate arbitration proceedings against the host country through arbitration institutions such as the International Center for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL), which provides investors with an effective means of legal redress. On energy trade and transit, the ECT clarifies rules on energy trade liberalization and transit transport to ensure the free flow of energy between member states, and stipulates rules on the construction and operation of transit facilities to guarantee the safety and reliability of energy transport. On sustainable development, in December 2024, the ECT adopted a series of modernization amendments to emphasize member states' commitment to environmental protection and climate change, and introduced a "sustainable development" clause requiring member states to meet their obligations under the Paris Agreement.

Azerbaijan, as a full party to the *Energy Charter Treaty (ECT)*, signed and ratified the treaty in 1994 and has continued to participate in it since its entry into force in 1998. At the same time, China signed *the Declaration on the International Energy Charter* on May 20, 2015, joining the framework of the treaty as a "cooperating state", and the ECT provides clear legal guidelines and strong safeguards for Chinese companies investing in energy in Azerbaijan and other member states. Specifically, the ECT requires member states to provide fair and equitable treatment to foreign investors and to ensure that Chinese companies are not discriminated against in their energy projects in Azerbaijan. The treaty also emphasizes the principles of transparency and non-discrimination, requiring member states to maintain a high degree of transparency in their policies and regulations in the energy sector, thereby reducing the policy uncertainty faced by Chinese companies. In addition, the international arbitration mechanism established by the ECT allows investors to initiate arbitration proceedings against the host government, providing a reliable legal remedy for investment disputes that Chinese companies may encounter in Azerbaijan.

## 3. Legal Risks Faced by Chinese Companies Investing in Azerbaijan's Energy Sector

### 3.1 Investment Protection and Dispute Resolution Risks

Investment protection and dispute settlement mechanisms are crucial aspects of transnational investment. A sound investment protection framework can provide a stable legal environment for enterprises, while an effective dispute settlement mechanism is the last line of defense to safeguard their legitimate rights and interests. When analyzing Chinese enterprises' investment in Azerbaijan's energy sector, investment protection and dispute settlement risks are two important aspects that cannot be ignored. These risks are not only related to the economic interests of enterprises, but also directly affect the sustainability and stability of investment projects. An in-depth understanding of these risks, therefore, is of great significance for safeguarding investment security and promoting Sino-Azerbaijani energy cooperation.

The competent authority for investment in Azerbaijan is the Ministry of Economy, and the department responsible for foreign investment is the Export and Investment Promotion Agency of the Republic of Azerbaijan (AZPROMO). This organization is responsible for the development of Azerbaijan's non-oil sector, promotion of products in foreign markets, raising awareness of foreign consumers about the country's products, providing services to interested investors, and so on.

The main laws and regulations governing foreign investment in Azerbaijan are as follows: *Law on Investment Activity*, *Law on Protection of Foreign Investments*, *Law on Antimonopoly*

*Transactions*, *General Tax Code*, *Law on Privatization*. (Department of Outward Investment and Economic Cooperation et al, 2024)

Azerbaijani law provides that foreign companies enjoy national treatment in Azerbaijan. Limited tax incentives may be provided to foreign investors in the following cases: (1) goods such as equipment and materials imported into Azerbaijan by foreign businessmen as an investment, as well as private property and goods brought into the country by the staff of the foreign enterprise and their families, are exempted from customs duties and value-added tax; and (2) in the case of a major foreign investment project, the tax incentives to which the project is entitled can be stipulated through the signing of a contract on a case-by-case basis. For example, for investment and development projects in oil and gas or other mineral resources, foreign investors may enjoy tax benefits such as exemption from import duties and VAT according to the cooperation agreement signed with the Azerbaijani government. (3) Foreign investment enjoys the full protection of the national laws of Azerbaijan. No nationalization or expropriation of foreign-owned enterprises shall be permitted except under specific circumstances; foreign businessmen shall be compensated promptly, equitably and effectively for economic losses suffered as a result of nationalization or expropriation of property in Azerbaijan (Department of Outward Investment and Economic Cooperation et al, 2024).

In Azerbaijan, commercial disputes can be resolved mainly by filing complaints in local courts and applying the laws of the host country, or by enforcing the contractual provisions on complaints, applicable law and arbitration. In addition, parties may also resort to local government intervention to resolve disputes. However, Azerbaijan suffers from inefficiency in economic case management. Despite strict intervention in criminal cases against the government, the resolution of economic disputes often takes a long time, the impartiality and effectiveness of law enforcement agencies in economic cases needs to be improved, and difficulties in enforcing court decisions are common (Department of Outward Investment and Economic Cooperation et al, 2024).

In terms of international arbitration, arbitration clauses are usually specified in contracts between large companies, but some companies may use offshore companies to avoid economic liability, which brings additional complexity to dispute resolution. Therefore, when investing in Azerbaijan, companies need to fully consider these features of the legal environment in order to reduce potential risks.

In the area of mutual legal assistance, under Azerbaijani law, judgement handed down by foreign courts in accordance with the laws of the State in which they are situated are recognized and enforced only if they are in conformity with Azerbaijani domestic law and public order and if the State in which the parties are situated is a signatory to international treaties. Recognition and enforcement of a foreign court's judgement will often not take place if: 1. the Azerbaijani court has existing exclusive jurisdiction over the subject matter of the judgement; 2. the judgement has been rendered in the Azerbaijani court; and the judgment in question already exists in an Azerbaijani court or proceedings in an Azerbaijani court have already begun; 3. the judgment of the foreign court has not entered into force in that country; 4. the principle of reciprocity has not been met; and 5. recognition and enforcement would be contrary to the provisions of Azerbaijani law and sovereign interests (Shanghai City Development Law Firm, 2018).

Azerbaijan is not only a party to *the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, but has also acceded to the 1961 *European Convention on International Commercial Arbitration* and the 1965 *Washington Convention on* *the Settlement of Investment Disputes* between States and Nationals of Other States. Azerbaijan's International Arbitration Act of 18 November 1991 also provided for the enforceability of extraterritorial arbitration subject to Azerbaijani law, and the Supreme Court of Azerbaijan had the power to decide whether an extraterritorial arbitral award could be recognized and enforced in its territory.

Recognition and enforcement of a foreign arbitral award may be refused in Azerbaijan if: 1. the parties concerned are not capable of signing an arbitration clause or the arbitration clause is invalid under the applicable law; 2. the parties concerned have not been properly notified while choosing arbitrators or the arbitration proceedings or are for some reason not in a position to submit the relevant evidence at the time of the arbitration; 3. there is no provision for arbitration clauses, but the dispute is resolved by arbitration or the arbitration settlement exceeds the part of the agreement to be resolved by arbitration; 4. the composition of the arbitral tribunal or the arbitration procedure is not in accordance with the provisions of the agreement signed by the parties or the parties have not agreed on the place of arbitration; 5. the arbitral award is not final or the court of the place where the arbitral award was relied upon has declared a stay of execution; 6. the recognition and enforcement of the arbitral award would be contrary to the provisions of the laws of Azerbaijan and to the sovereign interests of the country (Zhang, 2014).

### 3.2 Contractual Risk

Chinese companies face a number of risks and challenges in contract management in energy projects in Azerbaijan. First, energy project contracts are complex and often involve technical terms (e.g., cost recovery ratio in the Production Sharing Agreement), which, if not clearly defined, may lead to difficulties in contract fulfillment or disputes. For example, disputes often arise from ambiguous terms in agreements, especially when it comes to key terms such as "force majeure", the lack of a clear definition of which may lead to disagreements between the two parties on the fulfillment of contractual obligations in the event of force majeure (e.g., social unrest or natural disasters). During the contract execution of a tender project for an Indonesian state-owned enterprise won by Chinese company A, the price of raw steel increased sharply by 2-3 times due to the Russian-Ukrainian war and epidemics, while the price of sea transportation also rose sharply. These factors caused the project cost to increase significantly, and continued execution of the contract would result in a loss. However, the price adjustment clause in the contract was very harsh and the Indonesian owner did not agree to compensate for the cost increase. As a result, the Chinese side proposed to terminate the contract, but faced the risk of possible huge claims from the Indonesian side as well as being blacklisted. First of all, there was the problem of unclear contract terms in this case: the contract did not specify the price adjustment mechanism when the price of raw materials and transportation costs rose sharply, which led to disputes between the two parties on the issue of cost sharing. Again, there were external factors: the Russian-Ukrainian war and epidemic were unforeseeable external factors, but the contract did not specify whether these factors belong to the scope of "force majeure", which led to differences between the parties. As a result, the lack of clarity in the terms of the contract led to disputess over the allocation of risks and responsibilities, which ultimately led to difficulties in the implementation of the contract.

In addition, energy projects are prone to risks of government intervention and arbitration. The Supreme Court may refuse to recognize and enforce decisions of foreign arbitral awards when deciding cases that conflict with Azerbaijani legislation or public order and morals, and violate Azerbaijan's sovereignty. Its Civil Code and Code of Civil Procedure have similar provisions that rights and obligations under contracts should not violate public order and morals, national security and sovereignty, and the law. This also requires Chinese enterprises to pay attention to and respect local customs and consult laws and regulations when signing contracts, so as to avoid violation of illegal contract terms due to policy changes. At the same time, while Azerbaijan's investment law promises to protect foreign investment, the Azerbaijani government can impose restrictions on energy projects on the grounds of "national security" or "public interest" through regulations such as *the Investment Law* and *Tax Code*. Azerbaijan's bilateral investment treaties (BITs) with a number of countries often include "public interest exceptions" that allow the government to adjust the contract under certain conditions. According to a report by China National media CNR.cn, on February 6, 2025, Azerbaijan terminated its cooperation with the U.S. Agency for International Development (USAID) on the grounds that there was "no legal basis" for the termination (CNR, 2025), a sign of the government's strong control over the activities of outside organizations, and an indirect reflection of its dominance over foreign-invested projects.

In order to cope with these risks, Chinese companies should pay special attention to the details of contract terms when signing contracts to ensure that the terms are clear and unambiguous, protect the rights and interests of both parties, and avoid future risks caused by "ambiguous terms". At the same time, they should strengthen the monitoring and management of the contract execution process, and adjust the project plan in time to cope with possible risks, so as to ensure the smooth fulfillment of the contract.

### 3.3 Compliance and Labor Management Risks

Corruption in Azerbaijan has been a notable challenge in its governance structure. According to the report in 2024 by Transparency International, Azerbaijan is ranked 154th in the global ranking of clean countries (out of a total of 180 countries), with a score of 22/100 (0 being highly corrupt), which puts it in the category of a country at high risk of corruption. There is insufficient transparency in public procurement, independence of the judiciary, and contracts in the energy sector. According to the World Bank Governance Indicators, the Control of Corruption indicator score for 2023 is -1.19547 (range -2.5 to +2.5), significantly lower than the global average. Corruption permeates not only government institutions but also the business sector, leading to administrative inefficiencies, miscarriages of justice and negative impacts on business operations.

Corruption in Azerbaijan has a negative impact on the investment climate in a number of ways. First, corruption increases operational costs and legal risks for firms, especially in obtaining licenses, contract approvals, and day-to-day operations, where firms may have to pay additional "gray costs," which not only raises the cost of investment, but can also lead to project delays. According to the World Bank's 2019 Enterprise Survey, 12 percent of Azerbaijani firms have experienced at least one request for a bribe in all government interactions (including tax, customs, licensing, etc.), and 35.7 percent of Azerbaijani firms admitted to paying a bribe for government permit. In addition, the survey noted that the percentage of firms asked to pay bribes when obtaining construction permits, government contracts, or meeting with tax officials was 18.2%, 5.6%, and 9.7%, respectively (World Bank Group et al., 2019). These data suggest that corruption is a relatively common phenomenon in business operations in Azerbaijan, especially in interactions with government agencies..Daimler was fined US$185 million by the U.S. Department of Justice in 2010 for violating the U.S. *Foreign Corrupt*

*Practices Act (FCPA)* by paying bribes through intermediaries to officials in several countries, including Azerbaijan. Second, corruption reduces administrative efficiency, causing companies to face cumbersome processes and non-transparent operations when going through the relevant procedures, further increasing the cost of time. In addition, corruption may lead to an unstable investment environment, affecting investor confidence and even triggering social discontent and increasing social instability.

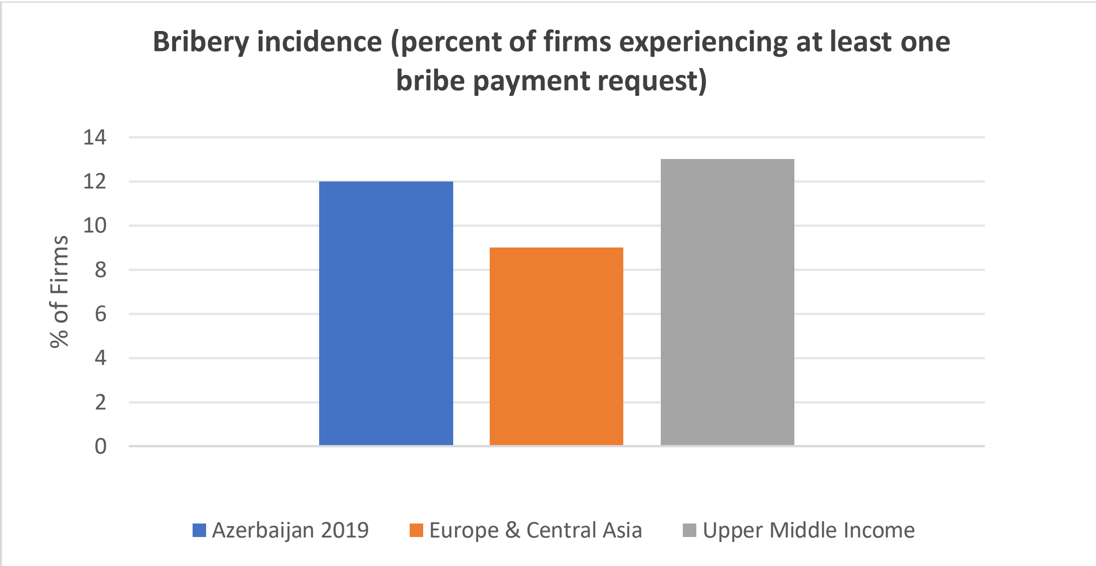


***Figure I*[31]**

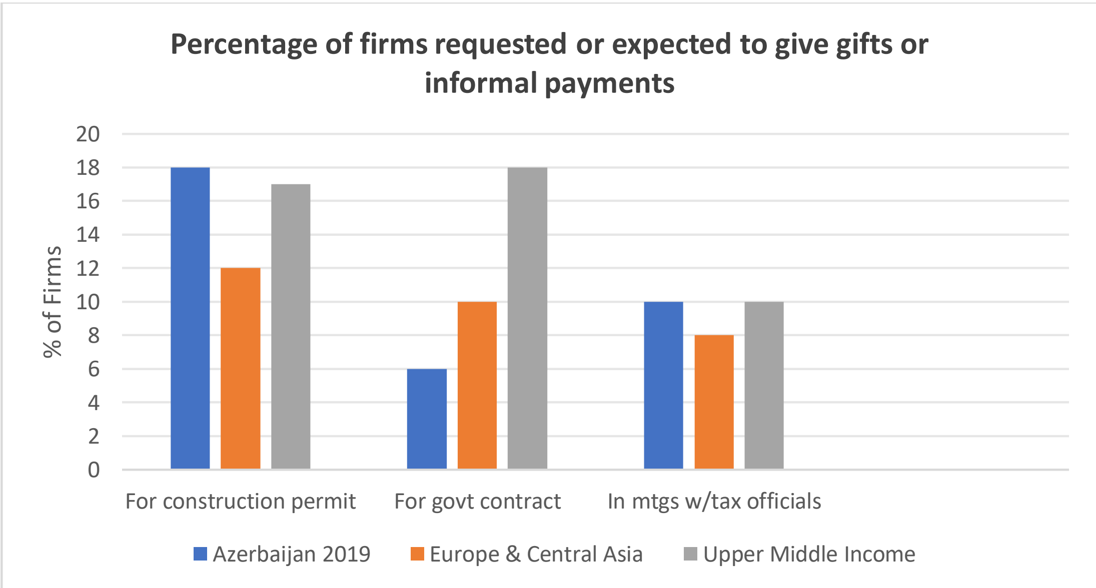


***Figure II*[32]**

[31] The chart is from *Enterprise Surveys Azerbaijan 2019 Country Profile* https://www.enterprisesurveys.org/content/dam/enterprisesurveys/documents/country/Azerbaijan-2019.pdf, page 9.
[32] The chart is from *Enterprise Surveys Azerbaijan 2019 Country Profile* https://www.enterprisesurveys.org/content/dam/enterprisesurveys/documents/country/Azerbaijan-2019.pdf, page 9.

| | Azerbaijan 2019 | | | | Europe & Central Asia | Upper Middle Income |
|---|---|---|---|---|---|---|
| | All Firms | Small firms | Medium firms | Large firms | | |
| Proportion of investment financed by equity or stock sales (%) | 22.5 | n.a. | n.a. | n.a. | 4.4 | 5.5 |
| **Crime** | | | | | | |
| If the establishment pays for security, average security costs (% of annual sales) | 2.8 | 2.4 | 3.1 | 2.8 | 2.1 | 2.8 |
| If there were losses, average losses due to theft and vandalism (% of annual sales) | n.a. | n.a. | n.a. | n.a. | 2.9 | 3.9 |
| **Informality** | | | | | | |
| Percent of firms competing against unregistered or informal firms | 29.9 | 31.5 | 31.3 | 21.1 | 34.2 | 49.6 |
| Percent of firms formally registered when they started operations in the country | 97.1 | 96.2 | 97.2 | 100.0 | 96.8 | 89.1 |
| **Regulations and Taxes** | | | | | | |
| Senior management time spent dealing with the requirements of government regulation (%) | 2.7 | 1.9 | 4.4 | 2.5 | 8.7 | 7.3 |
| Percent of firms that were visited or required to meet with tax officials | 42.4 | 32.3 | 46.9 | 69.4 | 39.4 | 46.9 |
| Days to obtain an import license | 37.7 | n.a. | n.a. | n.a. | 13.7 | 17.4 |
| Days to obtain a construction-related permit | 33.1 | n.a. | n.a. | n.a. | 84.4 | 65.0 |
| Days to obtain an operating license | 13.9 | 9.5 | n.a. | n.a. | 26.1 | 29.3 |
| **Corruption** | | | | | | |
| Bribery incidence (percent of firms experiencing at least one bribe payment request) | 12.1 | 11.3 | 13.0 | 12.1 | 9.3 | 12.5 |
| Percent of firms expected to give gifts to get a construction permit | 18.2 | 3.1 | 15.7 | 42.6 | 12.5 | 16.7 |
| Percent of firms expected to give gifts to secure government contract | 5.6 | 6.2 | 8.7 | 0.0 | 10.1 | 18.2 |
| Percent of firms expected to give gifts in meetings with tax officials | 9.7 | 8.0 | 16.5 | 3.0 | 8.0 | 10.2 |

***Figure III***[33]

[33] The chart is from *Enterprise Surveys Azerbaijan 2019 Country Profile* https://www.enterprisesurveys.org/content/dam/enterprisesurveys/documents/country/Azerbaijan-2019.pdf, page 12.

In key areas such as the oil and gas industry, corruption may further exacerbate investment risks. For example, state-owned enterprises (SOEs) and government departments in Azerbaijan may operate in a non-transparent manner during the project approval and implementation process, which poses a potential threat to investors' reputation and interests. At the same time, corruption may also affect the structure of investment, reducing FDI inflows and leading to investment inefficiencies.

Therefore, when entering the Azerbaijani market, investors need to strengthen their internal controls and compliance management to ensure that their operations are in line with local and international anti-corruption regulations. In addition, investors should follow the policy developments of the Azerbaijani government in the area of anti-corruption and administrative efficiency to minimize investment risks.

In terms of labour management risks, attention should also be paid to the localization ratio requirement for the employment of workers in foreign-owned enterprises. In accordance with the policy issued in 2009, Azerbaijan has partially amended the provisions of the *Law on Business Operation* concerning the composition of foreign enterprises. According to the amended law, the proportion of local employees in a foreign enterprise registered in Azerbaijan must not be less than 90%. This provision applies to all foreign-owned enterprises, including those in the energy sector, and in particular to projects involving Product Sharing Agreements (PSAs). In terms of management, although there is no explicit reference to the percentage of localized management, it is recommended that companies gradually increase the percentage of Azerbaijani employees in management, taking into account the policy trends in Azerbaijan in recent years (e.g., the promotion of localization of employment). Some countries (e.g., the UAE) require companies to gradually localize management according to an annual target, which can be used as a reference. In addition, Azerbaijan's *Law on Entry of Labor Migrants* stipulates that foreigners should apply for jobs that are specialized and skilled jobs for which local citizens cannot compete. This suggests that when hiring foreign workers, companies need to prove that the jobs in question cannot be met through the local labor market.

At the same time, in order to ensure domestic employment, the Government of Azerbaijan has intensified its efforts to regulate foreign labor, and since the fourth quarter of 2008 a quota system for foreign labor has been in place. Under current Azerbaijani law, foreigners wishing to work or be employed in Azerbaijan must apply for an individual work permit. Only after obtaining a work permit can the Migration Service and the Ministry of the Interior process procedures for long-term residence in Azerbaijan, otherwise they are penalized for illegal stay. The Ministry of Labor and Social Protection is the competent authority responsible for approving and issuing work permits for aliens, and applications for such permits are submitted to it by the employer. Work permits are valid for one year and must be renewed if the employer changes; they can be extended up to four times. Therefore, energy companies need to plan in advance and apply for a foreign worker quota and ensure the legal renewal of labor permits to avoid the risk of "visa dodging".

### 3.4 Environmental Legal Risk

The Republic of Azerbaijan's Ministry of Ecology and Natural Resources is body responsible for the country's environmental protection. Its primary responsibilities include creating national laws, rules, and policies pertaining to the preservation of the environment and the use of natural resources, overseeing their application, authorizing projects pertaining to these areas and granting pertinent business licenses, and arranging for international collaboration on these areas.

Relevant laws and regulations on environmental protection in Azerbaijan include: *the Environmental Protection Act, the Atmospheric Space Protection Act, the Ecological Safety Act, the Land Act, the Animals Act, the Plant Protection Act, the Fisheries and Fishing Act, the Hydro-Meteorology Act, the Underground Resources Act, the Industrial Wastes Act, the Water Supply and Wastewater Act,* and *the Protection of Natural Areas and Species Act*, among others. (Department of Outward Investment and Economic Cooperation et al., 2024)

Under current legislation, new industrial and construction projects are required to undergo an environmental demonstration and obtain the approval of the appropriate authorities prior to the commencement of work (i.e., the same applies to projects carried out by foreign companies investing or contracting in the country). In case of environmental pollution, penalties such as fines, rectification and closure are enforced in accordance with the relevant regulations. In this case, foreign companies investing in Azerbaijan that are not independent are required to complete an environmental assessment by the project owner and obtain approval from the Ministry of Ecology and Natural Resources, the Ministry of Emergency Situations, and the competent project authorities in Azerbaijan before construction can begin.

In May 2024, Azerbaijan's Minister of Ecology and Natural Resources, Babayev, stated that the country would reduce greenhouse gas emissions by 35% by 2030 and 40% by 2050 compared to the baseline year (1990), and that Azerbaijan is working on new laws around carbon dioxide emissions and managing carbon credits.

Azerbaijan's energy sector has an impact on the environment, and the government is increasingly focused on enforcing environmental laws. Chinese companies carrying out energy development may face fines or project interruptions for violating environmental regulations. Companies should assess and comply with Azerbaijan's environmental regulations in advance to avoid legal risks.

## 4. Countermeasures for Chinese Enterprises

### 4.1 Investment and Dispute Resolution Risk Mitigation

When investing in Azerbaijan, Chinese enterprises must prioritize thorough legal due diligence in the initial stages. This involves understanding the whole picture of the Azerbaijani market, conducting on-site visits to assess local conditions, and staying abreast of industry trends. Generally speaking, the legal due diligence of an overseas investment project includes three basic levels: legal due diligence of the target company, legal due diligence of the counterparty, and country-specific legal due diligence (Zhang, Xu & Yang, 2022). While legal due diligence of the target company and legal due diligence of the counterparty are more prevalent and known in domestic investment projects, country-specific legal due diligence is exclusive to offshore investment projects, with a wider scope and longer time span. It is advisable for Chinese companies to engage local Azerbaijani legal experts to conduct full due diligence on the requirements for foreign investment access, incentives and preferential policies for foreign investment, foreign exchange control measures, national security review and anti-monopoly regulation, religious regulations, company establishment and governance, and the validity and fulfillment of commercial contracts, etc. In addition, the enterprises should set up a high-caliber internationalized legal team with strong professional capability.

Concurrently, the enterprises should focus on enhancing the legal acumen of personnel involved in overseas investments through targeted training programs (Jiang, Chandra & Man, 2024). Companies need to recognize the importance of ongoing legal education for overseas investment staff, which can ensure compliance and effectively mitigate risk.

When it comes to dispute resolution, enterprises are advised to explicitly choose international arbitration mechanisms, such as International Center for Settlement of Investment Disputes (ICSID) or United Nations Commission on International Trade Law (UNCITRAL) arbitration rules, in their contracts to avoid the problem of judicial inefficiency in Azerbaijan. Meanwhile, companies can take out insurance through China Export Credit Insurance Corporation (Sinosure) or Multilateral Investment Guarantee Agency (MIGA) to cover political risks such as expropriation and default. Additionally, leveraging the framework of the China-Azerbaijan Bilateral Investment Agreement (BIT) can facilitate the establishment of intergovernmental communication channels. These are instrumental in promoting negotiated settlements of disputes.

### 4.2 Compliance and Labor Management Risk Mitigation

In order to cope with compliance risks, enterprises should draw on domestic and overseas experience and refer to *the Best Practice Guidelines for Internal Control, Corporate Ethics and Compliance* issued by OECD, *the Guidelines for Compliance Management Systems* issued by International Organization for Standardization, and the *FCPA (the U.S. Foreign Corrupt Practices Act)*, etc., to set up an internal compliance system, formulate an anti-corruption policy, and prohibit employees from engaging in “gray transactions”. In addition, there are a number of Non-governmental organizations (NGOs) in Azerbaijan that focus on anti-corruption and transparency. Such organizations often work to improve transparency and efficiency in the use of public funds through monitoring and advocacy. Collaboration with such organizations can provide an additional oversight mechanism for the use of public project funds. It is recommended that local NGOs be introduced as partners in public projects in Azerbaijan to monitor the use of public funds. This model of cooperation would not only increase transparency and public trust in the projects, but would also effectively reduce the risk of corruption. At the same time, “anti-corruption clauses” can be included in investment agreements to clarify liability for breach of contract. In terms of bidding and tendering, the strict bidding and tendering system effectively reduces the occurrence of commercial bribery, and there are specialized agencies to supervise and inspect the implementation of centralized government procurement and bidding and tendering system. If any unfairness is found, whether it is unsuccessful bidders or other people, they can make inquiries or file a complaint with the court (He, 2012). Enterprises should follow the example of countries such as the United States and Canada to promote the use of government electronic bidding system (such as [Azerbaijan State Procurement Network] (https://etender.gov.az/)) to reduce human intervention.

In terms of labor relations risks, Chinese enterprises should familiarize themselves with the labor regulations of the host country. In the pre-investment decision-making stage, they should incorporate the labor relations risk into the investment assessment, rely on professional consultants to investigate the background of the employment environment and the labor security requirements of the investment place, and study in-depth the laws and regulations and policies related to the local labor and employment. This will enable them to fully consider whether the risk of labor relations might seriously affect the smooth implementation of the investment project.

During the course of project implementation, the enterprise should strictly comply with the legal requirements and grasp the level of wages and treatment of local and industry employees, so as to make the enterprise comply with the labor standards and minimize the risks. There are differences in the understanding of the functions of trade unions between China and foreign countries, and the trade unions in the countries along the Belt and Road route have the mission of safeguarding the rights and interests of employees, and are less involved in the human resource management of enterprises. Enterprises should understand the roles, influences and characteristics of the activities of trade unions in the relevant industries, pay attention to dealing with the relationship with local trade unions, and listen to trade union suggestions frequently to prevent strikes from occurring (Department of Outward Investment and Economic Cooperation et al., 2024). If possible, enterprises can join local employers' associations to understand and refer to the common methods and approaches used by other member enterprises to handle labor disputes. In addition, caring for employees is also an important task. Enterprises can establish channels for employees to express their demands, understand the needs of laborers, communicate effectively through the collective bargaining system, resolve conflicts of interest between labor and management in a timely manner, and build a harmonious labor relationship in overseas employment. (Huang & Wang, 2023)

In terms of labor management, enterprises should cooperate with the government to establish an education and training mechanism for cultivating high-quality talents (Hu, 2022). Training for upskilling and re-skilling should anticipate future changes in business and employer needs. This includes responding to changes brought about by societal, environmental, and technological changes, as well as the risks and opportunities associated with automation, digitization, just transformation, and sustainable development (OECD, 2023). It is recommended to plan ahead to ensure that the proportion of local employees reaches 90%, and to train technical talents in a targeted manner through cooperation with Azerbaijani universities or vocational training institutions. At the same time, the proportion of Azerbaijani executives should be gradually increased to enhance the trust of the government and society. In addition, enterprises should publish CSR reports on a regular basis, and disclose measures to protect the environment and labor rights and interests, so as to enhance the image of the enterprise. Enterprises can also join the United Nations Global Compact (UNGC) to obtain compliance management support through international platforms.

### 4.3 Contractual Risk Mitigation

Contractual risk is one of the most significant legal challenges faced by Chinese enterprises investing in Azerbaijan's energy sector. Ambiguities in contract terms, unilateral modifications by the host government, and weak enforcement mechanisms all contribute to potential disputes. To mitigate these risks, enterprises should adopt a multi-faceted approach that strengthens contract clarity, establishes fair risk allocation mechanisms, and ensures enforceability under international law. At the same time, a third-party legal advisor familiar with Azerbaijan's energy laws should be introduced to ensure that the contract terms comply with local laws and international practices.

A fundamental step in minimizing contractual disputes is ensuring that all key terms are explicitly defined. Energy investments are susceptible to unforeseen events such as political instability, natural disasters, and trade restrictions. Contracts should clearly specify what constitutes a force majeure event, the rights and obligations of each party in such circumstances, and the procedures for suspending or terminating obligations. Given the volatility of energy prices and transportation costs, contracts must incorporate flexible pricing terms. These mechanisms should allow for periodic renegotiation or automatic adjustments based on benchmark indices such as Brent crude price fluctuations. In addition, contracts should explicitly state the preferred dispute resolution mechanism. It is advisable for Chinese enterprises to opt for international arbitration under institutions such as the ICSID or UNCITRAL, rather than relying on Azerbaijani domestic courts, which may present enforcement challenges.

Host governments sometimes alter investment terms post-agreement, introducing new taxes, regulatory requirements, or even expropriation risks. To prevent such unilateral modifications, contracts should incorporate stabilization clauses to ensure that the host government cannot retroactively alter the contract's core provisions, such as tax rates, licensing fees, or operational restrictions, without mutual consent (Dolzer, R., & Schreuer, C. , 2012). Meanwhile, in terms of the application of law, the contract could contain a clear choice between the application of international law (such as the ECT) or the law of a neutral third country to minimize the impact of policy changes in Azerbaijan. In cases where policy changes are unavoidable, investors should be granted the right to renegotiate terms or seek compensation for losses incurred. Additionally, renegotiation mechanisms should be established to provide a structured process for contract revisions in response to significant legislative or regulatory changes (Salacuse, J. W., 2013). This ensures that sudden policy shifts do not disproportionately impact foreign investors and that both parties can reach a fair and balanced agreement.

Given the long-term nature of energy projects, defining risk allocation is essential to ensuring financial and operational stability. Instead of wholly foreign-owned operations, Chinese enterprises can enter joint ventures with local Azerbaijani partners. This not only mitigates political risks but also increases cooperation with the host government, reducing the likelihood of legal disputes. Furthermore, indemnity clauses should be included to require the host country to compensate foreign investors for losses resulting from regulatory changes, third-party actions, or unforeseen legal disputes. Political risk insurance, provided by institutions such as the China Export & Credit Insurance Corporation (Sinosure) or the Multilateral Investment Guarantee Agency (MIGA), can serve as an additional safeguard against expropriation and contract breaches by the host government.

Even with well-drafted contracts, enforcement remains a challenge, particularly in jurisdictions where judicial efficiency is questionable. To ensure that contracts are honored, enterprises should require host governments or state-owned enterprises (SOEs) to provide bank guarantees or escrow accounts as financial security for contractual obligations. In the event of non-compliance, penalty clauses should be incorporated into contracts, specifying substantial financial consequences for breaches by either party. Given Azerbaijan's participation in the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Chinese enterprises should structure contracts in a way that facilitates the recognition and enforcement of arbitral rulings in international jurisdictions.

By implementing these contractual risk mitigation strategies, Chinese enterprises can significantly reduce legal uncertainties, protect financial interests, and ensure the long-term success of their investments in Azerbaijan's energy sector.

## 4.4 Environmental Risk Mitigation

In recent years, the investment of Chinese enterprises abroad has been called “predatory development”, “China’s environmental neo-colonialism”, “China’s environmental threat”, “China’s ecological dumping” and so on, due to the ecological damage and environmental pollution caused to the host country many times (Han, 2013).

On January 26, 2015, Mexico’s Federal Environmental Protection Agency (hereinafter referred to as the “EPA”), citing violations of ecological balance and environmental protection regulations as well as longstanding non-payment of fines, completely halted the Chinese-funded shopping mall project, “DragonMart Cancun ”, located on the outskirts of the country’s Caribbean resort town of Cancun. The EPA found that the developers of DragonMart Cancun were liable for a fine of about US$1.5 million for failing to conduct a thorough environmental impact assessment before leveling the land and for failing to obtain authorization from the federal government for the rezoning of the land. Chinese invested Myitsone Dam in Myanmar, which began construction in 2007 with a planned investment of US$3.6 billion, was halted in September 2011 because it did not comply with the requirements of the Environmental Impact Assessment Report (EIA Report) and could have led to a variety of ecological and environmental problems, including the destruction of biodiversity and the pollution of river water.

In the context of the Belt and Road Initiative, Chinese enterprises may face the risk of fines or project disruption due to violations of local environmental regulations when carrying out overseas energy development and other investment activities. Enterprises should assess and strictly comply with the environmental regulations of Azerbaijan in advance, enhance their sense of environmental responsibility, and take the initiative to assume the responsibility of environmental protection. The environmental protection obligations in international law are mostly soft law in nature, and there are no specific provisions on the environmental protection obligations of multinational corporations and the liability for environmental damage. The level of development of the environmental protection legal system varies from country to country. However, Chinese enterprises investing overseas must not use this to evade their environmental obligations, but should proactively take the responsibility for environmental protection.

Chinese enterprises can add environmental clauses in bilateral investment agreements (Tan, 2015). The current development trend of international investment law shows that, with the enhancement of environmental awareness, more and more bilateral investment agreements have begun to balance the interests of the host country and the investor. The aim is to pay attention to the protection of the rights and interests of investors at the same time as focusing on the protection of the host country's ecological environment and other social well-being issues. Chinese enterprises, as capital exporters, should effectively fulfill their environmental responsibilities on the one hand, and on the other hand, they need to be alert to the fact that certain countries may use their environmental obligations as a means of setting environmental barriers and practicing investment protectionism (non-tarrif barriers). Therefore, the inclusion of environmental provisions in BITs can not only clarify the willingness of Chinese enterprises to fulfill the host country’s environmental obligations, but also promote the host country’s environmental regulatory measures in line with the requirements of non-discrimination and goodwill, and reduce conflicts of interest. In short, Chinese enterprises should maintain a prudent attitude in the face of the possibility that the environmental protection obligations of the investing countries may rise to the level of mandatory binding treaty obligations, and for now, they should also focus on the fulfillment of soft law obligations.

## 5. Conclusion

The growing presence of Chinese enterprises in Azerbaijan's energy sector offers promising investment opportunities. The legal risks associated with investment protection, contract enforcement, regulatory compliance, and environmental obligations, however, present significant challenges. This study has explored these key risk factors and proposed strategic measures to mitigate potential liabilities.

First, investment protection and dispute resolution remain critical concerns. The Energy Charter Treaty (ECT) provides a robust legal framework for safeguarding foreign investments. Sole reliance solely on international investment treaties is considered insufficient. Chinese enterprises should incorporate well-defined arbitration clauses within contractual agreements and utilize international dispute resolution mechanisms, such as the ICSID or UNCITRAL framework, to ensure fair adjudication.

Second, contractual clarity is essential to minimizing legal disputes. Ambiguous provisions, particularly concerning force majeure clauses and cost-sharing mechanisms, have been a recurring source of litigation in transnational energy investments. To address this, enterprises must refine contract language, ensuring compliance with Azerbaijani legal standards while incorporating best practices from international contract law, such as the inclusion of stability clauses and renegotiation mechanisms.

Third, compliance risks, including anti-corruption and labor market regulations, necessitate proactive governance. Given Azerbaijan's relatively high corruption perception index and stringent localization policies, Chinese enterprises must implement rigorous internal compliance frameworks. This includes conducting third-party audits, engaging in transparent public procurement processes, and establishing structured labor agreements that align with national workforce localization mandates.

Fourth, environmental regulations are becoming increasingly stringent. As Azerbaijan transitions towards sustainable energy, foreign investors must align their operational models with evolving environmental laws. The integration of environmental risk assessments, adherence to the Paris Agreement obligations, and proactive engagement with local regulatory agencies can mitigate potential legal liabilities and reputational risks.

Looking forward, the geopolitical landscape and energy policies in Azerbaijan will continue to evolve, impacting the legal framework governing foreign investments. Chinese enterprises must adopt a forward-looking approach, continuously monitoring legislative changes, engaging with local legal counsel, and fostering diplomatic and corporate relations to navigate potential policy shifts.

By implementing these strategic measures, Chinese enterprises can effectively mitigate legal risks, enhance regulatory compliance, and achieve sustainable investment success in Azerbaijan's dynamic energy sector.

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