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# AZERBAIJAN ANONYMOUS

**AZERBAIJAN'S STATE OIL COMPANY AND WHY  
THE EXTRACTIVE INDUSTRIES TRANSPARENCY  
INITIATIVE NEEDS TO GO FURTHER**

A report by Global Witness, December 2013

# CONTENTS

<b>Executive Summary</b> .....	3
<b>Introduction &amp; Recommendations</b> .....	4
Global Witness' findings.....	5
What needs to happen.....	5
Recommendations .....	6
What should “beneficial ownership disclosure” mean? .....	8
<b>Section 1: Azerbaijan, oil &amp; EITI</b> .....	9
Azerbaijan: the importance of oil.....	10
Why has the EITI not reduced corruption in Azerbaijan?.....	11
<b>Section 2: Making millions from Socar: the mysterious Anar Aliyev</b> .....	13
So who is Anar Aliyev? .....	14
<b>Case study 1. Socar Trading SA</b> .....	18
Anar Aliyev's company profits from Socar's oil trading subsidiary.....	18
Socar Trading: Where did the profits go?.....	19
What is an ‘ultimate beneficial owner’? .....	20
Socar International DMCC: another part-private oil trading subsidiary .....	21
Socar's response to Global Witness .....	23
<b>Case Study 2: The Sumato Energy Group</b> .....	24
The \$10,000 hotel bill and more links to Anar Aliyev.....	24
<b>Case study 3: UGE-Lancer</b> .....	26
Anar Aliyev's company signs oil deal with Socar .....	26
<b>Three steps toward transparency: “If you stop pedalling, you fall off”</b> .....	28
<b>Conclusion</b> .....	30
<b>Annex 1</b> .....	31
The EITI in Azerbaijan: a patchy record .....	31
EITI's new rules, 2013.....	33
<b>Annex 2</b> .....	34
List of companies with links to Anar Aliyev .....	34
<b>REFERENCES</b> .....	35

# EXECUTIVE SUMMARY

The international Extractive Industries Transparency Initiative (EITI) was set up to give citizens of resource-rich countries information about how much their governments were earning from natural resources in order to prevent corruption. It is a voluntary initiative, focusing on oil, gas and mining revenues.

Azerbaijan was the first country to be assessed as EITI-compliant, yet research by Global Witness shows that private companies are benefitting from billions of dollars' worth of business handling Azerbaijani oil even though it is not clear why they are involved or who owns them.

As information on ownership is not currently available from EITI reports, Global Witness has pieced together, over the course of a year, the links between many of these deals by examining company records and annual accounts from various countries' corporate registries.

This new investigation has found that one man, Anar Aliyev, has held ownership stakes in at least 48 deals

with the State Oil Company of the Azerbaijan Republic (Socar), including production sharing agreements and joint ventures, although very little is known about him or how he achieved this position in the Azerbaijani oil industry. Global Witness has found that Anar Aliyev's companies published accounts showing profits of US\$375 million over five years, though the companies' auditors found that these accounts were incomplete, so a more exact figure is unknown. Socar has not properly explained its dealings with Anar Aliyev, nor has it disclosed the hidden beneficiaries of other companies it does business with.

The lack of transparency highlights gaps in the EITI, as it shows that countries can comply with its rules while large deals are being struck with very little transparency. The beneficial ownership of companies operating, investing or bidding on extractive assets will be disclosed under a new EITI pilot programme with the intention of making it mandatory in 2016: this report shows how vital it is for Azerbaijan to be part of this pilot and for EITI participants to ensure the rule is observed.



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OIL AND PETROLEUM PRODUCTS MADE UP AROUND 95% OF AZERBAIJAN'S TOTAL EXPORT REVENUES IN 2011



# INTRODUCTION & RECOMMENDATIONS<sup>i</sup>

Privately-owned companies are making millions handling oil that belongs to the Azerbaijani people, yet the identity of their owners is hidden and it is not clear why they are involved. This opacity poses a credibility problem for the Extractive Industries Transparency Initiative (EITI), of which Azerbaijan is a long-standing member, and raises the concern that private individuals, including Anar Aliyev and others he may be fronting for, could be benefitting at the expense of the citizens of Azerbaijan.

While Socar and its partners may well have acted within the law, the lack of transparency about Socar's partners and how they came to be involved in the Azerbaijani oil industry raises questions over potential conflicts of interest, preferential treatment, and the risk of corruption. The fact that little is known about one individual linked to 50 deals only heightens these concerns. Such suspicions can only be dispelled by making information publicly

available about these companies, their beneficiaries and activities, and why they were chosen, and by permanently improving the processes around the allocation of contracts in the future.

These findings should be of great concern to the international community as a whole. Oil and its derivative products are central to the Azerbaijani economy, making up 95% of exports in 2011. Azerbaijan is also fast becoming a vital country for oil and gas supply to the European Union. In June 2013, it was agreed that gas from Azerbaijan would be transported via a new pipeline project to Italy, to diversify Europe's gas supplies.

Therefore it is important for Europe that Azerbaijan keeps the oil and gas flowing and maintains a transparent and well-run energy industry. Yet this briefing shows that much of the oil business in Azerbaijan remains opaque, and corruption is still perceived to be at epidemic levels. This is especially worrying because ten years ago the country was one of the first to sign up to the EITI and, in

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<sup>i</sup> References for the Executive Summary and Introduction can be found within the main text of the report.



Andy Johnstone/Panos

OIL DOMINATES THE LANDSCAPE AND THE LIVES OF ORDINARY AZERBAIJANIS.

2009, it was the first to be assessed to have fulfilled all of its requirements.

The EITI was created to improve the transparency of an opaque and notoriously corrupt business, and give citizens of resource-rich countries information about how much their governments were earning from natural resources. One of its strengths is that it should enable civil society to hold governments to account if discrepancies are found in the revenue figures. Azerbaijanis hoped that the EITI could be the first step towards genuine transparency and accountability from both the government and the oil companies, and that it could lead to progressive reform and greater trust between the people and their leaders.

A decade later and reform has stalled. Journalists are harassed and jailed on trumped-up charges. People do not see the EITI as having achieved its aims of reducing corruption and poverty and the initial enthusiasm that greeted the implementation of this process in Azerbaijan has diminished.

Central to this apparent lack of progress in Azerbaijan's oil sector is the opacity of the state oil company, Socar. For years Azerbaijani civil society organisations have highlighted this problem, but even though dialogue is supposed to be a key element of being an EITI-compliant country, Socar fails to respond adequately to enquiries from citizens' groups about its dealings.

So far, despite the EITI, the Azerbaijani people are still in the dark about the decision-making process for significant extractive deals and cannot see where substantial amounts earned from the country's resources are going. As the largest state company of Azerbaijan, Socar is of vital importance to the future well-being of the country and it is therefore in the public interest that questions about its opacity be taken seriously. This report highlights deals struck by Socar that are opaque and suggests that this opacity is systemic.

## Global Witness' findings

- The ownership structure of many of the companies partnered with Socar is not public, so it is unclear who is benefitting from some of Azerbaijan's oil deals.
- In most cases, Global Witness could find no evidence of proper bidding processes or public tenders.
- One man, Anar Aliyev, appears to be involved in 50 joint ventures, alliances or significant business partnerships with Socar, with ownership stakes in

48. The deals are sometimes very large, earning his companies hundreds of millions of dollars.

- There is little publicly available information as to who Anar Aliyev is, what he does, whether he is representing other interests, and how his companies managed to get such extensive business with Socar.
- These deals include major subsidiaries of Socar, such as its Swiss-based oil trading subsidiary Socar Trading. This company's private shareholders, which included Anar Aliyev, had their shares bought by Socar in a deal that made Anar Aliyev's company US\$118 million in profit, in exchange for an investment of just US\$5 million.
- The involvement of private companies with hidden ownership without a clear business rationale undermines Socar's own public narrative that it formed Socar Trading to bring oil trading in-house and create a new revenue stream.

Global Witness asked Socar for its response: it replied that the company conforms to all national laws and is in accordance with the practices of internationally-known firms, but it failed to respond to specific questions. Global Witness also made many attempts to contact Anar Aliyev, but received no reply.

## What needs to happen

Implementation of the EITI process needs to be improved in Azerbaijan, and opacity must be addressed. Although Socar publishes its revenues as required by the initiative's reporting rules, this information is not yet broken down enough ("disaggregated") to be of much use to civil society. That companies can be signed up to the EITI and report revenues they pay to the government, despite little being known of their ownership or how they obtained their contracts, has raised serious questions among Azerbaijani civil society members about the EITI process in their country; as one told Global Witness, "EITI [in Azerbaijan] is like a dead fish, it has stopped moving and is starting to smell."

Some of these issues are being addressed by the EITI. New rules established in May 2013 (see Annex 1, page 33) require, amongst other things, disclosure of payments to the government by extractive companies on a project-by-project basis, enabling citizens to follow the money. Azerbaijan's EITI multi-stakeholder group (comprising representatives from civil society, extractive companies and government) should immediately implement these new rules. However, some are pitched only at the level of "encouragements" – including

revealing the real “beneficial” owners of companies involved in extractive deals – and recent statements by an Azerbaijani official indicate that the government does not intend to support the implementation of rules that are not requirements.

This report shows why the EITI board needs to make these “encouragements” mandatory for the initiative to have real impact. Global Witness has written extensively about these problems in our investigative reports, including *Rigged?* (2012) and our *Secret Sales* (2012-13) exposé series, which reveal similar problems surrounding shadowy business interests in Nigeria and the Democratic Republic of Congo. Beyond the debate on what should be required, the EITI board should also clamp down strongly on countries that flout the rules so that they do not enjoy benefits to their reputations without implementing effective transparency.

Yet even if Azerbaijan perfects the existing EITI process, other aspects of its oil business not currently covered by the EITI remain obscure, as this report will show. Governments that are true to the spirit of the EITI should continue to create more transparency as part of an evolving process. If Azerbaijan wants to remain at the forefront of EITI, it should not only actively implement these requirements and encouragements but also go further. As the first country to become EITI-compliant, Azerbaijan could set a powerful example by raising the bar to address the parts of the extractive value chain still shrouded in secrecy and therefore vulnerable to corruption.

If the Azerbaijani government continues to fail to address these issues and to ignore the longstanding complaints of civil society organisations, it will promote a perception that it is using the EITI as a box-ticking exercise, and is not interested in a truly collaborative process that aims to create effective transparency.

## Recommendations

### 1) Azerbaijan’s EITI multi-stakeholder group (civil society, extractive companies and government) should:

- As a matter of urgency, comply with the new EITI encouragement of maintaining “a publicly available register of the beneficial owners of the corporate entity(ies) that bid for, operate or invest in extractive assets, including the identity(ies) of their beneficial owner(s) and the level of ownership”.
- Disclose the level of state beneficial ownership in oil, gas and mining companies operating within Azerbaijan in accordance with the new EITI rules

(May 2013), including their subsidiaries and joint ventures, and details of the terms attached to their stake. Where there have been changes in the level of government and state-owned enterprise (SOE) ownership during the EITI reporting period, the government and SOE(s) are expected to disclose the terms of the transaction, including valuation and revenues.

- Fulfil the new EITI encouragement to make public all contracts and licences, including sub-contracts and ancillary contracts, and the terms for exploitation of oil, gas and minerals. This would allow the public to look at the contractual terms of an agreement and check these against the actual implementation of the agreement.
- Fulfil the new requirement to disclose “information related to the award or transfer of licences [...] including: a description of the process for transferring or awarding the licence”.
- Fulfil the new requirement that all revenues, including payments in kind, be disaggregated (i.e. broken down), at least by individual company, government entity and revenue stream on a project-by-project basis.
- Fulfil the new requirement regarding the disclosure of the volumes of oil sold and revenues received from government and state-owned enterprises’ own production, including payments in kind, and go further than the requirement by producing data disaggregated by product, price, market and sale volume. The new EITI Standard also recommends that there is a reconciliation of oil sales, which in this case would be between the data provided by SOCAR and data provided by the buying companies.
- Strive to improve the quality of EITI reports, the reporting process and the effectiveness of the oversight of the process, following complaints by civil society of consistent patterns of delayed reports and inconsistencies.

- Strive to improve the readability and public dissemination of EITI reports to better fulfil the requirement that EITI reports are “comprehensible, actively promoted, publicly accessible, and contribute to public debate”.

### 2) The Azerbaijani government should:

- Stop the harassment of civil society activists and journalists. Such activity reduces the independence

and fullness of civil society engagement, a key requirement of the EITI process.

- Actively promote fuller engagement with civil society in EITI and related matters, including making civil society fully involved in the EITI reconciliation process.
- Use its position on the Azerbaijan EITI multi-stakeholder group to ensure a high standard of EITI reporting, including implementing new requirements and encouragements, and addressing the gaps in transparency in oil trading.
- Repeal legislation passed in June 2012 that makes company ownership in Azerbaijan secret.
- Make budgetary expenditure, and spending from state oil fund Sofaz, more transparent. While this is beyond the current remit of EITI, this should be done along EITI-style principles, with full and open participation and oversight from civil society.

### **3) Socar, the state oil company of Azerbaijan, should:**

- Address the questions raised in this report by making a full public disclosure of the reasons for its extensive involvement with Anar Aliyev's companies (see p34), with information on how and why each company was chosen, and the terms attached to the deals.
- Disclose information regarding the tenders the company Sumato Energy won to sell Socar's oil (see p24), including the terms of the successful bid, the type and quantity of the oil, the reason why Sumato was selected, and information on the other bidders, including their names and bids.
- Publish a full list of the real "beneficial" owners of all companies Socar signs contracts with, including the deals that feature in this report, such as the current owners of UGE-Lancer (see p26), and the non-state-owned 50% of Socar International DMCC.
- Disclose the terms of the deal between it and Socar International DMCC, including the volumes of oil sold to and the revenues it received from these sales.
- Lead by example and publish disaggregated data by revenue stream on a project-by-project basis. A "project" should be defined as the extractive activities governed by a single contract, licence, lease, concession or similar legal agreement



Global Witness

WHAT GOES ON BEHIND THE CLOSED DOORS OF SOCAR, THE STATE OIL COMPANY OF AZERBAIJAN?

entered into with a government or state-owned entity, from which payment liabilities arise.

- Make efforts to respond fully and in a timely fashion to enquiries from civil society on its activities, partnerships, financial performance and other matters.

### **4) The international EITI board should:**

- Consider inviting the Committee to Protect Journalists to undertake an independent investigation into the harassment of journalists and civil society in Azerbaijan.
- As a matter of priority make the encouragements contained in the new 2013 rules mandatory as soon as feasible, particularly those regarding public registries of beneficial ownership and publication of contracts.
- Consider including other revenue streams – for example, oil trading and other downstream activities and those pertaining to service contracts – in the EITI reporting template.
- Ensure that the EITI does not risk its own legitimacy by promoting countries as transparent when in fact they do not meet the standards required of a compliant country, according to either the EITI rules or its principles.

### **5) The international community should:**

- Support the creation and publication of registries of company beneficial owners. The United Kingdom has agreed to adopt such a registry and the European Union and United States are



## What should “beneficial ownership disclosure” mean?

Companies involved in extraction in EITI implementing countries should disclose their beneficial owners, as should companies bidding for extractive deals. This disclosure should include:

- a) the names of real individuals (not further companies) who ultimately own and control the company. The lower the ownership percentage at which the names of these people have to be revealed, the better. At a minimum, it needs to be set at 10% – ideally it should be substantially lower;
- b) identification of whether any owner, no matter what the percentage held, is a politically exposed person (a senior politician from any country, their close family and associates as well as senior civil servants and military officers);
- c) their date of birth, nationality and country of residence;

- d) a means of contacting the beneficial owner; and
- e) a description of how the beneficial owner exercises control over the company (for example, names of the chain of companies that result in this person being the beneficial owner).

Oil, gas and mining companies should publish the above information via the EITI report. The onus should be placed upon the company to provide this information and not the multi-stakeholder group or implementing government. The beneficial ownership information supplied by companies should be audited as part of the independent EITI audit report. Multi-stakeholder groups should decide on penalties for companies failing to provide beneficial ownership information, or providing the wrong information. The benefits of lying about this information are potentially huge and therefore the penalties need to be set accordingly; a \$1,000 fine is not going to deter a \$1 million crime.

considering it. The international community, including Azerbaijan, should follow suit and opt for a system where companies are required to publicly disclose their ultimate beneficial owner.

- Support Switzerland’s attempts to adopt a transparency law that covers the whole Swiss commodity sector (both listed and non-listed companies, extractive and trading activities). Other countries where commodities such as oil are traded (rather than extracted) should also consider passing similar laws.

\* \* \*

The first section of this report shows how fundamental oil is to the Azerbaijani economy and assesses why EITI has had a limited effect on corruption in Azerbaijan.

The second part examines certain secretive deals struck by Socar:

- In the first case study, we analyse its oil trading subsidiary Socar Trading SA, which featured obscure private ownership for five years, and was then bought back by Socar at great expense, creating huge profits for these hidden owners. Then, having said it was taking full ownership of Socar Trading SA to bring oil trading in-house, Socar

inserted yet another company into its oil trading structure (Socar International DMCC) with 50% hidden ownership. This section also includes a summary of Socar’s response to our enquiries.

- The second case study examines a company, Sumato Energy, that traded Socar’s oil but whose owners were undisclosed.
- The third case study questions a production sharing agreement (PSA) signed by Socar in 2011 with a Singaporean company called UGE-Lancer, about which little is known.

All three companies – Socar Trading, Sumato Energy, UGE-Lancer – have links to Anar Aliyev, about whom little is also known, but whose involvement with Socar appears to go much deeper.

The final section stresses the importance of oil sector transparency and discusses how it can be achieved. The report’s annex contains detailed information about the EITI, the problems with its current implementation in Azerbaijan, and the new requirements introduced in 2013. A list of the 50 Socar companies and deals that have links to Anar Aliyev is also given here. Further details on these companies can be found on the Global Witness website.



# SECTION 1: AZERBAIJAN, OIL & EITI

This is a story about how little-known private companies are benefitting from deals struck by Socar, the state oil company of Azerbaijan, amassing assets worth hundreds of millions of dollars. The identity of the owners of many of these companies is unclear, as is why their companies were chosen to partner with Socar.

Detailed new research by Global Witness has revealed the identity of one of these individuals, a man named Anar Aliyev, whose companies have been involved in at least 48 joint ventures, production sharing contracts or other agreements with Socar. Global Witness found that companies linked to Anar Aliyev published profits of US\$375 million over a five-year period.<sup>1</sup> This raises the question as to whether profits that should have gone to the state company – and thus to the people of Azerbaijan – instead went to Anar Aliyev and/or other unknown individuals he may represent. Socar has yet to adequately explain the reasons for allowing such obscure private interests into lucrative areas of its business.



BRITISH PRIME MINISTER DAVID CAMERON WITH PRESIDENT OF AZERBAIJAN ILHAM ALIYEV: AZERI OIL AND GAS IS OF INCREASING SIGNIFICANCE TO EU COUNTRIES.

Azerbaijan is central to the EU's plans to diversify its energy supply. In August 2012, a funding agreement was signed by BP, Total and Socar for the Trans Adriatic Pipeline intended to bring gas from Azerbaijan via Greece to Italy, and onward to Western Europe.<sup>2</sup> It will form a central role in opening up "the Southern Corridor" and is meant to improve Europe's energy security, after disputes between Russia and Ukraine led to disruptions in the gas supply in 2006 and 2009. In short, Azerbaijan's natural resources are vital for both the country and for Europe. As Socar is at the heart of the Azerbaijani oil sector it is therefore important for all parties that this company is well-governed, transparent, accountable, and operated for the benefit of Azerbaijan's people.

The deals are worrying because they are set against the much bigger context of an oil-dependent country where there is evidence to suggest that the economy has been captured by a small elite. The lack of transparency highlights gaps in the EITI, a voluntary process that has been implemented in Azerbaijan for 10 years, as it shows that countries can comply with this initiative's rules while large deals are being struck with very little transparency at all. The EITI has not prevented such deals because in the past it has only looked at one, albeit essential, part of the problem, that of oil and gas *revenues*.

Full and open collaboration between EITI's three stakeholders (civil society, extractive companies and the government) – another of the initiative's key aims – has also yet to emerge, as civil society voices in general are currently under a great deal of pressure in Azerbaijan. Information on these deals needs to be available, and the wider Azerbaijani public needs to be able to talk openly about them without fear of reprisals.

Furthermore, governments and companies should not use their membership of the EITI as a fig leaf to hide behind when awkward questions are asked. When Global Witness wrote to Socar for its comments on the issues contained in this briefing, the company failed to answer individual questions and instead gave a general response, part of which referred to the country's EITI membership (see p23).<sup>3</sup> The EITI as it is practised in Azerbaijan does not currently address many of the issues raised in our letter, so Socar's reference to the initiative is not an adequate response.

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## Azerbaijan: the importance of oil

Oil is central to Azerbaijan's economy: in 2011 Azeri<sup>ii</sup> crude and petroleum products made up around 95% of the country's total export revenues.<sup>4</sup> Azerbaijan's oil industry is dominated by Socar (in full, the State Oil Company of the Azerbaijan Republic) with a turnover that made up 12.6% of Azerbaijan's GDP in 2010.<sup>5</sup>

Azerbaijan's oil production more than quadrupled in the first decade of this century,<sup>6</sup> generating billions for the state. Earnings from exports increased from US\$1.87 billion dollars in 2001 to US\$34.72 billion in 2011, according to the World Bank. As a result GDP rose in this period from US\$5.7 billion to US\$63.4 billion.<sup>7</sup>

Much of the revenue that Socar earns flows into the state oil fund, Sofaz. The creation of the fund was seen as a step forward by the European Bank for Reconstruction and Development (EBRD), modelled as it was on Norway's Government Pension Fund. However, there is one crucial difference: Norway's Pension Fund is managed by the Norwegian Central Bank on behalf of the Ministry of Finance and is accountable to the Norwegian parliament and therefore the people. In Azerbaijan, however, the country's president is responsible for the fund, sets its guidelines and can appoint and dismiss its executive director.<sup>8</sup>

Sofaz's revenues have risen from around US\$1.8 billion in 2006 to US\$33.8 billion in 2012, with US\$54 billion forecast in 2016.<sup>9</sup> Although the EITI has allowed citizens to track the money as it flows into Sofaz, there are many questions regarding how that money is being spent.

There are some positives: the oil boom has reduced poverty. The World Bank says that the percentage of people living below the poverty line in Azerbaijan has gone from near 50% in 2001 to under 8% in 2011.<sup>10</sup> But there appears to be little proportional increase in public spending. To take healthcare as an example, a report by the United Nations from 2008 concluded that, although the amount of money spent on healthcare had increased, the total as a percentage of GDP remained very low compared with other countries:



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AZERBAIJAN'S OIL BOOM HAS NOT LED TO A SIGNIFICANT IMPROVEMENT IN SOCIAL DEVELOPMENT INDICATORS.

*Reviewing the public expenditure of Azerbaijan on health as a percentage of GDP in relation to its GDP per capita and in comparison with other countries [...], we can clearly observe that not only is Azerbaijan spending much less of its GDP on health than most of the countries in the world, but also it spends very little relative to its economic capacity and what could be accepted as a 'norm.'*

[...]

*Low state budget health expenditure seems to be one of the most essential reasons for relatively high child and maternal mortality rates in the country.<sup>11</sup>*

According to the most recent information from the International Monetary Fund, there has been little improvement in 2013: "High oil revenues have not translated into improved indicators for health and education, as public spending in these areas remains relatively low, and outcomes lag other countries with similar per capita income levels."<sup>12</sup>

In conclusion: an alarming gap between the sizeable oil revenues earned over the past 10 years and the impact on social services begs questions about the state management of these revenues.

ii Azerbaijani and Azeri are often used interchangeably. This report uses the former, though the industry refers to oil from Azerbaijan as Azeri.

It seems that a conclusion drawn in a 2009 report on EITI by researchers from Princeton University is still relevant:

*There is an ongoing risk that the Azerbaijani government could reap reputational rewards from its EITI engagement that are disproportionate to its actual achievements. In other words, plaudits for the government's pioneering role in the EITI could be used by the state to obscure its shortcomings in oil revenue management and other areas.<sup>13</sup>*

Governments that are true to the spirit of the EITI should make the initiative the starting point for disclosure and continue to create more transparency as part of an evolving process, not a box-ticking exercise to pass an initial validation. If the Azerbaijani government is truly interested in transparency it should start by:

- first improving the EITI process as it stands,
- then by implementing the new 2013 requirements and encouragements, and,
- lastly, by going further than EITI and bringing transparency to other areas not covered by the new rules.

The obscurity we highlight in Azerbaijan also poses a challenge for the EITI, which should enforce its new standards and suspend those countries that do not fulfil them. It should also make the encouragements a mandatory requirement as soon as is feasible.

## Why has the EITI not reduced corruption in Azerbaijan?

The launch of the EITI by British prime minister Tony Blair in Johannesburg in 2002 was a ground-breaking moment: for the first time, companies, governments and civil society were brought together to shed more light on the revenues that oil-rich nations earn from the extractive industry.

Countries signing up to the voluntary scheme pledge to reveal what has historically been kept out of the public eye by an often corrupt business: how much money a government receives from companies extracting the country's oil, gas and minerals. The EITI requires that extractive companies disclose their payments to the government, and that the government discloses its receipts. The figures are reconciled and published in annual reports. A multi-stakeholder group – with representatives

from government, companies and civil society – is established to oversee the process and communicate the findings. More than US\$1 trillion in revenue has been reported since EITI was set up, with 25 “compliant” countries (as of October 2013) assessed as fulfilling the existing requirements.<sup>14</sup>

On the surface, the Azerbaijani government appears to take transparency seriously. It was one of the first countries to sign up for the EITI in 2003 and was the first to be validated as EITI-compliant in 2009.<sup>15</sup> The government sees the EITI as central to its credibility in good resource governance: the current president, Ilham Aliyev, mentioned the EITI in May 2006 to demonstrate the government's commitment to transparency:

*We are very determined to use oil wealth to develop a strong economy, and not to depend on oil and oil prices in the future. To achieve that, we need to have a high degree of transparency in accumulating and spending oil wealth. Azerbaijan is a leading country in the Extractive Industries Transparency Initiative, which has a main goal of having transparent accounting.<sup>16</sup>*

The EITI's aim is to reduce resource-related corruption, which should mean that more of the revenue from the sale of oil is spent on the country's citizens (the true owners of the natural resources), which should in turn lead to a reduction of poverty and an improvement of social indicators.

The box opposite demonstrates that although there has been some progress in this regard in Azerbaijan there should have been a lot more. Meanwhile, EITI's impact on perceptions of corruption in Azerbaijan appears to have been limited. In 2003, Azerbaijan was ranked 124<sup>th</sup> out of the 133 countries surveyed in Transparency International's Corruption Perceptions Index.<sup>17</sup> In 2013, it was 127<sup>th</sup> out of 177 countries – on a par with Russia, which has not implemented EITI.<sup>18</sup>

Azerbaijan also received a “weak” score of 48 – ranking it 28<sup>th</sup> out of 58 countries – in the Revenue Governance Index,<sup>19</sup> which assesses four key governance components, including reporting practices. And a report by the Revenue Watch Institute and Transparency International in 2011 on the transparency of extractive companies gave Socar, the country's largest company, zero out of 100 for its reporting on anti-corruption programmes.<sup>20</sup>

Knowledgeable sources have also told Global Witness that oil trading in Azerbaijan has become much more



AZERBAIJAN CELEBRATED 10 YEARS OF EITI IN 2013.

opaque since the creation of Socar Trading (see p18), with very little information released by Socar regarding oil tenders, their winners and the price paid.<sup>21</sup>

Why hasn't EITI reduced corruption? One reason is that in its initial form EITI focused on the disclosure of oil, gas and mining revenues, an essential first step and the backbone of any system of transparency, which meant countries could sign up knowing that initial reporting requirements were not too onerous or expensive to implement.

In some countries, including Azerbaijan, this narrow focus has resulted in a disconnect, especially as this reporting has not yet been detailed enough for civil society organisations to adequately "follow the money". As one recent paper on EITI by a former international EITI board member points out: "It is possible for a country to be deemed compliant with the EITI's rules, based on reporting of revenues, while other serious problems are untouched."<sup>22</sup> This issue is being addressed by the EITI with new rules formulated in May 2013 (see Annex 1).

But the problems run deeper. The EITI process relies on the goodwill of the government and a genuine commitment on its part to tackle corruption. However, in its report on corruption issues in Azerbaijan, the World Bank suggests that the government of Azerbaijan may lack such commitment because of the involvement in business of private actors who may have ties to the ruling elite:

*Corruption is considered a significant challenge, not simply as a result of bribe taxes and administrative barriers, which are pervasive, but also through direct ownership and control of large holding companies by political leaders and their families. [...] Corruption in Azerbaijan is an integral part of the governance regime, a multi-player prisoner's dilemma where no single player can make a unilateral move because they owe their position to the President's inner circle, and breaking the trust of this group would be severely punished.<sup>23</sup>*

Though the World Bank says that these problems affect the non-oil sector in particular, it suggests there may be systemic problems in Azerbaijan's business sector as a whole. It is worrying to note, given this risk of "political leaders" involvement in Azerbaijani business, that Socar is a deeply political organisation. For example, as president of Azerbaijan, Ilham Aliyev (himself a former vice-president of Socar<sup>24</sup>) has the power to hire and dismiss the company's head.<sup>25</sup>

The current head of Socar is Rovnag Abdullayev, who is also a member of parliament for the New Azerbaijan Party, President Aliyev's political party.<sup>26</sup> He was elected in November 2005, just before his appointment to Socar in December, and was re-elected to parliament in 2010.<sup>27</sup> The potential conflict of interest is clear – is Abdullayev representing the interests of the Azerbaijani state as a whole, or just the interests of its ruling party or the president?

This issue may be beyond actual requirements of the EITI, but is not in accordance with EITI's commitment to "the principle and practice of accountability by government to all citizens for the stewardship of revenue streams and public expenditure".<sup>28</sup>



SOCAR PRESIDENT ROVNAG ABDULLAYEV IS ALSO A MEMBER OF PARLIAMENT FOR PRESIDENT ALIYEV'S PARTY.



## SECTION 2: MAKING MILLIONS FROM SOCAR: THE MYSTERIOUS ANAR ALIYEV

The first section of this report examined how, despite implementing the Extractive Industries Transparency Initiative (EITI), corruption remains a problem in Azerbaijan, and social development is slow.

Part two examines certain deals struck by the state oil company of Azerbaijan, Socar, that lack transparency, and highlights the involvement of one man in particular. We have selected Socar not only because of its importance to Azerbaijan as a whole but also because of concerns raised by local civil society.<sup>29</sup> In 2009 a coalition of NGOs working on oil issues condemned Socar for signing two oil development deals “‘in the dark’ without public notice of its negotiations with the foreign companies involved, and without the traditional public contract signing ceremony”.<sup>30</sup>

This new research by Global Witness reveals that companies currently or previously owned by one man, Anar Aliyev, have held stakes in 48 different joint ventures, production sharing agreements, alliances or other business partnerships with Socar. A full list of these companies, and two others that Anar Aliyev has a connection with, can be found in Annex 2 with more details given on the Global Witness website.<sup>31</sup>

Anar Aliyev is only 35 years old and, as far as Global Witness is aware, has never been publicly named by Socar as being a shareholder of any of these interests. Our concern, based on 15 years of investigating obscure oil deals, is that in the absence of information on both Aliyev’s role in these deals and the ultimate owners of the companies involved, inevitable and urgent questions arise about who else is benefitting from Azerbaijan’s oil, and whether Anar Aliyev may be fronting for hidden individuals. Without very clear information about these deals, such concerns will not go away.

The deals are worth hundreds of millions of dollars, and have resulted in substantial gains for Anar Aliyev’s companies. The two main parent companies through which this network is owned declared profits totalling US\$375 million in a period of just five years where the vast majority of their business appears to be with Socar.<sup>32</sup> One of his companies made a profit of US\$118

million on its investment of just US\$5 million in Socar’s oil trading subsidiary, Socar Trading SA.<sup>33</sup>

The exact profits Anar Aliyev’s companies made from these deals are unclear. This is because the companies involved in 48 of these deals are owned by two further companies based in Singapore that do not report fully on the financial activities of the individual companies they own, in contravention of Singaporean law. Their failure to do so forced their auditors to qualify their opinion on their accounts.<sup>34</sup> Our assessment of the profits is therefore likely to be incomplete.

With information on profits or ownership not available from EITI reports or state sources, Global Witness pieced together the links between many of these deals through painstaking new research involving the examination of company records and annual accounts from various countries’ corporate registries. Some of these deals have been flagged before as deserving of scrutiny, by a journalist from Radio Free Europe/Radio Liberty,<sup>35</sup> the Eurasian oil industry newspaper *Nefte Compass*<sup>36</sup> and investigations by a group of Azerbaijanis living in Switzerland.<sup>37</sup>

Socar has not released information on how or why these deals were struck. This is not to suggest that the deals themselves are corrupt, but given the risk, as the World Bank states, of “vested interests” in the Azerbaijani economy as a whole,<sup>38</sup> Socar should immediately make publicly available the process by which a company was selected, the full ownership details of the company, and the rationale for its remuneration and equity holdings. In the deals outlined below this does not seem to have happened.

Like Socar itself, several Anar Aliyev-linked companies and their joint ventures with Socar report to the EITI, including UGE-Lancer (see page 26).<sup>39</sup> This highlights certain inadequacies of the EITI as currently practised in Azerbaijan: although it may allow citizens to see how much money these companies and projects give to the government, it currently provides no information regarding the ultimate owners of these projects, so that those benefitting remain hidden from public scrutiny.



THE ONLY PHOTOGRAPH OF ANAR ALIYEV THAT GLOBAL WITNESS COULD LOCATE.

## So who is Anar Aliyev?

Global Witness found that a man named Anar Aliyev has been involved in some capacity with companies that have struck at least 48 deals with Socar, covering all facets of the supply chain of the oil industry and several auxiliary functions. He even held a stake through one of his companies in partnership with Socar in an Azerbaijani football team, Neftchala FK.<sup>40</sup> The extent of these deals makes him a key figure in the oil industry of Azerbaijan, even though he appears to be a relative newcomer: nearly all the Aliyev-linked companies in partnership with Socar were set up after 2005.<sup>41</sup>

Despite Anar Aliyev's apparent significance in Azerbaijani oil, publicly available information on him is thin on the ground. Searches in media databases (both English and Russian language) provide virtually no relevant results. Internet searches using his name as written in Azeri reveal little more. Global Witness was also unable to find out anything about his employment history or track record in the extractive or oil-trading business before these deals with Socar. Contacts in civil society in Azerbaijan that Global Witness asked had either not heard of him, or knew little other than his involvement in some of the companies mentioned below.

Global Witness has seen a document that indicates that Anar Nusrat oglu Aliyev was born in September

1978 in Nakhchivan,<sup>42</sup> an autonomous exclave of Azerbaijan. Despite Nakhchivan's separation from the main land mass of Azerbaijan, it is the birthplace of many political and business leaders of Azerbaijan, both past and present, including former president Heydar Aliyev (the incumbent president's father),<sup>43</sup> current Socar president Rovnag Abdullayev,<sup>44</sup> the Minister for Emergency Situations Kemaleddin Heydarov, and the executive director of the state oil fund Sofaz, Shahmar Movsumov.<sup>45</sup>

The Nakhchivani clan is highly important in Azerbaijani politics and society in general. As a report from the Norwegian Helsinki Committee, a civil society organisation that works on human rights' issues, states:

*[Under Heydar Aliyev] The heads of many strategically and profitably important institutions – posts in state agencies/ministerial positions, police chiefs, hospital directors, heads of factories, academics and so on – were from Nakhchivan. [...] Officials in top posts and influential oligarchs of Nakhchivan origin are notable for their personal loyalty to the Aliyev family.*

The report names ten Azerbaijani officials, including Abdullayev and Heydarov, and then adds:

*Today, the powerful ministers who are part of the Nakhchivan clan centre on the Aliyev family and its close networks and continue to make use of the sizable revenues from oil and gas to maintain their networks.*<sup>46</sup>

Anar Aliyev is not mentioned in this report and his geographic origins do not necessarily make him part of this group. It is unclear whether he knows any of these prominent Nakhchivanis, or whether his Nakhchivan roots played any part in his attaining his position in the Azerbaijani oil industry. It should also be noted that Aliyev is a very common surname in Azerbaijan, so no conclusions should be drawn from Anar Aliyev sharing a surname with others, including the president.

Global Witness wrote to both Anar Aliyev and Socar to ask if there was any personal or familial link between Anar Aliyev and Socar president Rovnag Abdullayev or other senior Socar officials. Anar Aliyev did not reply, Socar did not answer the question.

Questions therefore remain about how a relatively young, previously unknown entrepreneur came to hold interests in 48 deals with the state-owned oil company over the course of six years. There appears to be a reasonable risk that he may have achieved

his position through high-level political or other connections, especially given the World Bank's concerns about the control of Azerbaijani business by the political elite. Indeed, many sources in Azerbaijan told Global Witness that it would be unlikely that someone could have achieved such a position in the Azerbaijani oil industry without possessing close relations with either senior Socar officials or the Azerbaijani president's family.

This risk appears all the more apparent from the fact that Anar Aliyev's companies are involved not just in oil but also in a high-profile government scheme called Baku White City, which aims to redevelop Baku, Azerbaijan's capital. It is a major project that, according to one news report, "will cover an area greater than Monaco, becoming the biggest development in the Caucasus, and its population will be compared [sic] to that of Andorra."<sup>47</sup> One of the largest districts of Baku White City had even been designated to be the Olympic Village as part of the Azerbaijan's failed bid to host the 2020 Olympic Games.<sup>48</sup>

Company records show that at some point in 2012, a company that Anar Aliyev owned at the time – Union Grand Energy – acquired a 99% stake in a company called Baki AG Sheher [Baku White City] Office Building LLC, investing nearly US\$14 million in it.<sup>49</sup> Another company in which Anar Aliyev held a stake is also involved in the cleaning of the construction area's polluted land.<sup>50</sup>

Global Witness has made numerous attempts to contact Anar Aliyev for comment. On the first and third calls to the phone number given on Union Grand Energy's website, Global Witness was told that he worked there but was not in. On the second and fourth calls, the person who answered said that the



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ANAR ALIYEV'S PORTFOLIO EXTENDS TO HIGH-PROFILE CONSTRUCTION PROJECTS.

number was not Union Grand Energy's office and that nobody of his name was employed there. When Global Witness pointed out on the fourth call that someone on the same number had confirmed that it was Union Grand Energy's office, she replied that the person may have been mistaken and that the phone number had perhaps changed.

Attempts to reach Aliyev by post met with similar difficulties. A first letter to Union Grand Energy's address was received and signed for, but the address given on most company documents as Anar Aliyev's address could not be found by either a courier or a local driver. When another letter was sent to a different location given in company filings as his address, a person at the address refused to take the letter on the grounds that he was rarely there. However, on a second attempt the letter was refused on the grounds that nobody at that address knew of Anar Aliyev. The same response was given when a second letter was sent to Union Grand Energy's address. Global Witness also sent emails to addresses given on Union Grand Energy's website and faxed letters to Union Grand Energy and Heritage General Trading, another company that Anar Aliyev has been the shareholder of. We received no reply.

Global Witness also wrote to Socar with questions about Anar Aliyev. Though Socar did not mention him (or any other person) by name, it said:

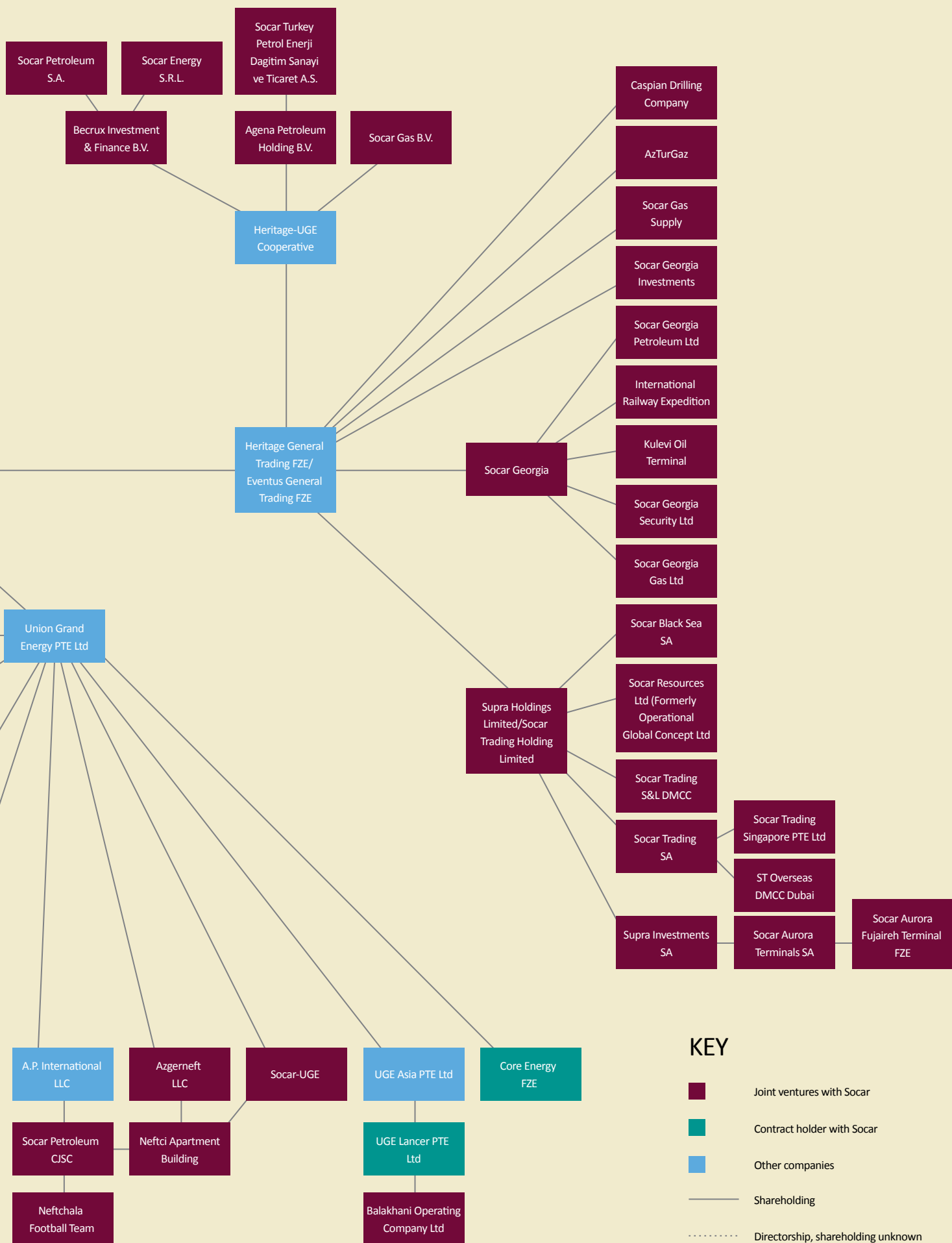
*It is a national priority and policy reflected in the laws of the Republic of Azerbaijan, equally supported by SOCAR to develop local companies and to create a favorable business environment for local entrepreneurs. In light of this enhanced attention directed to local companies and in compliance with local laws and regulations, SOCAR engages all types of companies, including those established by entrepreneurs of the Azerbaijani origin in and outside Azerbaijan, which are consistent with efficient operations and profitability.<sup>51</sup>*

Socar has indeed produced a favourable business environment for local entrepreneurs – or at least for one, Anar Aliyev.

ANAR ALIYEV'S WEB OF COMPANIES  
LINKED TO SOCAR. THESE LINKS MAY HAVE  
CHANGED OVER TIME AND OWNERSHIP  
STAKES ARE NOT ALWAYS 100%. FULL  
DETAILS ABOUT THE EXACT NATURE AND  
TIMINGS OF THESE LINKS CAN BE FOUND  
ON THE GLOBAL WITNESS WEBSITE







# SOCAR TRADING SA

## Anar Aliyev's company profits from Socar's oil trading subsidiary

The first case study involves an issue that Global Witness has highlighted extensively in the past in other countries: the insertion of hidden private interests into state business in deals that lack clear business rationale. Socar's current public explanation for this unravels on close examination.

The company in question, Swiss-registered Socar Trading SA, was founded in 2007 as an oil trading subsidiary of Socar. It represents a major element of Socar's activities, making sales worth US\$33.66 billion in 2011.<sup>52</sup> This is more than three times the size of Socar's own sales.<sup>53</sup>

Socar says it moved into oil trading in order to cut out the independent middlemen who had been responsible up until then for trading Azeri oil. The aim was to increase the value of the group and add a significant new profit margin through trading oil direct to the market.<sup>54</sup> So it is

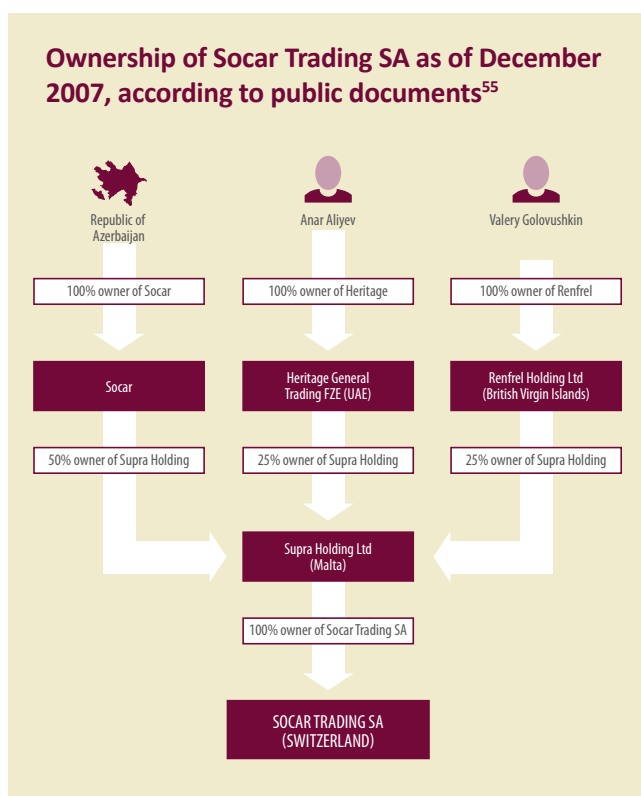
rather surprising that when Socar created Socar Trading SA it only owned 50% of the new company.

The original ownership structure is best understood through the diagram on this page, which shows that Socar Trading SA's parent company is a Malta-registered company called Supra Holding Limited<sup>iii</sup>.<sup>58</sup> But this company in turn was only 50% owned by state-owned Socar with the other 50% initially owned by two offshore companies: Heritage General Trading and Renfrel Holding. This means that, until August 2012 when Socar bought the shares of the offshore companies, half the money that this subsidiary was earning was going into private hands.

So who owned and controlled the offshore companies that held this private half of Socar Trading SA? According to company filings, Heritage General Trading was incorporated in the United Arab Emirates (UAE) and the legal owner was Anar Aliyev up until at least January 2013.<sup>59</sup> Heritage initially held 25% of Socar Trading SA, which later rose to 40% following a further share issue.<sup>60</sup> Anar Aliyev was also a director of Socar Trading SA from 19 August 2009 to 25 April 2012.<sup>61</sup>

The other offshore company, Renfrel, is registered in the British Virgin Islands which keeps company ownership secret.<sup>62</sup> However Socar Trading SA's CEO, Valery Golovushkin – a former vice president of Russian company Lukoil<sup>63</sup> – can be deduced to be the owner of Renfrel from company filings,<sup>64</sup> and was authorised to act “for and on behalf of” Renfrel at shareholders' meetings.<sup>65</sup> Global Witness wrote to Golovushkin at Socar Trading SA's address, but did not receive a reply.<sup>66</sup> Socar did not comment on Renfrel's ownership when contacted by Global Witness.

As a state company, Socar should be working for the benefit of the Azerbaijani state and its people, and focus on maximising its profits. So why did it choose to give up 50% of the revenues it could make from Socar Trading? When Socar issued bonds in London in 2012, the prospectus explained the founding of Socar Trading SA as a separate subsidiary in Switzerland by saying that “applicable regulation[s]” and “a matter



SOCAR TRADING SA WAS INCORPORATED IN SWITZERLAND ON 17 DECEMBER 2007.<sup>56</sup> SUPRA HOLDING WAS REGISTERED SIX DAYS EARLIER IN MALTA.<sup>57</sup>

iii Supra Holding Limited was renamed Socar Trading Holding Limited at the end of 2012. To avoid confusion, this report refers to this entity as Supra Holding throughout.

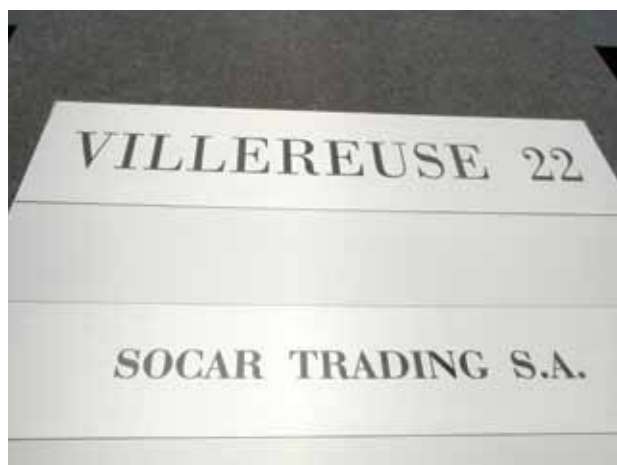
of practice” made Socar unable to enter into “certain other arrangements common in the industry”, including “storage [and] shipping arrangement[s]”.<sup>67</sup> Such vague language does not satisfactorily explain why such an entity was necessary. It also does not address why half of Socar Trading SA was owned by obscure private offshore companies from the time of its foundation until August 2012.

Perhaps there are other reasons for this arrangement – after all, partnerships between state and private companies are not unusual. The private sector can offer superior services, equipment and expertise, or assist with the high level of investment that certain projects require. In Socar’s response to Global Witness (see p23), the company appears to suggest that international partners were chosen in the selling of its crude oil because of their experience and ability to get financing for oil trading projects in new markets. But it did not answer our questions on why these partners specifically were chosen, nor did it give details about their experience or the financing that was actually provided.

Global Witness could find no information to suggest that Heritage offered any experience in oil trading. Renfrel, being associated with Russian oil executive Valery Golovushkin, may have offered some of this experience. However, Golovushkin is employed by Socar Trading as its president and CEO and therefore is presumably paid a salary for his expertise. As Golovushkin also owned Renfrel, a company which possessed a large and profitable stake in Socar Trading, this requires explanation as it, in our opinion, lacks a clear business rationale for a state company to give up so much equity to someone who may receive a salary already.

Another reason for a country to sign deals that are very preferential to private interests is when it has little capacity or capital to exploit its own resources and may therefore not be in a position to bargain. Yet Socar Trading SA was set up in 2007, when Azerbaijan was already enjoying increased revenues from rapidly increasing oil production and therefore should have had no need of outside investment on the relatively minor scale that Heritage and Renfrel offered, which was only US\$6.25 million.<sup>68</sup>

Even if these companies did provide some benefit, an important question remains: why did Socar choose to give up so much equity to these companies, rather than hire them as experts and pay them a fee? The fact that Socar’s partners in this deal are not well-known multinational companies but obscure offshore entities with opaque ownership can only raise concerns about the motivation.



Global Witness

WHY DID SOCAR GIVE UP EQUITY IN SOCAR TRADING SA TO PRIVATE SHAREHOLDERS?

Another part of Socar’s response to Global Witness was that such “cooperation with private companies allows [Socar] to increase the effectiveness and profitability of projects, as well as to convert loss-making projects into profitable ones”.<sup>69</sup> But as we will show, Socar paid a huge price to buy back the shares from the private owners in 2012.

The EITI’s new recommendations from May 2013 require that government and state-owned enterprises (including subsidiaries) should disclose their level of ownership in oil, gas and mining companies operating within the country, including details of the terms attached to their stake.<sup>70</sup> These new rules will cover the selling of oil by government and state-owned enterprises. This requirement will not disclose, however, the names of the “beneficial” owners (see box overleaf) of its private partners – this is currently only encouraged. The requirement is also not retrospective. In the interests of transparency Socar should release full ownership details on this now historic arrangement.

Without information about the true owners of these private partners, the concern remains that the deal may have been of greater benefit to Anar Aliyev and possibly others than it was to Socar or its ultimate owners, the Azerbaijani people. In a country such as Azerbaijan, where political and business interests are often interconnected, this is a matter of great public interest.

## Socar Trading: Where did the profits go?

The deal struck between Socar Trading SA and its ultimate parent, state-owned Socar, was substantial: it purchased 60% of Socar’s crude oil, costing US\$11.1 billion in 2011.<sup>71</sup> This percentage has recently risen to 90%, according to Socar.<sup>72</sup> This makes the fact that Socar chose to give up 50% of what it could make from Socar Trading SA all the more surprising.

Global Witness analysed the published accounts for the five years Socar Trading SA was 50% owned by hidden private interests. It appears that overall the private companies made more money than Socar did. This was a result of Socar purchasing back the private half of Socar Trading SA at a very high price in 2012.<sup>73</sup> Heritage had received its shares in return for a US\$5 million investment, while Renfrel had paid

US\$1.25 million for its shares.<sup>74</sup> Yet Socar eventually purchased the shares of Heritage and Renfrel for US\$103 million and US\$30 million<sup>75</sup> respectively.

Although it now owned 100% of Socar Trading, after taking into account the cost of buying back the shares, it appears that Socar made a profit over the five-year period of only US\$48.5 million (this includes

## What is an ‘ultimate beneficial owner’?

A company’s ultimate beneficial owner is the person or people who ultimately own and control the company: the people who pocket the profits and can make decisions about what the company does. This can, and often is, different from the company’s legal owner. A legal owner can be a proxy or nominee – someone who takes on the responsibility of legal ownership while having little to do with the day-to-day running of the company. A legal owner does not even have to be a person – it can be another company.

This system came about through the creation of limited liability companies that, as the name suggests, limited the personal liability of individuals going into business in order to promote enterprise and entrepreneurship. But the mechanism by which companies are considered to be a “legal person”

(i.e. not a real individual) separate from the “natural persons” (actual people) that run the business has an unwanted side effect: the ability to hide the real people who stand behind the company. This can be exploited by those looking to engage in dubious business, or move dirty money around the world, such as tax evaders and corrupt politicians.

Company registry records do not indicate whether the person listed as a shareholder is the ultimate beneficial owner or not. In this report, although Anar Aliyev is listed as a shareholder of certain companies, it is unclear whether he is the ultimate beneficiary or just the legal owner. Trying to ascertain the ultimate beneficial owner is very difficult, even for law enforcement agencies. No country currently has a company registry that publicly records the name of the beneficial owner and very few countries maintain a private record. Most countries’ company registries just give the name of the legal shareholder. Some jurisdictions, such as the British Virgin Islands, do not even publicly disclose that information. This is now the case in Azerbaijan: in June 2012, new legislation was passed to remove from the public record information on the legal owners of Azerbaijani companies that had previously been publicly available.<sup>76</sup> In May 2013 the EITI agreed to encourage beneficial ownership transparency during a piloting period, with the intention of making it a requirement by 2016.

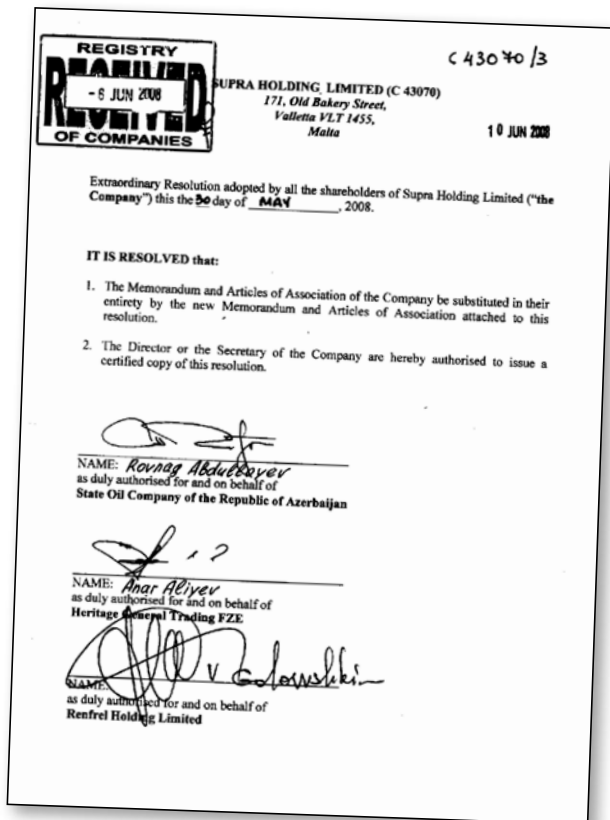
Internationally, progress is being made. In October 2013, the British prime minister, David Cameron, announced that a new registry of the beneficial owners of British companies would be maintained and, crucially, made available not only to law enforcement and tax inspectors, but to the wider general public. The European Union and United States are also considering such registers. The international community, including Azerbaijan, should follow suit.



Mortal Coil Media

IT IS PERFECTLY LEGAL TO HIRE PEOPLE TO ACT AS A COMPANY’S PROXY OWNERS, BUT IT HAS THE EFFECT OF HIDING THE PERSON WHO REALLY BENEFITS.





Extract from document "Extraordinary Meeting of Supra Holding Ltd", May 2008

ANAR ALIYEV, VALERY GOLOVUSHKIN, ROVNAG ABDULLAYEV APPEARED TO BE THE MAIN MEN AT SOCAR TRADING.

the assets that Socar now fully owns and dividends it had received). Heritage (whose shareholder at the time was Anar Aliyev) and Renfrel on the other hand made profits, including the sale back to Socar, of US\$118 million and US\$33.75 million<sup>iv</sup> respectively, returns on investment of 2,360% and 2,700%.<sup>77</sup> This brings us back to the question of why Socar offered an equity stake in the first place, instead of just hiring experts and paying them a reasonable fee. To compare: according to its published accounts, the Supra group (which owns Socar Trading SA) paid out US\$6.3 million in 2012 to its senior personnel, yet the owner(s) of Heritage and Renfrel earned a total of over US\$151 million when they sold their shares.<sup>78</sup>

In other words, the privately-owned Heritage and Renfrel, with only small investments into Socar Trading SA, made vast profits through dividends and the eventual sale of their shares to Socar. Did Socar make a bad business decision by giving up so much equity to private individuals and buying the shares back at a high price? Or did Renfrel and Heritage offer something that warranted their inclusion? It is not possible to say, without further information from Socar on why Heritage and Renfrel were selected and what they achieved.

## Socar International DMCC: another part-private oil trading subsidiary

Socar Trading SA is now fully-owned by Socar. In its reply to Global Witness, Socar said it made this decision because it now felt comfortable in trading oil: "As a result of continuous and successful cooperation, SOCAR transitioned and took control over its operations after gaining a necessary level of comfort."<sup>79</sup> This seems to suggest that Socar is now fully in control of the trading of Azerbaijani oil. But far from it: hidden interests remain, but in a different form.

Just as moves were being made to make Supra Holding, Socar Trading SA's parent company, fully-state owned, a new partially privately-owned middleman with hidden owners was being inserted between Socar and Supra. This company, Socar International DMCC, was registered in Dubai, UAE in June 2011. Again Socar owns only 50% of it.<sup>80</sup>

Socar mentions the creation of Socar International DMCC in its 2011 annual report, but fails to give any information about what this entity does or why it was created.<sup>81</sup> Media reports and Azerbaijani oil experts have indicated that, as well as managing investments, Socar International DMCC is also responsible for Socar's crude oil sales.<sup>82</sup> Yet company annual reporting for 2011 and 2012 shows that nearly all of Socar International DMCC's sales in its first two years of operation were not to outside parties, but to Socar Trading's parent company, Supra Holding.<sup>83</sup>

The quantity of oil involved is substantial: the oil sold by Socar International DMCC to Supra Holding was worth US\$1.68 billion in 2011 and US\$5.77 billion in 2012.<sup>84</sup> This means that a partly private company was inserted into the trading between Socar and its wholly-owned subsidiary Socar Trading SA when no such middleman was required before. Socar International DMCC made profits over these two years of over US\$66 million purely by selling oil from state-owned Socar to state-owned Supra Holding.<sup>85</sup> The involvement of hidden private interests making a profit in selling oil from Socar to its wholly-owned subsidiary poses a risk that private business figures are benefitting unduly. Without transparency over the arrangement such questions are a legitimate public concern.

<sup>iv</sup> Including a dividend of US\$20 million for Heritage and US\$5 million for Renfrel.



© Sebastian Opitz/No/Novarc/Corbis

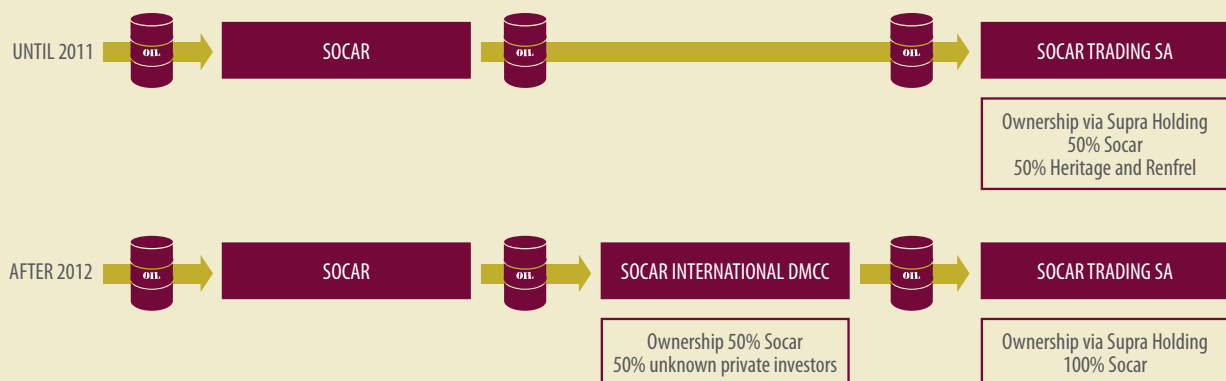
SOCAR INTERNATIONAL DMCC IS REGISTERED IN DUBAI (ABOVE), BUT THE REASON FOR ITS CREATION IS SHROUDED IN MYSTERY.

Global Witness could not find any reference in Socar company literature to the identities of even the legal owners of the other 50% shareholding in Socar International DMCC, let alone the ultimate beneficiaries. The company registry of the UAE, like many countries around the world, does not include publicly available ownership information or provide accounts, so the owners and the extent of their business remain hidden from public view. The people of Azerbaijan therefore do not know who stands to profit from the 50% stake

in Socar International DMCC. It is currently unclear whether Anar Aliyev has any link to this company.

According to one news article, Socar International DMCC was created to take over crude sales from Socar Trading in order that Socar Trading could develop activities in other regions.<sup>86</sup> But if this is the case, it negates Socar's above explanation – if Socar International DMCC is now doing Socar Trading SA's work, why is it 50% owned by private parties, given

**Diagram showing oil sales from Socar to Socar Trading SA – before and after the creation of Socar International DMCC**



that Socar has said it now feels comfortable with doing all the work itself?

This appears to be a very strange business arrangement. Why is Socar Trading SA not buying its oil directly from its ultimate owner, Socar, as before, but from Socar International DMCC, 50% of which is currently owned by hidden individuals? What has changed, other than Socar Trading SA becoming fully state-owned, to cause this new arrangement? Why do undisclosed individuals, profiting from the transferring of oil from Socar to Socar Trading SA via Socar International DMCC, need to be involved?

Again, it is impossible to say, because Socar, as far as Global Witness could ascertain, has released little information on why Socar International DMCC was created or on the terms of its dealings with Socar and Socar Trading SA. In our letter to Socar, Global Witness asked about Socar International DMCC, but received no specific answers to our detailed questions. Global Witness also wrote to Socar International DMCC directly at its registered address in Dubai in the Almas Tower. However, the courier could not deliver the letter, saying that the company was “not listed” at the address.<sup>87</sup> The company’s listed phone number did not work.

As a matter of urgency, Socar needs to explain the rationale for inserting Socar International DMCC into the buying and selling of its oil, and disclose the hidden owners behind the other 50% of Socar International DMCC.

In a 2011 report on state oil trading, the Revenue Watch Institute recommended that all national oil companies should follow best practice procedures regarding oil sales with each buying company reporting: “information by shipment, including the shipment number, contract number, invoice number and data, quantity, price, loading port and data, quality of crude, destination, due date, settlement and vessel name”.<sup>88</sup> This is something that needs to happen in Azerbaijan given the emergence of state oil trading as a provider of government revenue.

Countries that trade in commodities such as oil (rather than extract them) should also consider passing transparency laws that cover such activity. In April 2013 Switzerland’s foreign affairs committee voted in favour of a motion that requires its Federal Council to examine a draft transparency law including the whole Swiss commodity sector (both listed and non-listed companies, extractive and trading activities).<sup>89</sup> Other countries that trade in commodities should follow Switzerland’s lead.

## Socar’s response to Global Witness

Global Witness wrote to Socar for its comments. It replied:

*SOCAR carries out all of its activities and makes decisions in accordance with the laws of the Republic of Azerbaijan and internal procedures and regulations of SOCAR, prepared in accordance with the world’s best practices of internationally known firms.*

*[...]*

*Commencing from 2007, SOCAR made a commitment and decision to diversify its trading activities. [...] In 2008, SOCAR decided to deliver these volumes directly to end-users worldwide, in particular, across Europe, Asia and the Americas. Thus, the company has increased the value of Azerbaijan’s crude exports and captured additional margin for the SOCAR group. In order to further optimize and diversify its trading operations, Socar has employed more than 100 employees and has housed offices in world trading centers,*

*including Geneva, Singapore, Vietnam, Dubai, Lagos, New York, Cairo and Istanbul. Given the start-up nature of the projects and the lack of readiness to calculate risks properly ex ante, we had engaged joint international partners due to their extensive experience and readiness to procure financing on better commercial terms for our projects. As a result of continuous and successful cooperation, SOCAR transitioned and took control over its operations after gaining a necessary level of comfort.*

*[...]*

*the Republic of Azerbaijan is a founding member of the Extractive Industry Transparency Initiative (“EITI”) task force subjecting the reviews of Socar to thorough examination and auditing.<sup>90</sup>*

The fact that Socar refers to the EITI – despite the initiative not covering the issues we raise in our letter – highlights how the Azerbaijani government presents the EITI as if it were the answer to any questions about the governance of its oil industry.

# THE SUMATO ENERGY GROUP

## The \$10,000 hotel bill and more links to Anar Aliyev

This case study also involves oil trading and unknown private interests, and queries how the company in question achieved its position. Anar Aliyev appears to be linked to this deal, although it is not clear exactly how.

The Sumato Energy Group is a group of energy-trading firms that appeared to buy oil exclusively from Socar and Socar-related entities, according to the business press.<sup>91</sup> The amounts are significant both in volume<sup>92</sup> and value: Sumato Energy PTE Ltd filings for 2011 give its cost of sales – the price they paid for their oil purchases – as US\$1.98 billion. This suggests that the Azerbaijani state company sold Sumato nearly US\$2 billion worth of oil in 2011.<sup>93</sup> It is not known at what price Sumato sold this oil, or to whom.

It is also unclear how Sumato Energy Group found itself in this lucrative position. Socar announced that the company had won a tender in 2007,<sup>94</sup> but Global Witness could not find any information about the tendering process, qualification criteria, the identity of owners or bidders, the winning bid or the contracts themselves. According to journalists who have worked

on the issue, Socar stopped publishing information regarding oil tenders around the time of the creation of Socar Trading in 2007.<sup>95</sup>

Global Witness wrote to Sumato Energy Group, which did not reply, and to Socar, which did not respond to our specific questions about Sumato.

Sumato Energy Group is made up of four legally independent companies incorporated in New Zealand, Singapore, Switzerland and the UAE, employing a total of 17 people, as of September 2010.<sup>96</sup> The first Sumato company was registered in New Zealand in December 2005 as Sumato Energy Group Limited.<sup>97</sup> Its director from 2005 to 2010 was Ian Taylor.<sup>98</sup>

Global Witness has written about Ian Taylor before. His company, GT Group, is a company service provider. These businesses register companies on behalf of others and act as “proxy” or nominee directors – paid to take legal responsibility for a company while having nothing to do with the running of it. The name of a company’s real owner – the “ultimate beneficial owner” – is obscured through the use of these proxies (see p20). In this case, Ian Taylor acted as the director of Sumato Energy Group Limited on behalf of other unknown owners.



ANAR ALIYEV RAN UP A BILL OF OVER US \$10,000 IN TWO DAYS AT THIS EXCLUSIVE SWISS HOTEL.



Taylor has registered entities that have gone on to be involved in all kinds of shadowy business, including the alleged laundering of the proceeds of Mexican cocaine smugglers, arms smuggling from North Korea, what has been described as the largest tax fraud scheme in Russian history, and suspicious capital flight from Kyrgyzstan during a revolution, as documented in Global Witness' 2012 report *Grave Secrecy*.<sup>99</sup> At the time of the arms smuggling scandal, a GT Group press release said: "GT Group Limited is not responsible for the operation or activities of companies it has incorporated."<sup>100</sup>

Of course, this is not to suggest that Sumato has been involved in any of these activities, only that its nominee director is known to have registered companies that have done so, and that he does not get involved in the running of companies for which he is a director. It does mean, though, that the real owners of Sumato Energy Group Ltd remain hidden. However, Global Witness has seen one document that reveals that a man named Azim Novruzov became a shareholder of the Sumato company registered in the UAE (Sumato Energy FZE) in May 2009;<sup>101</sup> it is unclear whether this individual is just a legal shareholder or a beneficial owner as well. Global Witness attempted to contact this person via letters to Sumato's Dubai and Singapore offices, to the Baku address given on the share certificate, and by phone, but was unsuccessful. We also sent an email to an address given on a business website for Sumato Energy FZE but received no reply.

Global Witness has not found any evidence to suggest that Anar Aliyev owns Sumato. However, there is some compelling evidence that links Sumato to Anar Aliyev and his other companies:

- Sumato Energy PTE Ltd and Union Grand Energy (the latter owned by Anar Aliyev at least until January 2013) share the same registered address in Singapore.<sup>102</sup>
- Sumato Energy PTE Ltd has shared the same director and company secretary as Union Grand Energy and UGE-Lancer, companies that have been owned by Anar Aliyev.<sup>103</sup>
- Azim Novruzov, a registered shareholder of Sumato Energy FZE, is listed online as the contact person for another company that was owned by Anar Aliyev.<sup>104</sup>
- Corporate filings list an individual called Lothar Tauschke as the director of Swiss company Sumato Energy Services SA, another of the four companies in the group.<sup>105</sup> A press release on the website of the Azerbaijan embassy in Germany

refers to Tauschke as also being a manager at UGE-Lancer,<sup>106</sup> the company owned by Anar Aliyev that signed a product-sharing agreement with Socar in 2011 (see 26).

- Global Witness has seen two documents that purport to be hotel bills of Anar Aliyev from the luxury 5-star Grand Kempinski Hotel in Geneva. They appear to have been paid for by a man named Metin Talishli, the Deputy General Manager of Sumato Energy Services SA. One is for 10,253 Swiss francs (US\$10,887) for a stay from 2 to 4 January 2012,<sup>107</sup> indicating that Anar Aliyev may have stayed in a Deluxe Junior Suite Lakeview room which, as of April 2013, costs 5,000 Swiss francs a night (US\$5,355).<sup>108</sup> A second bill from August 2011 shows another two-night stay in the hotel for Anar Aliyev as well as Azim Novruzov, a shareholder of Sumato Energy FZE.<sup>109</sup> However, this time Anar Aliyev's expenses, again paid by Metin Talishli, were much more modest: 367 Swiss francs (US\$472) for room service, featuring champagne, vodka and Red Bull, gin and Diet Coke.<sup>110</sup>
- The representative of Sumato Energy Services SA who paid these hotel bills, Metin Talishli, was also a director of two companies owned by Anar Aliyev's Union Grand Energy.<sup>111</sup>

Global Witness wrote to both Sumato Energy and Anar Aliyev to ask them why Sumato had paid Anar Aliyev's hotel bills, and how the two parties were connected. Global Witness did not receive a reply. Global Witness also contacted Metin Talishli, who refused to answer questions on the subject of Sumato. The Sumato Group is believed to have ceased operations around 2013.

It is in the public interest for the connection between Anar Aliyev and Sumato to be revealed because Anar Aliyev possesses links to both the supplier Socar (he was a director of Socar Trading SA at the time the hotel bills were paid)<sup>112</sup> and its customer Sumato (as explained above in the bullet points). This raises the possibility of a conflict of interest, especially when the apparent customer is paying for Anar Aliyev's expensive hotel bills in Geneva.

This case study highlights once more that companies with obscure ownership have found themselves in a lucrative position selling Socar's oil with little information about how they obtained the position. The EITI's new requirements do not cover the selling of oil by private companies. Therefore it is all the more important that Socar discloses more information regarding Sumato's owners and the tenders it won.

## UGE-LANCER

### Anar Aliyev's company signs oil deal with Socar

Anar Aliyev's involvement with Socar goes beyond oil trading. This final case study examines his involvement in oil exploration and production.

On 6 May 2011, the Azerbaijan parliament agreed a production sharing agreement (PSA) to develop the Balakhani-Sabunchu-Ramana and Kurdakhani onshore oilfields in Azerbaijan which contain possible recoverable reserves of around 7.3 million tons of oil, equivalent to around 52.1 million barrels, worth US\$5.8 billion at average 2011 prices.<sup>113</sup> According to Socar's website, UGE-Lancer Ltd holds a 75% stake in the PSA, leaving Socar with 25%.<sup>114</sup> However, media reports suggest that Socar's share of the profits will be different, starting at 55%, and rising to 92.5% based on fulfilment of production targets.<sup>115</sup> It is unclear how Socar selected UGE-Lancer; Global Witness could find no information about whether a tender was held, and if there was, who participated.

When the PSA was ratified by the Azerbaijani parliament, an MP reportedly said: "I searched on the internet out of curiosity, but nothing came up [...] I suspect that this company could be fake. Why aren't we told which countries this company has operated in besides Azerbaijan?" He said that parliament should not approve agreements signed with companies "whose origin is unknown". Socar's president Rovnag Abdullayev, a member of parliament himself, is reported to have replied that UGE-Lancer<sup>v</sup> has implemented projects in Germany, Romania, Uzbekistan and Georgia since 2003: "We also established an eco-engineering joint venture jointly with this company in 2003 and implemented a number of environmental projects in Azerbaijan."<sup>116</sup>

In fact, the activities he attributed to UGE-Lancer were conducted by a different company, called Lancer Services SA,<sup>117</sup> although both are owned by the same parent company, Union Grand Energy PTE Ltd,<sup>118</sup> and the joint venture he referred to was set up in 2006, not 2003.<sup>119</sup> Socar's actual partner in the PSA was later

confirmed on its website and in the press as UGE-Lancer,<sup>120</sup> a company registered in Singapore.

Global Witness could find no information this company has implemented in the countries Abdullayev mentioned in parliament, although its parent company, Union Grand Energy, has been active in Romania and Georgia through other subsidiaries.<sup>121</sup> Global Witness would welcome any information on any projects UGE-Lancer has been involved in in Germany, Romania and Uzbekistan.

So who owns UGE-Lancer's parent company, Union Grand Energy, which is also registered in Singapore? It is Anar Aliyev – who is listed in company records as its sole shareholder from shortly after it was incorporated in November 2008.<sup>122</sup> However, Union Grand Energy does not name him on its website, saying merely that its sole owner is also its founder, "who despite his young age is one of the top leaders and successful businessmen in the energy industry in the CIS countries and Middle East".<sup>123</sup> It is unclear whether Anar Aliyev is, or was, the ultimate beneficial owner.

This agreement is by no means the only business that Union Grand Energy has with Socar. Through a web of subsidiary companies, many in secrecy jurisdictions (countries which do not publicly disclose the names of company shareholders), Global Witness has discovered that Union Grand Energy has held stakes in 40 different Socar deals (for more detailed information on these companies see the Global Witness website).

According to its website, Union Grand Energy is an oil and gas company involved in everything from exploration and production to shipping and drilling,<sup>124</sup> and has a network of ten ports and 1,000 staff.<sup>125</sup> It boasts that: "UGE [Union Grand Energy] ranks as one of the leading companies in the energy sector of the Caspian region and CIS [Commonwealth of Independent States] countries in terms of the [sic] production and exports and is presently one of the leading sellers of the oil machinery and equipment."<sup>126</sup> This is an impressive development for a company that is only six years old. Yet the vast majority of Union Grand Energy's business appears to be just with Socar.

As substantial profits may be earned by UGE-Lancer, it is necessary to ask what justified the state company to

<sup>v</sup> Original reporting also confused the spelling of the company, writing "UGE-Lanser" and reported the company as being German.



Yola Monakhov/Panos

#### WHY DID SOCAR SIGN A PRODUCTION SHARING AGREEMENT IN 2011 WITH AN OBSCURE SINGAPOREAN COMPANY?

partner with this young private company? Production sharing agreements between a state and a private company are common in the oil industry, but what was UGE-Lancer agreeing to provide in return? Its parent company claims that it is a “leading company” in the region, but why was this company selected over more established and better-known players? As no details about the tender (or even whether there was one) or the contract have been published, it is not possible to say.

At the time the deal was signed, Socar suggested that UGE-Lancer was to invest US\$1 billion into the project.<sup>127</sup> But UGE-Lancer has filed “dormant” accounts from its first published accounts for the financial year ending June 2009 to its last (as of October 2013) which were for the year ending December 2011.<sup>128</sup> This is a declaration that it has not been involved in any business activity or investment up until the end of 2011. Media reports since then,<sup>129</sup> and the fact that UGE-Lancer paid a signature bonus in February 2012 of US\$2 million,<sup>130</sup> suggests that the oil fields are now currently active.

In January 2013, UGE-Lancer announced its intention to join the EITI and submit reports based on the initiative’s transparency requirements.<sup>131</sup> In the same month, its parent company Union Grand Energy changed its shareholder from Anar Aliyev to a UAE-registered company called Horizon Investments Hld FZE. As the UAE does not list shareholders, the new owner is secret.<sup>132</sup> So Anar Aliyev has disappeared from the shareholding registry of both Union Grand Energy and Heritage General Trading, the company that formerly held shares in Socar Trading SA. It is unclear why these changes were made, but the timing was ironic: just as UGE-Lancer committed to the

transparency of publishing the revenues it pays to the government, its ownership was made more opaque.

In short, the Azerbaijani public has no idea who will benefit from Union Grand Energy’s joint ventures and production sharing agreements with Socar, as its current owners remain undisclosed.

Global Witness has made several attempts to contact Anar Aliyev for his comment on these matters (see p15). We received no response. Global Witness wrote to Socar, which did not answer our specific question on this subject, and UGE-Lancer’s parent company, Union Grand Energy, which did not respond. A representative from UGE-Lancer was on the attendance list at the EITI ten-year anniversary conference in Baku in September 2013, but it appears that he did not attend.<sup>133</sup>

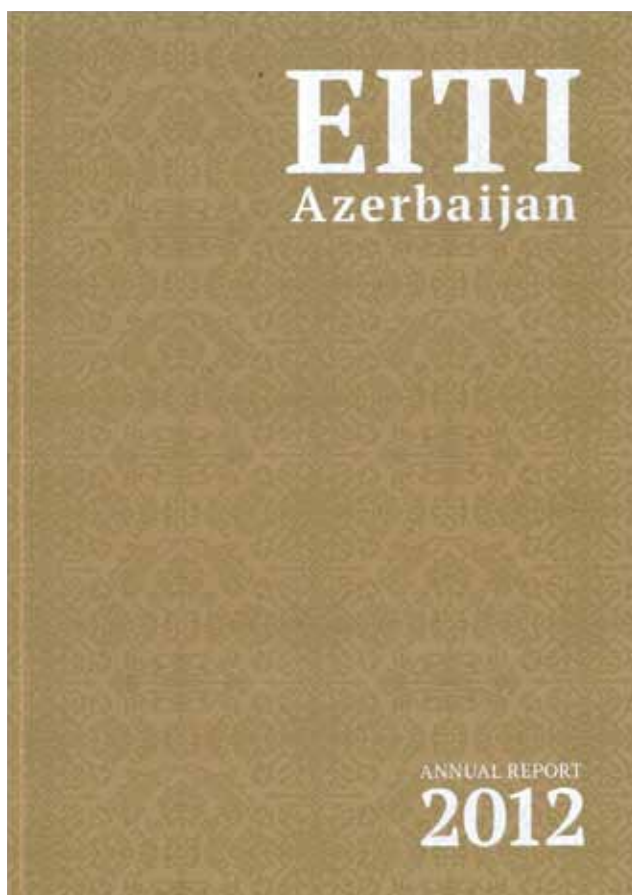
The new 2013 EITI rules (see Annex 1, p33) state that implementing countries should disclose information “related to the award or transfer of licences”. Although this requirement is not backdated, the concerns raised in this report suggest that the Azerbaijani government should include UGE-Lancer when fulfilling this new requirement.

Finally, the new rules encourage the public disclosure of “any contracts and licences that provide the terms attached to the exploitation of oil, gas and minerals”. If Azerbaijan wants to continue to be at the forefront of the EITI and wishes to dispel any concerns about the potential for corruption, it should implement this proposal immediately by publishing the product sharing agreement contract struck between UGE-Lancer and Socar.

# THREE STEPS TOWARDS TRANSPARENCY: “IF YOU STOP PEDALLING, YOU FALL OFF”

These case studies highlight opacity in Azerbaijan’s state oil company Socar. If, in a country where the EITI has been welcomed by government, a major state-owned company remains opaque in its dealings then new measures must be taken to improve transparency. The Azerbaijani government needs to demonstrate that the EITI is not a façade for deflecting attention from the type of opaque deals we highlight in this report.

This section sets out three steps towards a transparent and well-run oil industry. These steps should be made in a continual effort to improve, not to tick a box and then do nothing. As an Azerbaijani civil society member engaged in the EITI process wrote: “Implementing EITI is like riding a bicycle. If you stop pedalling, you fall off.”<sup>134</sup>



EITI REPORTS IN AZERBAIJAN: ‘THE THINNEST IN THE WORLD’ ACCORDING TO THE REVENUE WATCH INSTITUTE.

Firstly, governments should strive to ensure that the EITI process in its initial form is as strong as it possibly can be. Although Azerbaijan has been validated as EITI-compliant, there is still much room for improvement (see Annex 1, p31).

Secondly, Azerbaijan must fully implement new EITI requirements and encouragements agreed in May 2013 (see p33).

The EITI’s initial remit focussed on the revenues accrued from resource extraction. While information on revenues paid by a private company to government is a necessity, these payments must be meaningfully disaggregated on a project-by-project<sup>135</sup> basis to be of real value. The new standard requires project level disaggregation of revenue payments and Azerbaijan should implement this as soon as possible.

It is also vital for citizens to know more about how companies are selected in order to assess whether they were chosen fairly, whether they have the necessary expertise and ability, and whether their involvement is likely to have a beneficial effect overall. Azerbaijan should ensure it meets all the requirements regarding registers of licence holders and transparent allocation processes in time for its second validation in 2015.

The Azerbaijani government should follow best practice procedures for the selection of companies through open and transparent public tenders, as Global Witness outlined in *The Citizens’ Checklist*, published in 2011.<sup>136</sup> The checklist, currently available in English, French and Russian, contains recommendations on how the extractive licensing process (the selection of companies) should be made public.

Citizens should also know who owns the companies involved in resource deals, as it is these people who are in a position to benefit financially from the country’s natural resources. Azerbaijan should implement the disclosure of beneficial ownership of companies as quickly as possible to ensure an operational, effective working standard is in place by 2016,<sup>137</sup> when this encouragement is due to become a requirement.





Global Witness

#### BAKU: A CITY BUILT ON OIL.

The Azerbaijani government should also disclose contracts and consider making contract transparency part of national legislation. This has already happened in Niger, Guinea and Liberia, among others.<sup>138</sup> Contract transparency has not been addressed in depth in this report; Revenue Watch Institute's *Contracts Confidential* is recommended reading on this matter.<sup>139</sup>

All companies and governments of EITI-implementing countries should embrace these innovations and make them work. It is now up to EITI countries' multi-stakeholder groups and the international EITI board to ensure that these new rules are implemented effectively and serve as a basis for continued strengthening of the standard in the future.

Yet even if this happens, this is not the end of the story: other areas of the oil industry outside EITI's remit will still remain susceptible to malpractice.

So, thirdly, countries such as Azerbaijan should go beyond the EITI by practising transparency throughout their value chain. Although EITI currently covers companies involved in the upstream process – oil and gas exploration, extraction and production – this report demonstrates how huge revenues can be accrued by companies involved elsewhere in the oil business.

Though the new EITI rules will require disclosure of the volumes sold and the revenues accrued from the sale of oil by the government and state-owned enterprises, they will not cover the downstream activities of non-state-owned companies such as former Azeri oil trader Sumato Energy. Yet when large profits can potentially be made by unknown individuals the need for continued efforts to promote transparency in the public interest is clear.

The EITI has been revolutionary in shining a light on a traditionally opaque business. It should not be viewed as a panacea against corruption, but rather as a necessary first step in an on-going process.

# CONCLUSION

This report has highlighted the alarming lack of transparency in certain deals struck by Socar, the state oil company of Azerbaijan. It demonstrates that, currently, a country can be perceived to have a relatively good record when it comes to implementing the EITI but needs to go much further to create meaningful transparency and accountability. Countries must do this not only by meeting new requirements and encouragements but by responding to citizens' demands for information in other critical areas. This research raises serious questions about the nature of resource deals, questions which, unanswered, generate suspicion of corruption and wrongdoing. Such suspicions can only be dispelled through more comprehensive disclosure.

This report thus poses a challenge not only for the Azerbaijani government, but also for the EITI. Launched in 2002, the initiative has been a vital first step in the disclosure of some information, namely the amounts of revenues resource-rich countries are earning from their oil, gas and minerals. Yet our findings suggest that for the EITI to have a truly lasting impact it must continue evolving. As a recent report on the EITI concluded:

*[EITI] Compliance has long been treated as an end-state and a country only has to continue publishing EITI reports, as well as an annual report by the MSG [multi-stakeholder group] on its activities. The biggest challenge for the EITI is the creation of incentives which prompt governments and MSGs to go further, given that Compliance in itself does not necessarily equate to wider reform.<sup>140</sup>*

New rules introduced in the EITI in May 2013 require further disclosure, but do not necessarily create incentives which prompt governments to go further still.

If the EITI wants to tackle corruption and create accountability by shining a light on aspects of a business that have been historically opaque, it needs to make its rules as strong as possible so that countries that are not truly interested in transparency are not given a free pass. If countries like Azerbaijan do not address serious transparency gaps through their EITI reporting, not only will the credibility of the EITI be threatened, but citizens will remain in the dark about who is benefitting from their natural resource wealth.



LASTING BENEFITS FROM OIL ONLY ARISE OUT OF TRANSPARENCY, GOOD GOVERNANCE AND ACCOUNTABILITY.

# ANNEX 1

## The EITI in Azerbaijan: a patchy record

Azerbaijan was validated as EITI-compliant in 2009 and will undergo its second validation process in 2015, assessed by an independent observer. Although Azerbaijan is perceived to have a good record<sup>141</sup>: Although Azerbaijan is perceived to have a good record, there is still much room for improvement in the current EITI process in Azerbaijan.

### A free and independent civil society

A key tenet of the EITI is that civil society must be independent and allowed to operate freely; effective transparency requires unrestricted reporting and the freedom to openly discuss the EITI data, its shortfalls and implications. It is therefore disturbing to note that since 2008 Azerbaijan has seen many journalists jailed on fabricated charges<sup>141</sup> and other members of civil society harassed and arrested.<sup>142</sup>

In February 2013, Ilgar Mammadov, an Azerbaijani opposition leader and a member of the advisory board of the Revenue Watch Institute, which is a member of the international EITI multi-stakeholder group coalition, was arrested for allegedly inciting riots. Amnesty International called the charges “trumped up” and bearing “all the hallmarks of a politically motivated prosecution”.<sup>143</sup> This was brought to the attention of the international board of the EITI by the Revenue Watch Institute and other organisations in 2013.

In its 2012 report on Human Rights in Azerbaijan, the US State Department commented that the most significant human rights problems in the country included:

*Restrictions on freedom of expression, including intimidation, arrest, and use of force against journalists and human rights and democracy activists online and offline. [...] Unfair administration of justice, including continued reports of arbitrary arrest and detention, politically motivated imprisonment, lack of due process, executive influence over the judiciary [...] reports of torture and abuse in police or military custody that resulted in at least four deaths [...] continued official impediments to the registration of human rights nongovernmental organizations (NGOs)<sup>144</sup>*



PA/AP

FREEDOM OF SPEECH AND PUBLIC ASSEMBLY ARE SEVERELY CURTAILED IN AZERBAIJAN.

The Azerbaijani government has also been criticised by the European Union for passing a law in 2013 that makes defamation on the internet a criminal offence, punishable by imprisonment. The Council of Europe Commissioner for Human Rights warned of the “chilling effect that these provisions are bound to have on those wishing to use the Internet to raise legitimate critical voices”.<sup>145</sup>

### An equal partnership and engagement with government entities

EITI’s great strength is that it has enabled civil society, companies and governments<sup>146</sup> to open up the issue of oil revenues for public discussion within a mutually agreed forum. As one Azerbaijani civil society activist commented in 2009: “Five to six years ago [circa 2003], even discussing extractive industries revenues was taboo. Under EITI, it is not.”<sup>147</sup> All stakeholders (government, companies and civil society) must be equal partners within EITI, but in 2009, some six years after Azerbaijan signed up to EITI, a report by researchers from Princeton University, assisted by Global Witness, highlighted that some members of civil society in Azerbaijan felt that they were merely observers in the transparency process, and not equal partners.<sup>148</sup> Furthermore:

*Several stakeholders agree that interest in the EITI is waning among coalition members. However, Coalition members assert that this waning of interest [in EITI] is a direct result of government officials not taking CSO [civil society organisations] recommendations seriously.<sup>149</sup>*

[...]



© SERGEI ILNITSKY/epa/Corbis

## OIL: A BLESSING OR A CURSE?

*Stakeholders report that only a few, high-level people in government know about EITI and only rarely respond to CSO and media enquiries.<sup>150</sup>*

*[...]*

*CSOs active in the EITI are mostly free to express opinions, but there is a difference between the government listening to and acting on proposed solutions.<sup>151</sup>*

The situation does not appear to have improved since 2009: a representative from Azerbaijani civil society confirmed in 2013 that interest in EITI among government officials and politicians remained low, and that no ministers or members of parliament attended the EITI ten-year anniversary conference in Baku in September 2013.<sup>152</sup>

A second highlighted his impression that the state oil company Socar lacks the willingness to fully engage, saying: “We write but they never reply.”<sup>153</sup> A third commented: “EITI is a toy given to CSOs to play the game, not to stop corruption.”<sup>154</sup>

### Report quality, readability and communication

There are longstanding complaints concerning the quality of Azerbaijan’s EITI reports. According to the 2009 Princeton University report: “Civil society is legitimately critical of consistent patterns of delayed reports and divergent figures, which have plagued EITI reporting in Azerbaijan since its inception.”<sup>155</sup> Global Witness’ conversations with members of

Azerbaijani civil society in 2013 indicate that these problems persist.<sup>156</sup>

In 2013, a commentator from the Revenue Watch Institute said: “Azerbaijan’s EITI reports are the thinnest in the world,”<sup>157</sup> and the World Bank, though acknowledging Azerbaijan’s positive developments by implementing the initiative, stated in 2011 that “there are concerns that EITI reports are unreadable by non-experts”.<sup>158</sup> The government must make steps to improve the quality and readability of its reports.

EITI reports are supposed to be “comprehensible, actively promoted, publicly accessible, and contribute to public debate”. In Azerbaijan, EITI reports are published on the websites of state oil fund Sofaz and the EITI civil society coalition. But although they are printed in Azerbaijani and English, the Princeton researchers found there were no plans to distribute the reports.<sup>159</sup> More recent conversations with Azerbaijani civil society confirmed that public dissemination continues to be a problem.<sup>160</sup>

### Disaggregated information

One final but vital issue raised by civil society is the lack of “disaggregated” information in the country’s EITI reports. The information disclosed does not currently break down payments from different companies or give the monetary value of in-kind payments – an important point, given the size of in-kind payments in Azerbaijan (for example, payments in oil), estimated by Revenue Watch Institute to be around 70% of total government revenue in 2010.<sup>161</sup>



The Revenue Watch report comments:

*In countries that participate in EITI, the full disclosure and reconciliation of crude sales should be mandatory. [...] Aggregate or incomplete data hold less promise. Existing EITI reports illustrate several methods for reporting on production share earnings that fall short of a useful standard:*

*Azerbaijan, Cameroon and Congo-Brazzaville provide only the number of barrels that constitute their production share and in-kind revenue. Citizens*

*have no way of knowing what the NOC [National Oil Company] did with that oil or the monetary value it generated.*<sup>162</sup>

The new EITI rules require the disaggregation of payments by each company, government entity and revenue stream on a project-by-project level, including the monetary value of in-kind payments, something the Azerbaijani government has been resisting.<sup>163</sup> In relations to its oil sales, Azerbaijan should go beyond these new requirements and disaggregate its data by at least product, price, market, and sale volume.

## EITI's new rules, 2013

Changes were agreed in May 2013<sup>164</sup> to broaden the EITI approach and deepen the level of data disclosed, divided into requirements and encouragements:

### New requirements

- EITI data must be presented on a project-by-project basis by each individual company, government entity and revenue stream. This project-level reporting complements similar disclosure requirements of section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the European Union Accounting and Transparency Directives to collectively lay the foundations of a global revenue disclosure standard.<sup>165</sup>
- Government and state-owned enterprises must disclose their level of beneficial ownership in oil, gas and mining companies operating within the country, including those held by their subsidiaries and joint ventures. This should include details of the terms of their stake.
- The volume and revenues of sales of state oil must be disclosed, with the data disaggregated by individual company, government entity and revenue stream, as well as on a project-by-project basis.
- Countries must maintain a publicly available register of licences, including the name of the company that holds the licence (but they are only encouraged to reveal the company's beneficial owner).

- Countries are required to describe the process for transferring or awarding licences, the technical and financial criteria used, and information about the recipient of the licence. In the case of a bidding process the list of applicants and bid criteria must be disclosed.

### New encouragements

- Countries are encouraged (but unfortunately not required as yet) to publicly disclose any contracts and licences that provide the terms attached to the exploitation of oil, gas and minerals.
- It is recommended that countries maintain a publicly available register of the beneficial ownership of those who bid, operate or invest in extractive assets. A beneficial owner means the natural person(s) who directly or indirectly ultimately owns or controls the company (see p20). In the case of joint ventures, each entity should disclose its beneficial owners. The aim is for this to become a requirement by 2016; until then countries are encouraged to pilot reporting of beneficial ownership.

These rules are a positive advance on EITI's previous remit, although the elements above that are currently only encouraged must become requirements if the EITI is to properly tackle these issues. The Azerbaijani government has indicated that although it aims to become the first country to be compliant with these new rules, it does not intend to support the implementation of any rules that are only encouragements and not requirements.<sup>166</sup>

# ANNEX 2

## List of companies with links to Anar Aliyev

Investigations by Global Witness have discovered that the Azerbaijan state-owned oil company, Socar, has been involved in at least 50 production sharing contracts, joint ventures or other deals linked to one man, Anar Aliyev (see p 13), with shareholdings in 48 of them. These deals, or the companies that hold them, are listed below. Further information about the nature of these links can be found on the Global Witness website. It should be noted that we make no allegation of wrongdoing with regard to these companies, their other shareholders and their activities.

1. Supra Holding Limited (Supra)
2. Socar Trading SA
3. ST Overseas DMCC
4. Supra Investments SA
5. Socar Aurora Terminals SA
6. Socar Aurora Fujairah Terminal FZE
7. Socar Trading S&L DMCC
8. Socar Trading Singapore PTE Ltd
9. Socar Black Sea SA
10. Socar Resources Ltd
11. Socar-UGE
12. Azgerneft LLC
13. Ekol Environmental Services CJSC (Ekol)
14. AzTurgaz JV
15. Caspian Drilling Company
16. Socar Energy Georgia LLC
17. Socar Georgia Petroleum
18. Socar Georgia Gas
19. Socar Georgia Security
20. Kulevi Oil Terminal
21. International Railway Expedition
22. AzLab
23. Socar Gulf GJSC
24. Socar Gas Supply Ltd
25. Socar Georgia Investments
26. Socar Petroleum CSJC
27. Neftchala Football Club
28. Neftchi Apartment Building
29. Becrux Investment & Finance BV
30. Agena Petroleum Holding BV
31. Socar Gas BV
32. Socar Petroleum SA
33. Socar Energy SRL
34. Socar HC Heavy Crane
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37. Core Energy FZE
38. UGE-Lancer Pte Ltd / Balakhani, Sabunchu, and Ramana oil fields PSA
39. Bahar Energy Limited / Bahar Gum Deniz PSA
40. Rafi Oil FZE / Surakhany PSA
41. Socar-CMS
42. Caspian Catering Service
43. Socar-CSCR MMC
44. Gulf Drilling Supply FZE
45. Socar Turkey Petrol Enerji Dagitim Sanayi ve Ticaret AS
46. Caspian Marine Construction
47. Caspian Shipyard Company LLC
48. Socar-Rodan
49. Socar Turkey Gaz Dagitim Sanayi Ve Ticaret Anonim Şirketi (which translates as Socar Gas Distribution Industry And Trade Co Turkey)
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## THE MYSTERY PARTNER OF AZERBAIJAN'S STATE OIL COMPANY?