COMMERCIAL LAWS OF ARMENIA
June 2012
AN ASSESSMENT BY THE EBRD

Office of the General Counsel

European Bank
for Reconstruction and Development

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Basis of Assessment: *This document draws on legal assessment work conducted by the Bank (see www.ebrd.com/law) and was last updated during the preparation of the 2012 EBRD Strategy for Armenia, reflecting the situation at that time. The assessment is also grounded on the experience of the Office of the General Counsel in working on legal reform and EBRD investment activities in Armenia and does not constitute legal advice. For further information please contact ltt@ebrd.com .*

1. Overall Assessment

Over the last decade, the Armenian authorities have made considerable efforts to upgrade the commercial, tax and financial legislation in order to improve the business environment. Measures to reduce unnecessary regulation and burdensome tax inspections on companies are under way. However, significant gaps in the legal and regulatory framework remain. In addition, as is often the case in early transition countries, implementation of the law by courts and officials remains an issue.

The company law framework was reformed in 2001. Most recently in 2010 a corporate governance code has been prepared with the assistance of EBRD. The code now needs to be used on a wider basis. The law of secured transactions has been improved in relation to immovable assets with the introduction of an effective registration system (yet to be digitised), but requires improvement in the area of movable assets. Insolvency law has been modified with improvements in certain areas (e.g. commencement of insolvency proceedings, treatment of creditors, reorganisation and liquidation proceedings), but remains weak in other areas (e.g. financing of reorganisation or avoidance of pre-insolvency transactions).

Despite the recent introduction of a Law on Electronic Communications, key aspects of best practice in the sector appears largely absent, particularly in such areas as number portability, local loop unbundling or wholesale broadband. The EBRD is currently working with the Armenian authorities to assist in resolving some of these issues. In the energy sector the effective implementation of efficiency measures requires a review of the legal and institutional environment. The Armenian government has sought EBRD's assistance on this issue in relation to the housing sector. PPPs and concessions are not specifically regulated. The absence of a clear legal and regulatory framework is an obstacle to the funding of projects. Finally, whereas Armenia has adopted a law on procurement in 2010, its effective implementation will require further efforts to increase capacity among procurement officials.

2. The Legal System

2.1 Constitution and courts

The Republic of Armenia adopted its Constitution in 1995 after it became independent from the Soviet Union in 1991. The Constitution was revised in 2005. The Constitution declares a division of power among the executive, legislative and judicial branches, providing also for an independent judiciary and personal freedoms.

The President of the Republic is directly elected by the public for a five-year term. The President is the head of the country and is empowered *inter alia* to: sign and promulgate laws passed by the National Assembly; dissolve the National Assembly and designate special elections after consultations with the President of the National Assembly and the Prime Minister; appoint the Prime Minister and the members of the Government.

The Government of Armenia holds the executive power. Meetings of the Government are chaired by the President unless the President recommends that the Prime Minister should do so. Government decisions are signed by the Prime Minister and approved by the President. The National Assembly may authorise the Government to adopt resolutions that have the effect of law, provided they do not contravene the existing laws. Such resolutions must be signed by the President of the Republic.

Legislative power in Armenia is vested in the National Assembly constituted of 131 deputies. The Deputies and the Government have the right of legislative initiative. The National Assembly also supervises the implementation of the state budget, as well as of the use of loans and credits received from foreign governments and international organisations.

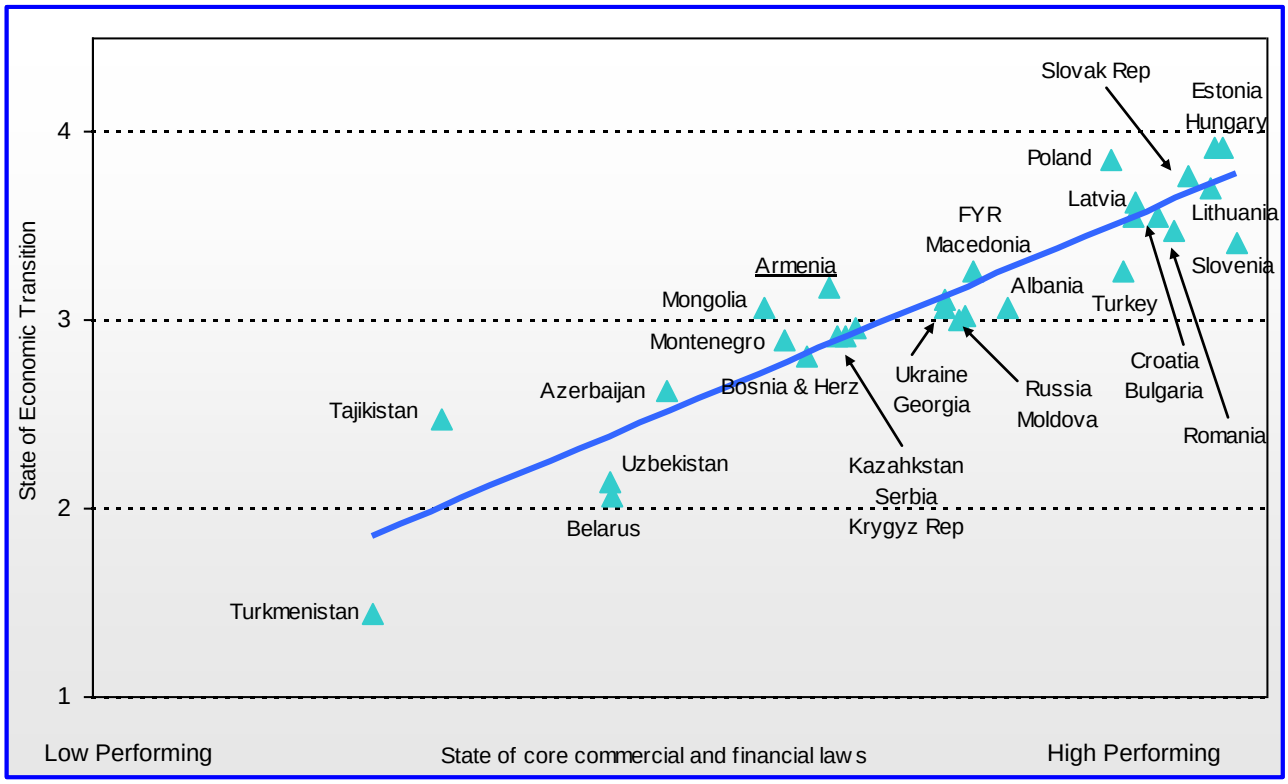
The Armenian court system is regulated by the Judicial Code adopted in 2007 and substantially amended in 2009. The Code provides for a three-tiered courts system, comprising courts of first instance, courts of appeal and the Court of Cassation. First instance courts are of general jurisdiction, whereas the appellate courts have criminal and civil divisions, the latter also hearing appeals in commercial matters. The Court of Cassation is the highest court, except for with regards to constitutional matters.

The Constitutional Court consists of nine members, five appointed by Parliament and four by the President. The Constitutional Court decides mostly in regard to constitutional matters, including: the constitutionality of laws, regulations and other acts adopted by the National Assembly, President or Government; and compliance with the Constitution of international treaties that Armenia intends to enter into.

2.2 Relationship between legal transition and economic progress

Experience in transition countries suggests that advances in law reform and economic development progress or regress hand in hand. Given the positive correlations throughout the Bank's countries of operations between legal transition, on the one hand, and overall economic progress, on the other hand, it is reasonable to expect that the future success of the transition process in Armenia will depend in part on the country's ability to strengthen the rule of law and improve the quality of courts.

Chart 1 – Rule of law and progress in transition in the EBRD countries of operations



***Source**: EBRD Transition Report 2010 Table 1.1; EBRD Composite Country Law Index, July 2011*

***Note**: The **horizontal axis** measures the performance of commercial and financial laws. The **vertical axis** displays the EBRD transition index as an average of transition indicators between 1997 and 2010 with 1 referring to very early transition stages, and 4 referring to an advanced transition level.*

2.3 Recent developments in the investment climate

The Armenian legislative act governing investment was initially passed in 1994, however due to its ambiguity and a number of legislative gaps a new law was passed in 2000. In general, the legislation on paper provides some favourable aspects that in theory should assist with attracting foreign investment. In particular, according to the legislation, foreign and Armenian investors receive equal treatment. Based on the legislative provisions 100% foreign participation is possible in any sector of the economy; however foreign investors will need a licence in order to operate in certain sectors, such as banking and insurance. Furthermore, the legislation offers protection against nationalisation; expropriation and confiscation by the state is allowed only in extreme circumstances and full compensation is guaranteed by the law. In addition, if provisions of the legislation change, foreign investments may remain subject to the laws existing at the time they were made for a period of up to five years.

The government has expressed its favourable attitude toward foreign investment on numerous occasions and has taken active steps in order to develop and improve the investment climate. One of the most significant events occurred when Armenia joined the World Trade Organisation (WTO) in 2002 and became a member in the Multilateral Investment Guarantee Agency (MIGA) of the World Bank. Also, the government has established the Armenia Development Agency (ADA) which is designed to be a one-stop shop for all investor needs. One of the main aims of the ADA is to facilitate foreign investment and promote exports.

Armenia's efforts have been noted in the World Bank's Doing Business Reports as it has been improving its ratings for the last couple of years. In the 2012 edition of the Report, Armenia ranked 55th out of the 183 economies in the world and was among the top 10 most improved economies across 3 or more areas measured by the Doing Business Report 2010/2011.

At the same time, excessive regulations remain a difficult obstacle to investment with over 25,000 legal norms in effect at the national level. Although many of these legal norms are well designed, there are inconsistencies, contradictions and complexities in the legal framework that are burdensome for citizens and businesses. A regulatory guillotine, announced by the government in June 2011, should help reduce obstacles to doing business and further improve the business environment.

Another persistent transition gap affecting the investment climate is the lack of investor confidence in the judiciary, despite recent institutional reforms and intensive technical assistance by external aid providers. This situation was reflected in the 2011 *EBRD – World Bank Business Environment and Enterprise Performance Survey* (BEEPS), which indicated that only 33% of business respondents considered the courts to be fair and impartial.

Furthermore, an additional obstacle to foreign direct investment is the Nagorno-Karabakh situation, which has led to an economic blockade by the two most economically powerful regional states—Turkey and Azerbaijan.[1]

[1] Country Intelligence Report, Armenia, Global Insight. 18 April 2012.

2.4 Freedom of Information

Article 24 of The Constitution of 1995 states:
'Everyone is entitled to freedom of speech, including the freedom to seek, receive and disseminate information and ideas through any medium of information, regardless of State borders'.

The main aspect of the legal framework now governing Freedom of Information in Armenia (FOI) in Armenia is the Law on Freedom of Information approved by the Parliament on 23 September 2003 and in force in November 2003. The law allows for citizens to demand information from state and local bodies, state offices, organisations financed by the state budget, private organisations of public importance and state officials. The bodies must normally provide the information within five days from the date of the request. Oral requests are required to be responded to immediately.

Public bodies must appoint an official responsible for the implementation of the law. They must also publish information annually relating to the activities and services, budget, forms, lists of personnel (including education and salary), recruitment procedures, lists of information, program of public events, and information on the use of the Act. If the body maintains an official web site, then it must publish the information on the site.

Article 8 of the Law "On Freedom of Information" contains five categories of information that can be exempted from release. These apply in cases where the information:

1. contains state, official, bank or trade secrets
2. infringes the privacy of a person and his family, including the privacy of correspondence, telephone conversations, post, telegraph and other transmissions
3. contains pre-investigation data not subject to publicity
4. discloses data that requires limits on accessibility limitation conditioned by professional activity (medical, notary, attorney secrets)
5. infringes copyright and associated rights

The 5 exemptions are mandatory and are not subject to a requirement that harm to the public interest must be shown or that the public interest must be satisfied before the information is withheld.

Aside from the above appeals a denial for access to information can be made to the Office of the Human Rights Ombudsman. Several cases have also been referred to the Armenian courts.

A draft law on freedom of information was published in 2009 by the European Commission for Democracy through law (The Venice Commission). At present this draft has not been enacted and the law enacted in 2003 is still in force.

3. Evaluation of selected commercial laws

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: concessions, corporate governance, energy, insolvency, judicial capacity, public procurement, secured transactions, securities markets and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of such laws (also referred to as "effectiveness"). This section presents a summary of the results accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

All available results of these assessments can be found at www.ebrd.com/law.

3.1 Concessions

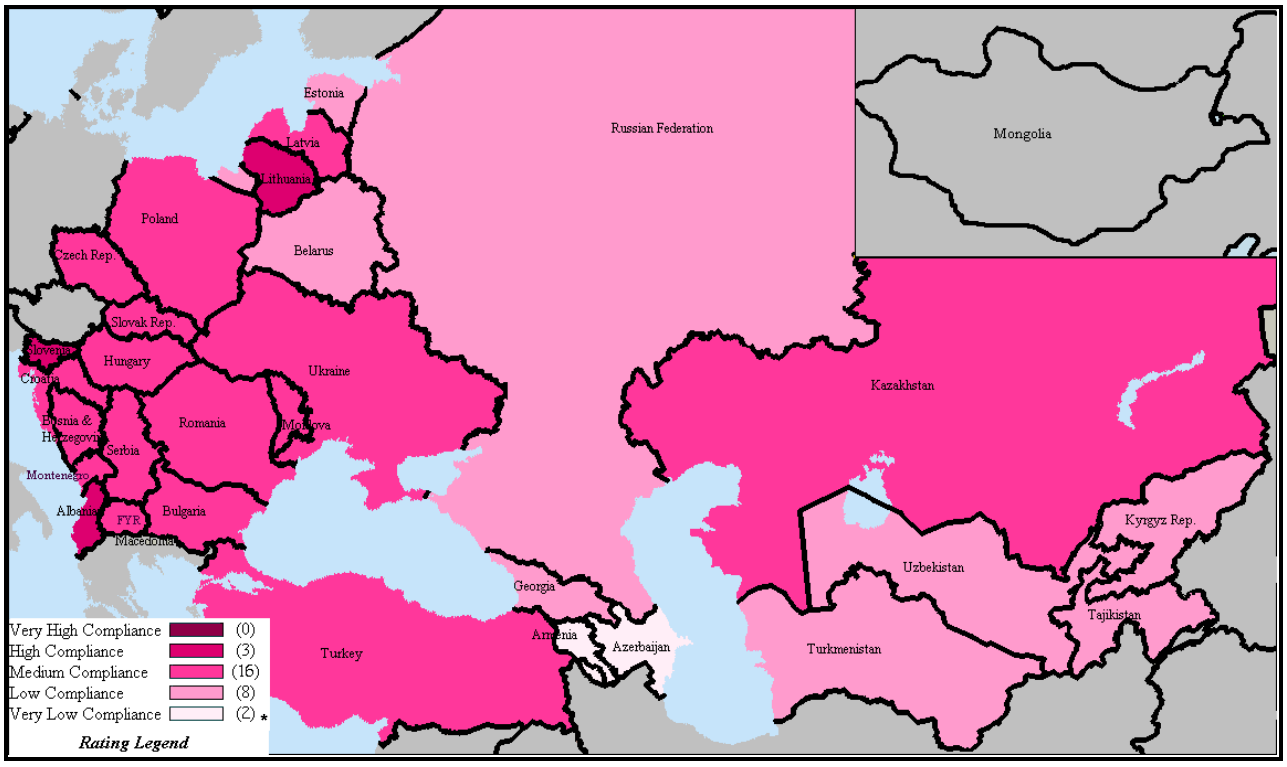
PPP is neither regulated nor clearly recognised or promoted at the policy level; concession is normally referred to as a natural resources license and not to public works or services. However, an implied general policy framework for improving the legal environment and promoting private sector participation in public works and services has been identified for example in the Poverty Reduction Strategy.

The most recent EBRD Concessions Sector Assessment has found the quality of concessions legislation to be in very low compliance with international standards (see Chart 2 below). Armenia does not have a general concession law. General laws do not refer to or regulate concessions apart from the general reference in the Law on Foreign Investments providing for concession as one of the forms of foreign investments. Two sector-specific laws regulate concessions, the mining and water sectors. In addition, there is also a reference to concessions in the Law on Railway Transport.

Even though concessions are referred to in the above sector laws the documents in question do not contain any clear modern definition of concessions and are very vague with regard to the selection procedures resting on the general principle that concessions are granted based on a competitive tender/auction. A positive feature of the water sector law is that the use of a template concession agreement is optional rather than binding. Government support and financial securities are defined in the general legislation such as the Civil Code and Law on Budgetary System, which recognise and provide for such elements. No clear reference is made to international arbitration for concession arrangements while the use of international arbitration is provided in privatisation contracts. The results of the EBRD Concessions Sector Assessment are illustrated in Chart 3 below.

Armenia remains one of the only few EBRD countries of operations where there has been no clear PPP policy, legal/regulatory and institutional Concessions framework. When properly designed and implemented, PPP may provide an invaluable source of additional private sector funding, capacity and resources to the country's infrastructure needs.

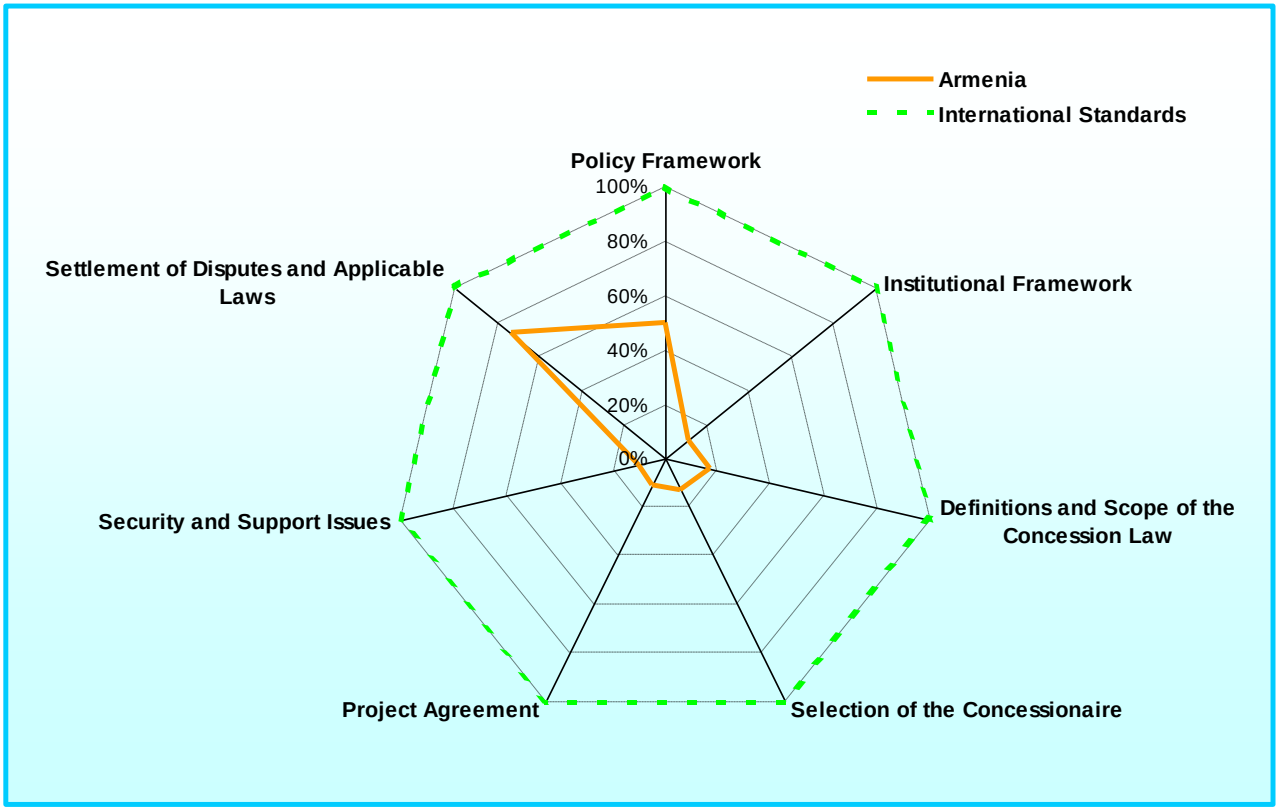
Chart 2 – Quality of concessions legislation in the EBRD countries of operations



***Source**: EBRD Concessions Sector Assessment 2007/08*

***Note**: The various categories represent the level of compliance of a given country's legislation ("the laws on the books") with international standards such as the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects. The asterisk indicates in which category Armenia ranks.*

Chart 3 – Quality of concessions legislation – Armenia (2007/8)



***Source**: EBRD Concessions Sector Assessment 2007/8*

***Note**: The extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.*

3.2 Corporate governance

The primary governing legislation for the corporate sector consists of the Civil Code, enacted in 1998, the Law on Joint-Stock Companies, enacted in 2001, the Law on Limited Liability Companies, enacted in 2001, and the Law on State Registration of Legal Entities, enacted in 2001, all as amended.

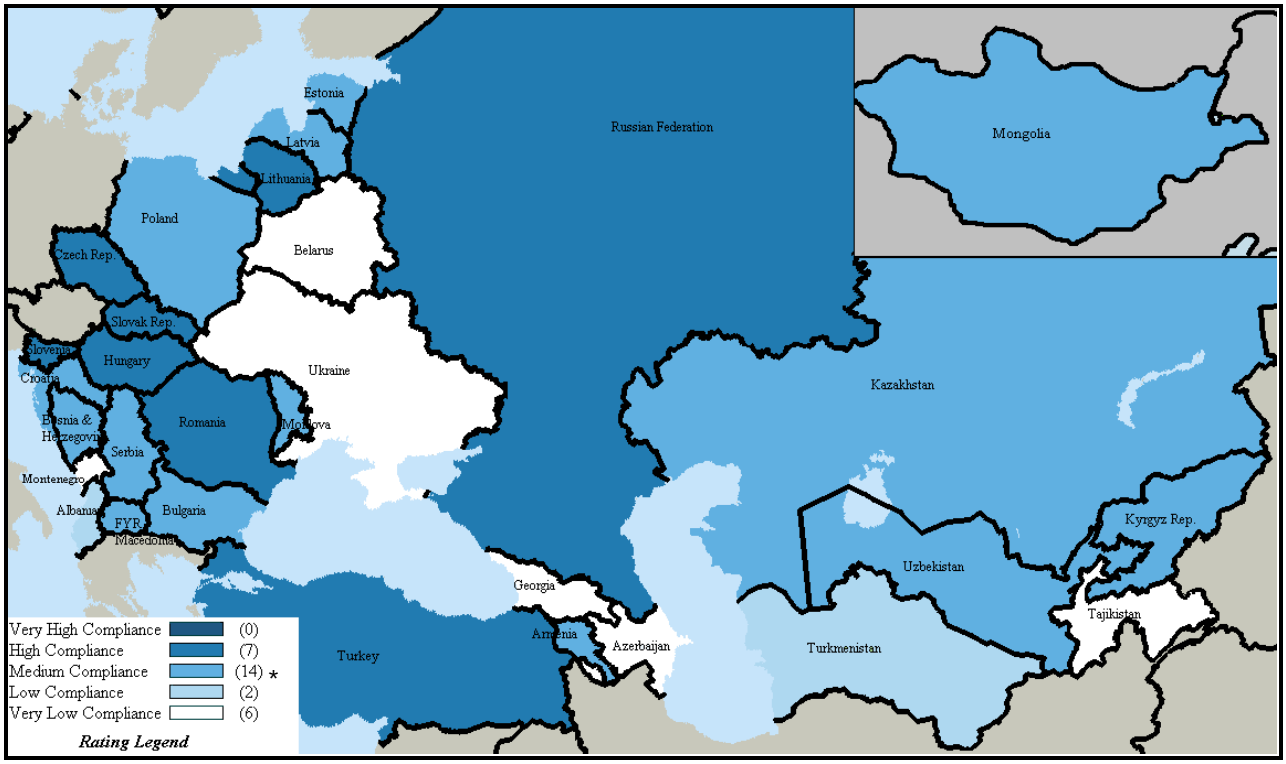
On 30 December, 2010, the Government approved a new Corporate Governance Code, prepared with the assistance of the EBRD. The code includes a reporting template, where companies are required to declare their compliance with the code's recommendations or explain the reasons for non compliance. On 23 June, 2011, the Government adopted Decree No 881 detailing the list of state owned enterprises that are required to report on the basis of the code. According to this Decree, the Code will apply to 416 state owned enterprises.

The 2007 EBRD assessment on corporate governance showed Armenia being in "Medium Compliance" with the OECD Principles of Corporate Governance (see Chart 4). Among the major shortcomings revealed by the assessment, it is worth noting the lack of exclusive shareholders' authority on increases of capital, the lack of specific provisions granting shareholders the right to ask questions and obtain answers at the general shareholders meeting, the lack of provisions regulating cross-shareholdings, the lack of transparency and weak disclosure – especially on related

party transactions and other key corporate governance issues - and unclear board responsibilities (see Chart 5). In recent years there have been a number of major reforms on corporate governance in Armenia, which have improved the framework. However, weak implementation and enforcement remain as the major weaknesses for an affective corporate governance system.
The EBRD is working with the Armenian Ministry of Economy towards the implementation of the new corporate governance code, approved by the Government at the end of 2010.

Having adopted a corporate governance code is not an end in itself, but the start of a process that should lead to better disclosure and transparency. It is now important that Armenian authorities commit the necessary time and resources in order to ensure proper implementation of the code so as to establish an active dialogue with companies and provide guidance on how to improve the companies' practices. This effort should contribute to the enhancement of ownership disclosure, shareholders rights and quality of information; to better monitor self-dealing and related party transactions; and to strengthen the oversight role of boards.

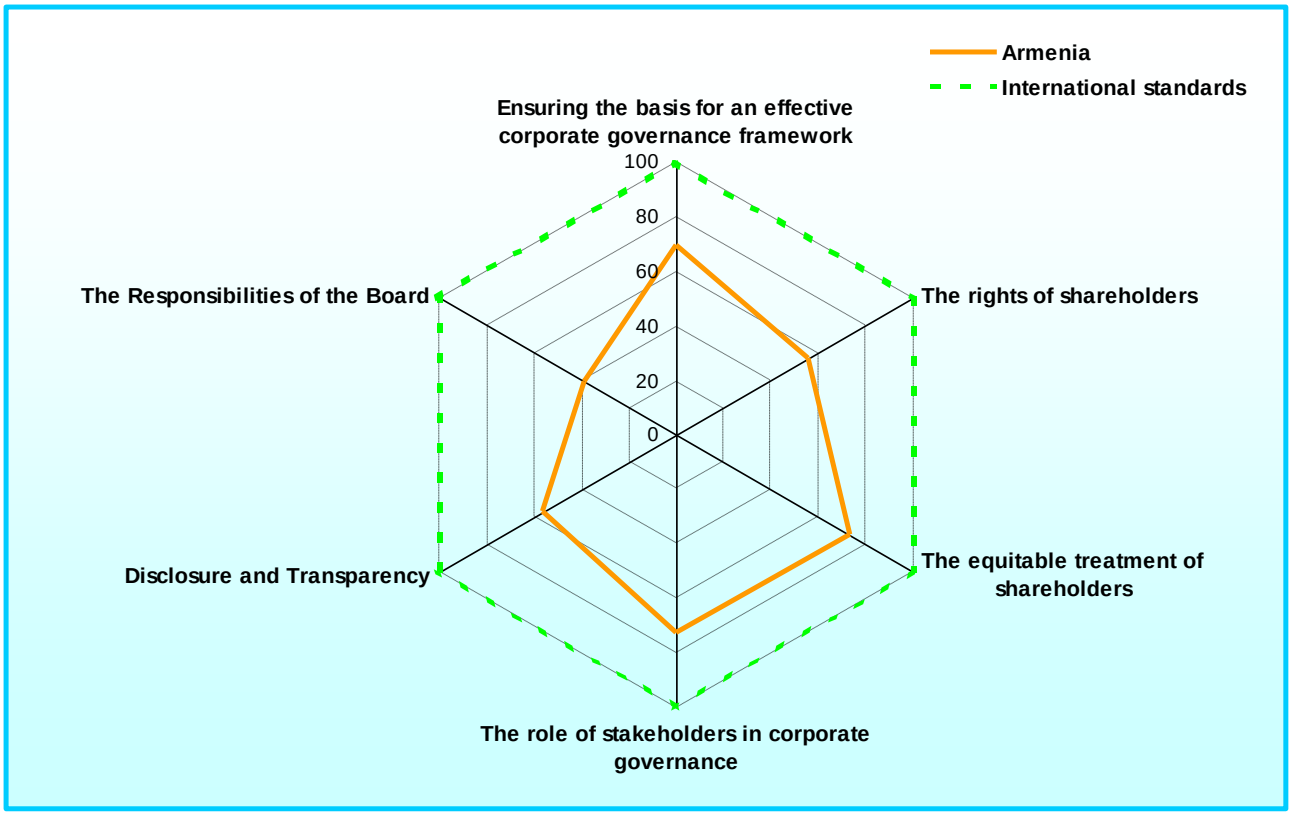
Chart 4 – Quality of corporate governance legislation in the EBRD countries of operations



***Source**: EBRD Corporate Governance Sector Assessment 2007*

***Note**: The various categories represent the level of compliance of a country's legislation (the "laws on the books") with international standards as set out in the OECD Principles of Corporate Governance. The asterisk indicates in which category Armenia ranks.*

Chart 5 – Quality of corporate governance legislation in Armenia (2007)



***Source**: EBRD Corporate Governance Sector Assessment 2007*

***Note**: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles.*

3.3 Energy

The main laws regulating the area of energy are the Condominium Law (2002) and Housing legislation. There is no specific legislation on the energy efficiency of buildings.

The 2009 EBRD assessment of energy legislation in Armenia has found that the institutional structure and the regulatory framework are well regulated by the law. The regulatory body, Armenian Public Services Regulatory Commission (PSCR), appears to be close to best standards both in terms of independence and authority. However, the assessment has identified legislative gaps in electricity network access and tariff structure. In particular, CJSC Armianskie Electroseti (AE) is the sole transmission company. Legislation requires that AE supplies electricity to any customer that meets the requirements set by PSRC. Non-discriminatory access to transmission and distribution networks is required. Thus far, only electricity exporters have made use of third-party access. The regulatory authority is responsible for setting tariffs and defining methodologies for tariff calculation. No subsidies or grants are provided to private or state companies to cover possible financial gaps and despite considerable preparatory work, a grid code has not yet been adopted (See Chart 6 below).

In the gas sector, the assessment found that third party access is established by law, with the PSRC responsible for ensuring that non-discriminatory conditions are applied by Armrosgazprom (a majority-Russian-owned company that, together with its subsidiaries, has complete control of the Armenian gas sector). The absence of regulated tariffs for third party access and the aforementioned

market conditions mean that third party access is not utilised in practice (Chart 7 illustrates quality of energy (gas) legislation in Armenia).

The residential sector in Armenia is one of the largest energy end-users in Armenia – using about 44% of electricity and 37% of heat from the country's total final consumption (IEA statistics, 2008). This figure, higher than most of the other transition countries, requires for urgent measures to be adopted by the government to reduce the energy spend in the urban housing sector.

The majority of Armenia's housing stock, especially in urban areas, consists of pre-fabricated multi-storey apartment buildings that are generally of poor construction, badly insulated and maintained and as a result provide a low level of energy efficiency and living comfort. Mostly based on the Russian GOST and SNIP standards, current construction standards and practices for residential buildings are behind the corresponding European and international standards and not effectively applied in the refurbishment of old and construction of new buildings.

EBRD's sector research (Armenia Market Demand Study conducted in September 2008 and the EBRD's assessment of sector legislation) concludes that there is significant potential for investment in energy efficiency measures in the residential sector provided the necessary regulatory changes are in place. Once introduced, the energy savings measures will also contribute to an increase of thermal comfort of the residents. However, shortcomings in the regulatory environment constitute a barrier to viable financing of energy efficiency in the building sector, and particularly the residential sub-sector. To facilitate potential private financing of energy efficiency opportunities, the government has sought the EBRD's help in examining the legal and institutional environment for urban housing stock to identify the gaps between the Armenian energy efficiency in buildings regulation and the international best practices. Based on the findings and recommendations of this project, the EBRD could assist the Armenian government in developing the necessary legal and regulatory framework that would unlock the energy efficiency project potential.

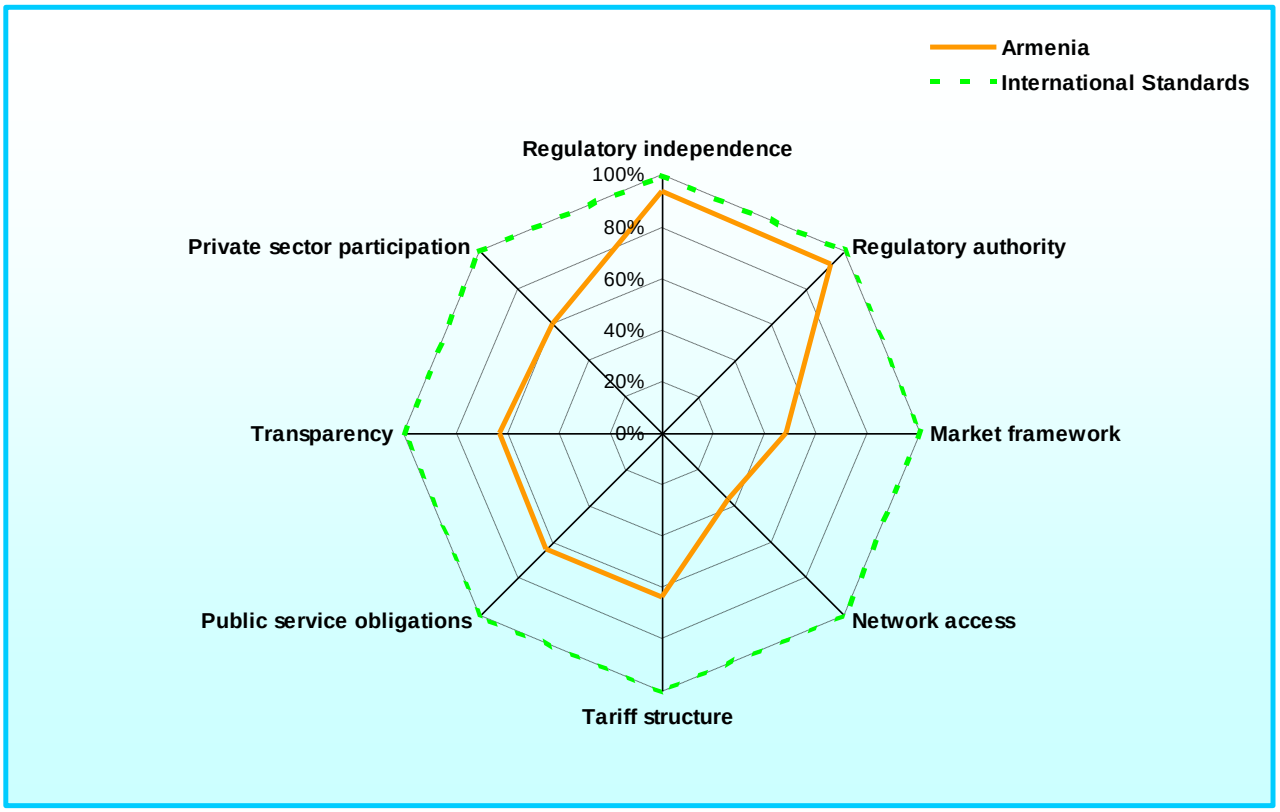
As reflected in its strategy for the energy sector in Armenia, the EBRD is interested in promoting energy efficiency and renewable energy production, thereby reducing energy intensity and diversifying supply sources in the country. An insufficient legal and regulatory framework for energy efficiency, however, has proven to be a significant barrier to energy efficiency investments in the residential sector. Furthermore, deficiencies in the housing legislation discourage borrowing by housing associations while lending to individuals remains unattractive to the commercial banks. During the forthcoming project, the EBRD will work directly with the relevant governmental institutions in Armenia in order to improve the policy, legal and regulatory framework for residential energy efficiency and thus facilitate the Bank's and private sector's investments in energy efficiency in Armenia.

Introducing improvements in the legal, regulatory and operational environment may result in a significant increase in energy efficiency and use of renewable energy in Armenia and thus, boost sector development.

EBRD's study will assess the overall legal, institutional and operational framework of urban housing stock in Armenia, making recommendations to enhance the framework. The project is phase one of a larger programme to implement the necessary legal and institutional changes, which would provide a comparative gap analysis with the best practice from other selected central and eastern European countries as well as identify opportunities for financing refurbishment of multi-storey housing stock, together with making recommendations on how a support programme could be structured. The findings from this phase one study would be used to assist the Ministry in drafting primary and secondary legislation on the energy performance of buildings, reviewing technical standards and improving the housing legislation.

The Armenian Ministry of Urban Development (the "Ministry") requested technical assistance with the development and enhancement of the legal and regulatory framework supporting energy efficiency in the building sector and assistance with identifying and addressing other sector deficiencies. The EBRD would recommend that the Ministry show continued support for the project and that it accepts and endorses the report's conclusions and legal reform recommendations.

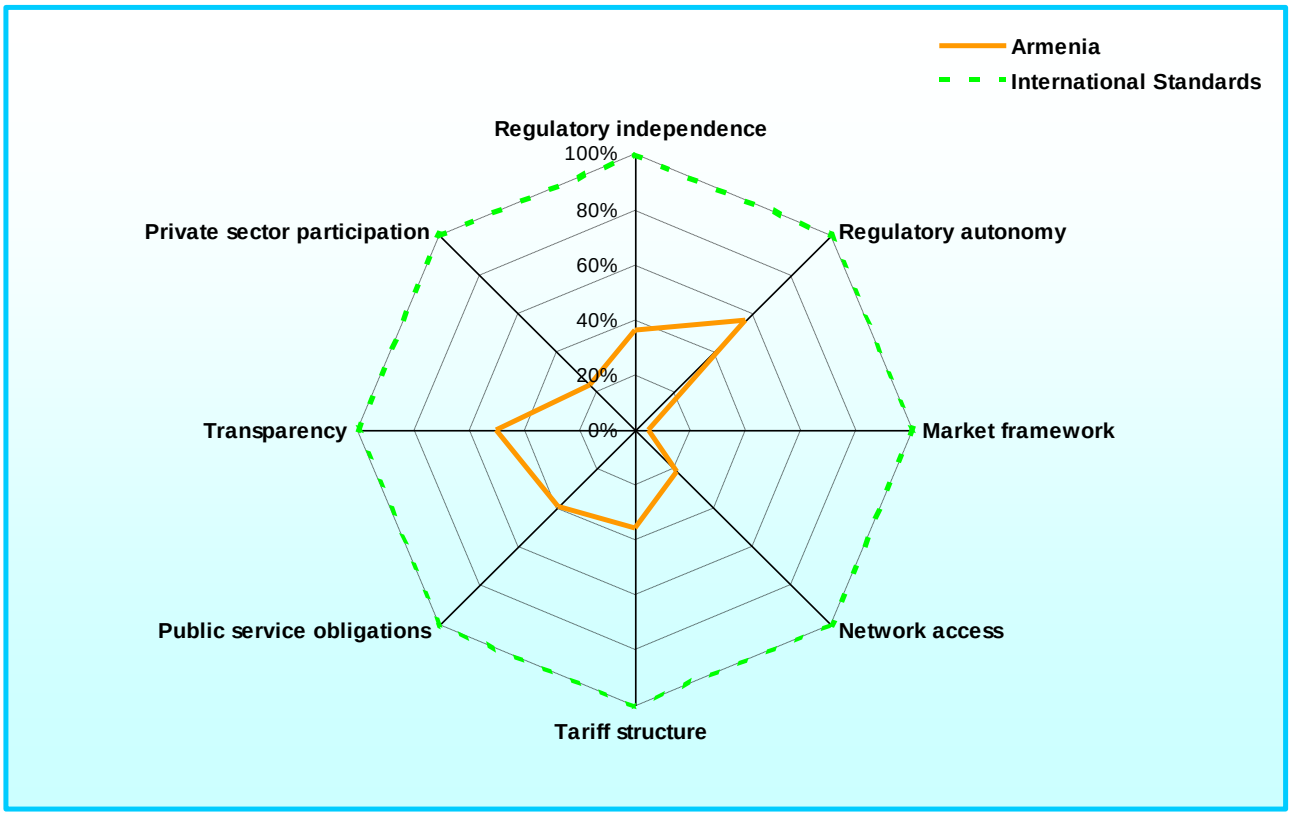
Chart 6 – Quality of energy (electricity) legislation in Armenia (2009)



Source: *EBRD Energy, law reform dimensions assessment project, 2009*

Note: *The extremity of each axis represents an ideal score i.e., corresponding to the benchmarks and indicators identified in the assessment model. The fuller the 'web', the more closely the energy laws of the country approximate these principles.*

Chart 7 – Quality of energy (gas) legislation in Armenia (2009)



Source: *EBRD Energy, law reform dimensions assessment project, 2009*

Note: *The extremity of each axis represents an ideal score i.e., corresponding to the benchmarks and indicators identified in the assessment model. The fuller the 'web', the more closely the energy laws of the country approximate these principles.*

3.4 Insolvency

Armenia adopted a new bankruptcy law in December 2006, the "New Insolvency Law" (hereinafter "the Law"). The Law is composed of 13 chapters and 107 articles. In addition to the Law, other legislation contains rules that are more general in nature. For example, the Civil Code of the Republic of Armenia includes articles related to when a citizen or a legal entity can generally be declared bankrupt.

The new Insolvency Law is considered an improvement from the previous regime. The 2009 EBRD Insolvency Sector Assessment concluded that Armenia is in medium compliance with international standards (see chart 6 below). The principal areas that have benefited from the new provisions are (1) the commencement of insolvency proceedings, (2) the treatment of creditors, (3) reorganisation proceedings, and (4) terminal proceedings (liquidation). More specifically, the Law includes changes that could make reorganisation of a distressed company more efficient and potentially maximise the recovery rate for creditors. The Law also introduces time limits for reorganisations, and gives creditors a greater say in the reorganisation process by allowing only creditors with approved claims (and not the debtor's owners) to vote on a plan.

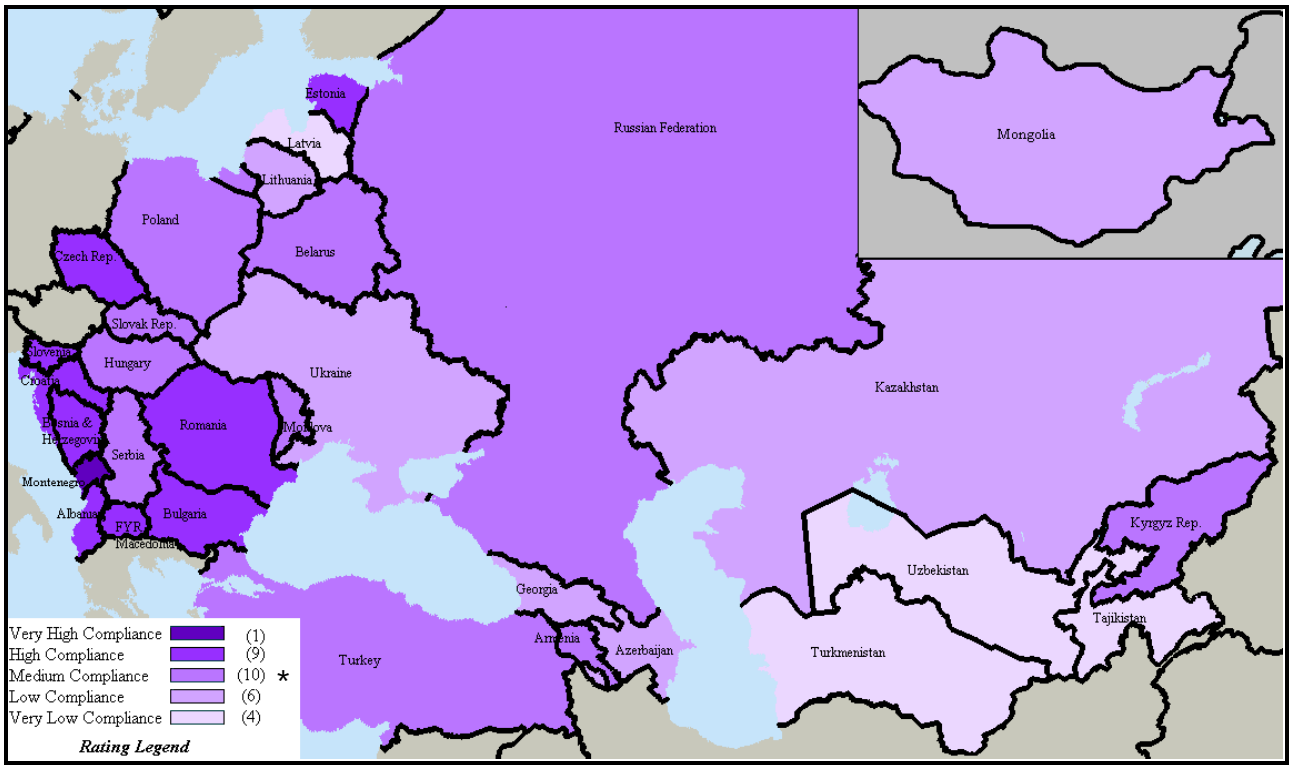
However, the law remains weak regarding the provision that provides material information to creditors, and also lacks a requirement for an independent analysis of a reorganisation plan that is

being proposed to creditors. Furthermore, there is no provision that would facilitate the financing of a proposed reorganisation (see Chart 7 below).

Other areas that would greatly benefit from further reform include the provisions dealing with the assets of the estate and the avoidance of pre-bankruptcy transactions. In many respects these are vague and create uncertainty. Additionally, the provisions that enable Armenia to deal with cross-border insolvency matters are also inadequate.

Lastly, the provisions relating to insolvency office holders in Armenia are inadequate particularly with regards to basic qualifications to act as an office holder. There are no provisions for licensing of office holders. Moreover, the profession lacks a professional work standard or code of ethics.

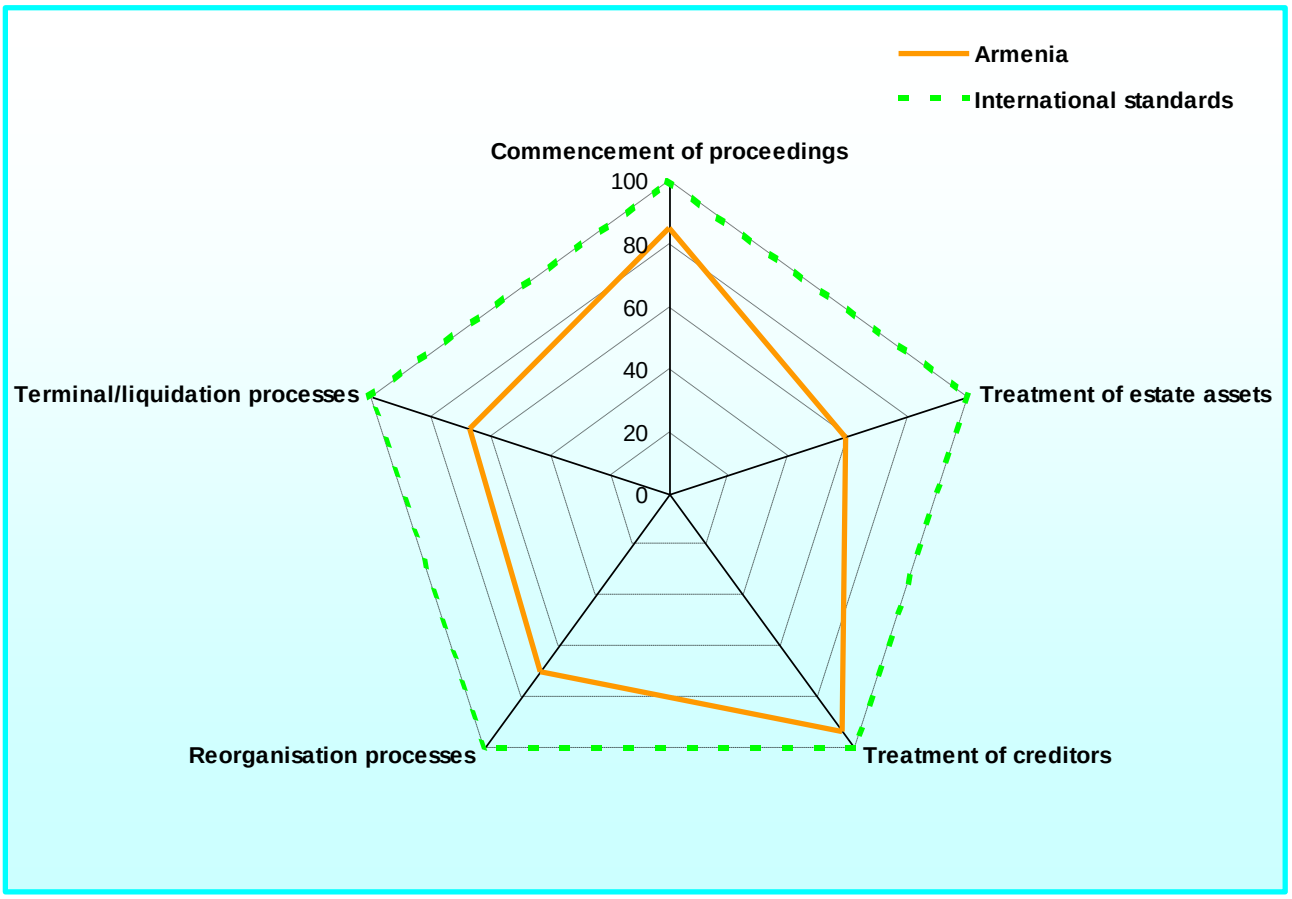
Chart 6 – Quality of insolvency legislation in the EBRD countries of operations



***Source**: EBRD Insolvency Sector Assessment 2009*

***Note**: The various categories indicate the level of compliance of each country's legislation (the "laws on the books") with international standards, such as the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on Legislative Guidelines for Insolvency Law, and others.*

Chart 7 – Quality of insolvency legislation in Armenia (2009)



***Source**: EBRD Insolvency Sector Assessment 2009*

***Note**: The extremity of each axis represents an ideal score, i.e. corresponding to international standards such as the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group's "Legislative Guidelines for Insolvency Law", and others.*

3.4 Judicial Capacity

Before the latest amendments to the Judicial Code, commercial disputes were heard by the Economic Court, which had jurisdiction over business-related cases for both natural and legal persons. The 2009 amendments eliminated the Economic Court. It was considered that having separate specialised courts for commercial matters contributed to inefficiencies in the court system and was not warranted in view of the country's small size. The abolition of the Economic Courts was a measure taken in the context of a large-scale judicial reform project that has been underway in Armenia for several years, supported by the World Bank. The project focuses on providing the country's judicial system with the administration, facilities and capacity needed to raise the effectiveness and transparency of the judiciary.

Some progress has been made; the European Commission's recent progress reports on implementation of the European Neighbourhood Policy point to improvements in transparency in the court system. However, the same reports note that the independence of the judiciary remains a serious concern. This is born out by the *EBRD – World Bank Business Environment and Enterprise Performance Survey* (BEEPS), which indicate that only 33% of business respondents considered the courts to be fair and impartial. Other priorities for reform in the justice sector include reform of the prosecutor's office and proper implementation of adopted legislation in all areas, including in

relation to commercial law. This objective would be furthered by strengthening judicial training arrangements in relation to commercial law and practice.

3.5 Public procurement

The Law on Procurement AL-206-N of 28 December 2010 has been adopted in order to harmonise Armenian public procurement regulation with the WTO Agreement for Government Procurement (GPA). In addition, public procurement is regulated by a number of government decrees, specifically on conducting procurement procedures electronically (eProcurement), procurement rules for the exterritorial procurement, on framework agreements, and on review and remedies procedures. Following that, Armenia completed GPA negotiations and as of 14 May 2011 become a party to the GPA, which is a major achievement in the EBRD region.

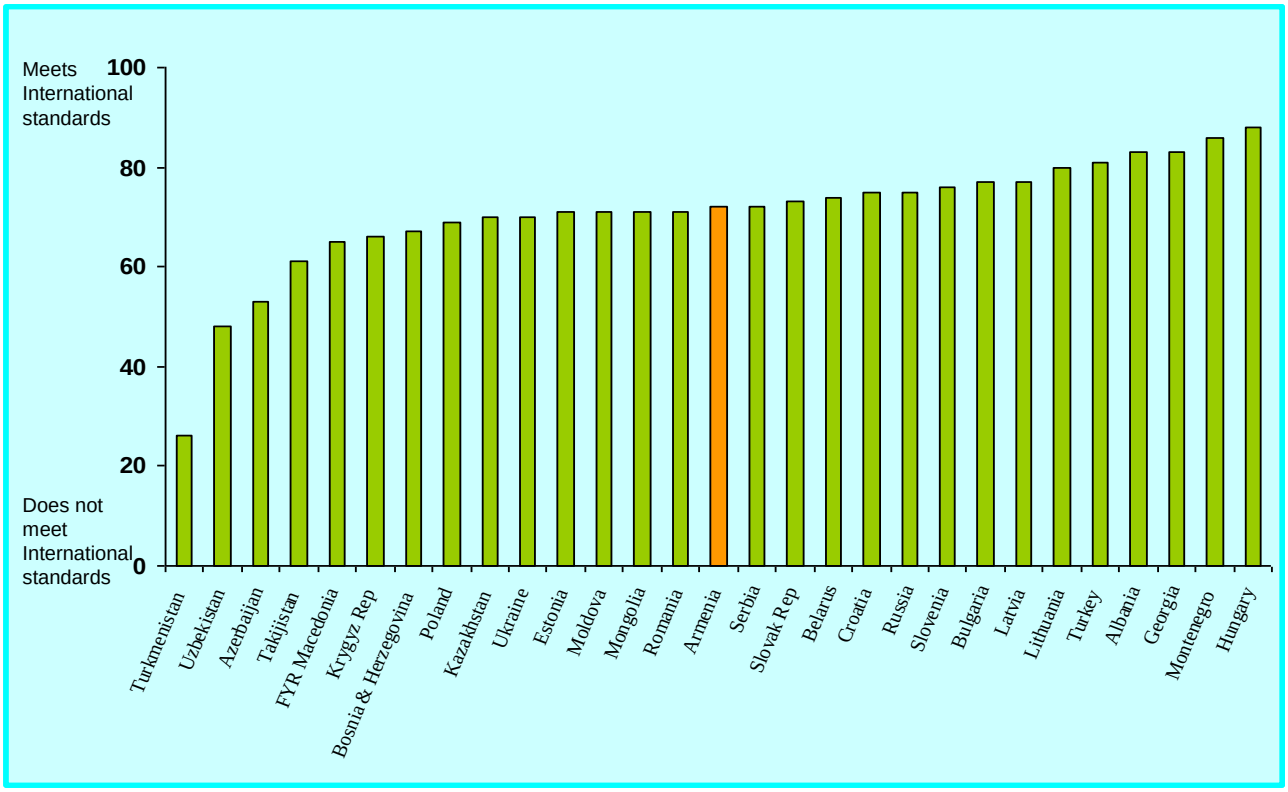
The Armenian public procurement legislation is based on sound principles of the WTO GPA. The law promotes competition and transparency in public procurement and aims to achieve efficiency by utilising a central eProcurement platform enabling conducting of all government procurement procedures electronically. The new legislation has also established an independent review and remedies system, which started it's work in June 2011.

In the EBRD 2010 assessment, Armenia's regulatory framework scored medium compliance with international procurement standards (71 percent) and due to adoption of the new laws has since improved ((see Chart 8 below). Unfortunately, local procurement practice, while reported to be competitive and focused on achieving good value for money, struggles with the implementation (Chart 10). This is due to high public procurement standards incorporated in the new GPA compliant legislation and local procurement officers require a significant amount of training in order to be capable to implement the new laws. As it is today, rules on tenders submission and responsibilities of tenderers may be unclear for local stakeholders, not to mention international tenderers. Also, government institutional capacities could be improved, as the survey revealed the low performance of regulatory authority and the public procurement remedies body.

At present there are reform initiatives undertaken by the government, with the EBRD and OECD/SIGMA assistance. Armenia applied for participation in the EBRD UNCITRAL Initiative and in October 2011 a policy workshop was organised, gathering together local stakeholders and policy makers. The workshop helped to clarify a national government reform agenda and to structure a technical cooperation project in order to support reform efforts. Under this project the Armenian public procurement secondary legislation will be reviewed and improved, guidelines for implementing framework agreements and conducting procurements will be drafted and a regulatory and procurement capacity building initiatives will take place.

The new Armenian public procurement laws are modern and reasonably responsive to market challenges, yet not all transparency safeguards recommended by international standards have been adopted in local legislation (Chart 9). In key policy areas, such as public procurement planning and public contract management significant gaps were identified and should be addressed. Recent amendments to the law and a brand new institutional framework result in a distinctly lower quality of local public procurement practice than expected from the GPA member.

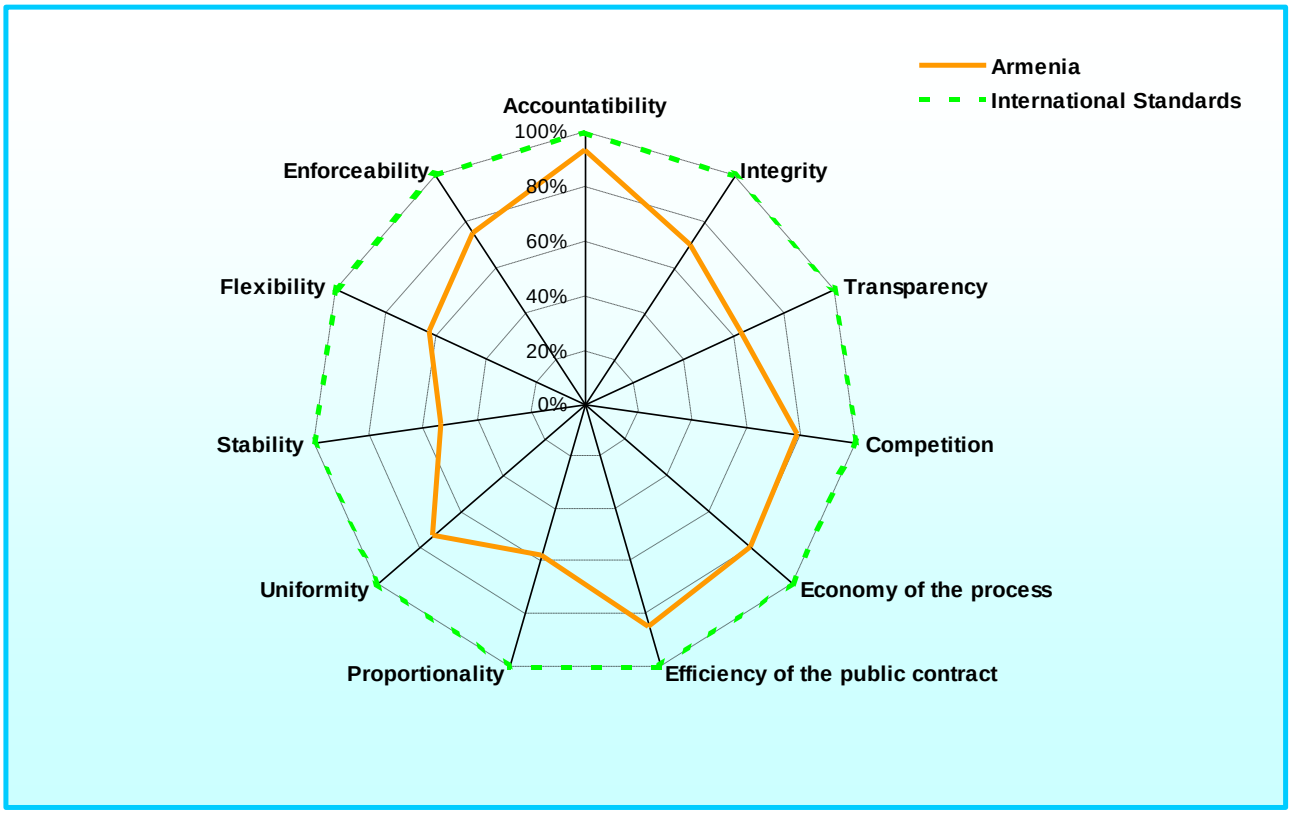
Chart 8 - Quality of Public Procurement legal framework in Armenia as compared to other EBRD countries of operation



***Source**: EBRD Public Procurement Assessment 2010*

***Note**: The score represents the level of compliance of the country's legal framework with international standards such as the revised UNCITRAL Model Law on Public Procurements. Armenia is highlighted in comparison with other countries.*

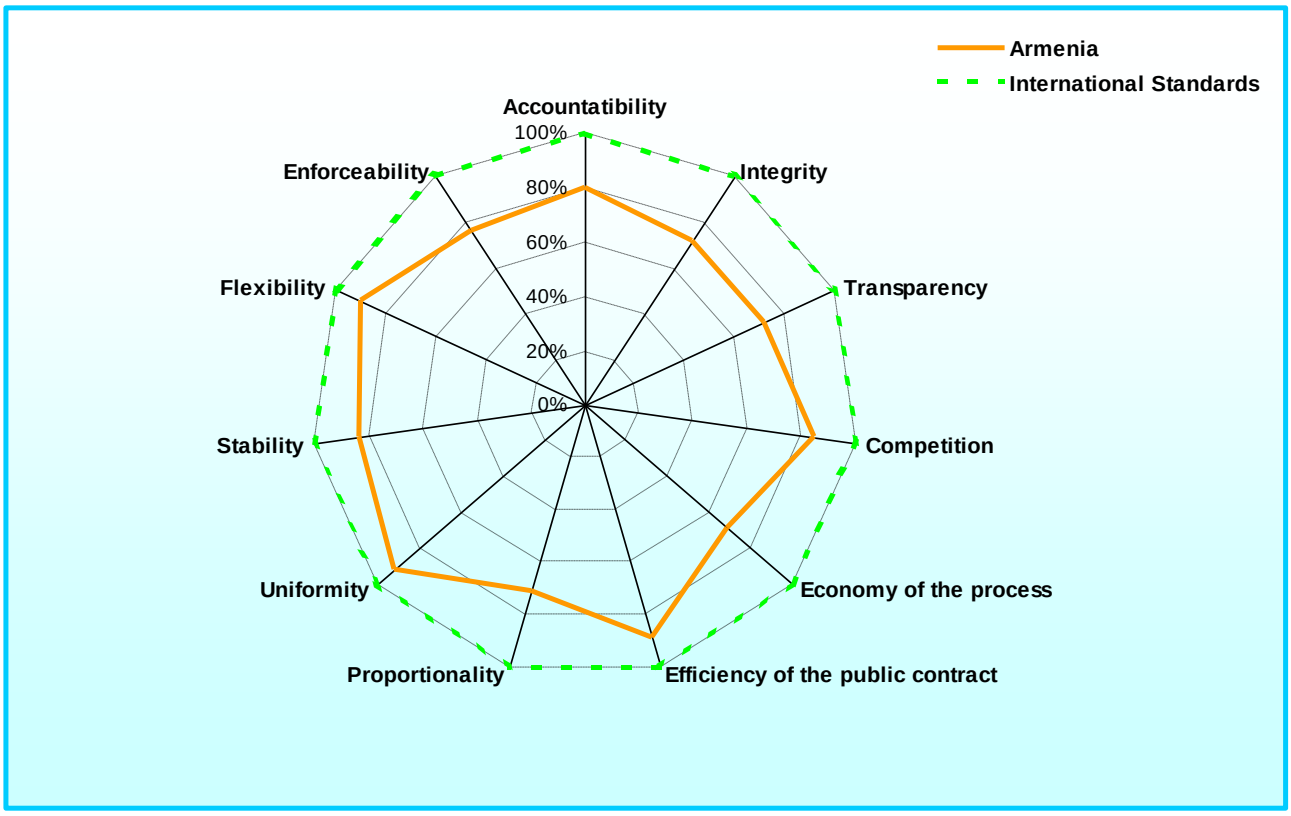
Chart 9 - Quality of Public Procurement legislation – Armenia (2010)



***Source**: EBRD Public Procurement Assessment 2010*

***Note**: The extremity of each axis represents an ideal score in line with international standards such as the revised UNCITRAL Model Law on Public Procurement. The fuller the 'web', the more closely the pubic procurement laws of the country approximate these standards.*

Chart 10 - Armenia - Quality of local procurement practice (2010)



***Source**: EBRD Public Procurement Assessment 2010*

***Note**: The extremity of each axis represents an ideal score in line with international standards such as the revised UNCITRAL Model Law on Public Procurement. The fuller the 'web', the more closely the public procurement practices of the country approximate these standards.*

3.6 Secured transactions

The following legislative acts regulate security over movable property:

- Civil Code of the Republic of Armenia, published on 10 August 1998;
- Law On Maintenance of Movable Property Cadastre, on Registration of the Right of Pledge and Leasing over Movable Property, published on 11 May 2004 (hereinafter the "Law on Register of Pledges over Movables");
- Resolution of the Government of the Republic of Armenia No 1678-N authorising the State Committee of Real Property Cadastre to carry out registration of security, published on 27 December 2004.

Provisions regulating security over immovable property are contained in the following legislative acts:

- Civil Code of the Republic of Armenia, published on 10 August 1998;
- Law on State Registration of the Rights to Property, published on 30 April 1999.

Articles 226-264 of the Civil Code (in force since 1 January 1999 and as amended) regulate security over movable property. The Code provides for different types of pledge that can be established without taking the collateralised asset into possession (e.g. a pledge of rights, monetary assets,

goods in commerce, etc.). Furthermore, the Code also provides for a possibility to take collateral over fluctuating pool of assets; however this option is limited only to the goods in commerce (stock of goods, raw material, supplies, etc). This restriction effectively excludes the possibility to use account receivables as an asset for pledging. Usage of a fluctuating pool of assets is further limited with the obligation to keep the value of the pledged assets constant thus exclusive of assets that change value on an everyday basis (equipment, inventory, etc.). It is not possible to use a general description of the pledged asset which unnecessarily increases the risk of mistakes appearing in the pledge documentation. Such mistakes can result in registration being rejected and/or the pledge is nullified. It is not mandatory to register the pledge except when a specific statute prescribes so for certain types of asset. However, the registration is advisable due to the priority achieved by registration over unregistered and unsecured creditors.

The Law on Register of Pledges over Movables governs the registration of security over movables since 2004. The registry functions are carried out by the State Committee of Real Property Cadastre which is the body originally entrusted with the real estate property cadastre. The registration system is far from perfect and structural reform is needed. The registration procedure requires the filling of the full security agreement and the law sets exhaustive lists of additional documents needed for registration as well as of reasons for rejecting it. According to the Order of the Chairman of the cadastre No 6-N (RA Bulletin of Departmental Normative Acts No 4, published on 15 February 2005) the application for registration can be made only to the sub-division of the cadastre situated in Yerevan ("Kentron" subdivision). This centralisation can increase costs for parties situated elsewhere. While the register maintains the unified database for pledged movable property it is not an electronic one and the information is accessible only upon submission of a written inquiry.

Articles 265-272 of the Civil Code regulate taking mortgages over immovable property. Securing creditors' rights over immovable property represents the better side of the secured transactions coin in Armenia. A relatively robust registry has been introduced under the State Committee of the Real Property Cadastre of the Republic of Armenia unifying the cadastre and property registration systems. This unity helped Armenia in avoiding obstacles of differing data and competing authorities found in dual systems across the region. Nevertheless, general improvement of the enforcement system and introduction of publicly accessible electronic system are the steps that need to be undertaken in order to further improve the protection of creditors' rights. A new Law on Covered Mortgage Bonds was adopted in 2008 but global economic downturn had negative impact on the development of the secondary mortgage market.
Several amendments were made to the Civil Code in recent years with the aim of simplifying the procedure for enforcement of security interests. The Code now allows for parties to contractually agree on out of court enforcement of the security. However, it seems that this procedure is not used by the market, despite the long and difficult court enforcement process.

Limitations on taking security over certain types of movable assets, an inadequate registration system and inefficient enforcement of creditors' rights restrict access to credit in Armenia. This is particularly true for SMEs which usually have limited resources to offer as collateral. Introducing a modern register of pledges over movable property, expanding the choice of assets available for pledging and improving the enforcement procedures would help the Bank in its support to the SME sector.

The working group lead by IFC (World Bank, Central Bank of Armenia, KfW Bank and USAID) was formed in 2009 with the aim of assisting development of the primary and secondary mortgage market.

Apart from the assistance aimed at improvement of the general framework of taking security over movable property, such as expanding the scope and quality of collateral options, promotion of reform of the system of registering security rights over movables is seen as another prime goal of the Bank's activities in the near future.

In addition to legislative reform the Bank should also provide technical assistance and expertise to the local institution in charge of the new registry ensuring that the new law is well understood, its goals sufficiently conveyed to the public and that it is efficiently applied in practice.

3.7 Securities markets

The Armenian securities markets legal framework is contained in the Republic of Armenia Law on Securities Market of 11 October 2007 (http://www.cba.am/EN/lalaws/securities__market.pdf). The market regulator in Armenia is the Central Bank of Armenia. Regarding stock exchanges - ARMEX is the only stock exchange operating in Armenia. Clearing and settlement of securities is performed by the Central Depository.

The 2007 EBRD Securities Markets Sector Assessment revealed that the quality of securities market legislation in Armenia is in medium compliance with international standards (see Chart 11 below).

Capital market activities are rather low and there are almost no corporate issuances and listings. In this respect the high ambitions of Armenia's government need to be noted, i.e. adoption of the law on Covered Mortgage Bonds of 26 May 2008 and the law on Asset Securitisation and Asset Backed Securities of 26 May 2008; however, there has been no issuance of financial instruments provided in the aforementioned legislation. In addition it must be underlined that the banking sector faces numerous challenges, such as insufficient capital and limited banking services. The Assessment has also revealed that a specific legislation on collective investment schemes (CISs) does not exist in Armenia. Under the Law on Licensing, the CISs must be licensed. The Government Resolution No. 469, dated September 30, 1994 sets out the model charter for CISs, is formally in force, however, in practice is not applied, since it is believed to contradict other laws as well as the Constitution. No other laws have material references to CISs. This mechanism is not in used and is considered defunct. Instead, *ad hoc* trust and financial advisory arrangements are being used as an interim measure.(Chart 12).

Armenia is part of the EBRD LC2 Initiative aiming at the development of local currency and capital markets, and as such EBRD is taking a number of actions to encourage local currency lending, i.e. Armenia is eligible to participate in the EBRD's ETC Programme providing local currency loans to private sector borrowers in ETCs.

Apart from strengthening the banking sector, i.e. developing interbank lending and money markets, no other action related to the development of local capital markets is considered, given the immaturity of the market.

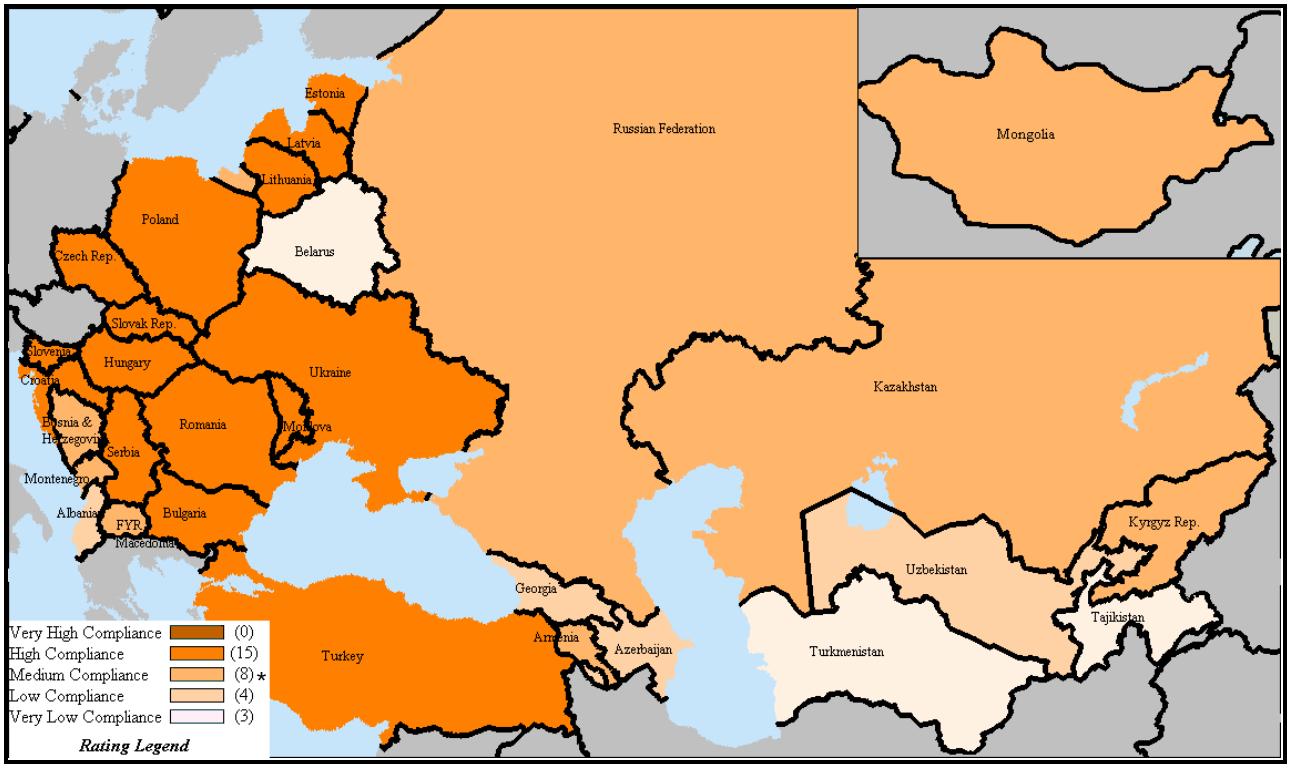
Currently the Armenian Central Bank, together with the government and in cooperation with the Central Securities Depository of Spain, has committed to implement the so called '*second column for capital market development*'. This, in particular, relates to a planned pension fund reform (making rules for investment in pension fund more flexible and assets more diversified) and integration of the Armenian Stock Exchange with NASDAQ OMX.

At present, it seems that the main priority for Armenia is to focus on the basics, i.e. strengthening money markets (including interbank market) and better government debt management and only in the longer term focus on more complex financial instruments, like ABS, if there will be, *at all*, a

rational for such instruments to be originated and issued in Armenia and by Armenian financial institutions.

EBRD is of the opinion that there are short and long term opportunities for capital markets development in Armenia; however, before providing a legal framework for more complex financial instruments, like ABS, the government of Armenia should focus first on the basics of financial markets, this being money markets and government debt management and related government bond issuance; moreover, EBRD welcomes the current pension fund reform, which may attract more institutional investors to the country; finally, EBRD encourages private sector companies in Armenia to apply for EBRD's local currency loans under the ETC Programme.

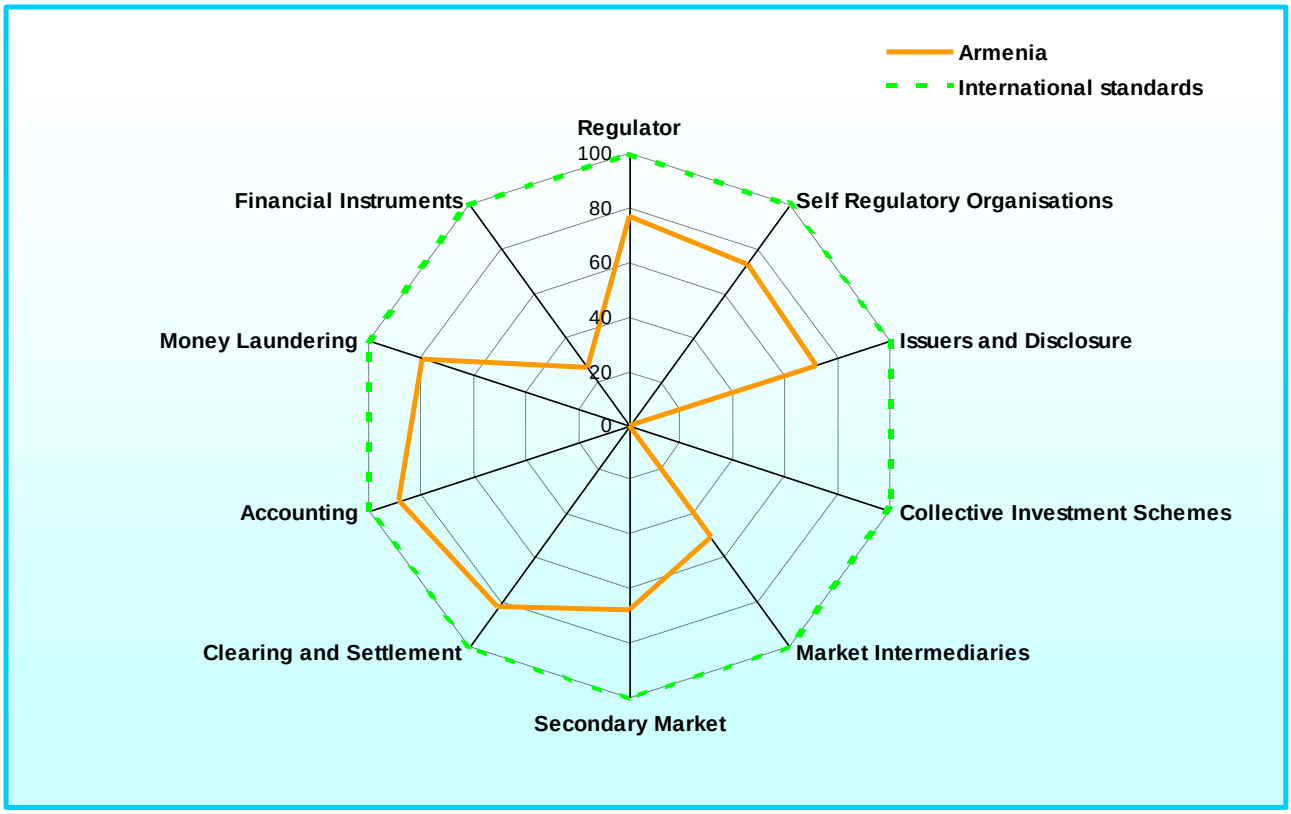
Chart 11 – Quality of securities market legislation in the EBRD countries of operations



***Source**: EBRD Securities Markets Sector Assessment 2007*

***Note**: The various categories represent the level of compliance of a given country's legislation (the "laws on the books") with international standards such as the IOSCO Principles. The asterisk indicates in which category Armenia ranks.*

Chart 12 – Quality of securities markets legislation in Armenia (2007)



***Source**: EBRD Securities Markets Sector Assessment 2007*

***Note**: The extremity of each axis represents an ideal score in line with international standards such as the IOSCO Principles. The fuller the 'web,' the more closely the country's securities markets laws approximate these standards.*

3.8 Telecommunications / Electronic Communications

The electronic communications sector in Armenia is largely governed by the Law on Electronic Communications, 2005, as supplemented by implementing regulations.

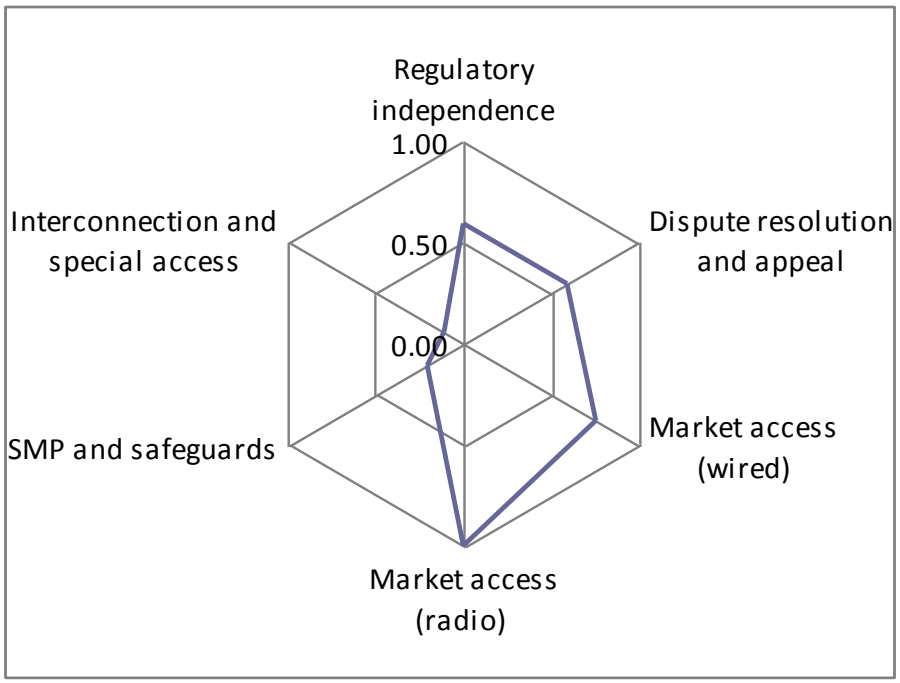
While Armenia is moving progressively toward sector best practice, the legislative/regulatory framework necessary to implement the key aspects of such practice appears largely absent, particularly in critical areas such as number portability, local loop unbundling (LLU) or wholesale broadband. Infrastructure sharing is rare, though the regulator (Public Services Regulatory Commission – PSRC) has recently moved to prepare a regulation on duct sharing. On the positive side, PSRC appears to be an independent and professionally functioning institution, although it does not always seem to use its powers robustly enough to push competition, particularly against the incumbent fixed-line operator (Armentel). The EBRD assessment of telecommunications regulatory framework has found that the legal framework does not provide legal certainty that the conditions of a Reference Interconnection Offer (RIO) will fully apply and that there is little evidence that the RIO is being used. Moreover, the assessment results showed that while work is ongoing to establish significant market power and the corresponding remedies, there are significant gaps in competitive safeguards for alternative or new operators (see Chart 13 below). Fixed broadband would appear to be limited by poor fixed network penetration and resistance by Armentel to LLU (See Chart 14a below). Balancing the slow growth in fixed broadband, however, is healthy growth in mobile broadband: Armenia appears to have a progressive policy with respect to radio

frequency spectrum, with 3G services flourishing and amongst the highest rates in the region (see Chart 14b below).

An ambitious national broadband plan that the government had been developing with the aid of World Bank appears to have stalled. This plan needs to be resurrected and implemented (on an open access basis and in a manner which least distorts the competitive market) if the high demand, especially in the rural areas, is to be met. Also on the reform side, EBRD's Legal Transition Team is currently working with PSRC to implement a number of the practical regulatory initiatives aimed at moving Armenia further towards effective implementation of best practice and facilitating investment in high-capacity broadband infrastructure of the sort foreseen in the abovementioned national broadband plan.

In the short to medium term, immediate resurrection and implementation of the governments national broadband plan (appropriately re-tuned to ensure open access and minimal market distortion), is recommended, as is the swift implementation of the competitive safeguards that will underpin investment in broadband infrastructure. In the broader medium terms, an institutional and policy approach to electronic communications and a wider information communication technology area which is more attuned to the developing trends of technology and regulatory convergence evidenced in more developed markets is also recommended.

Chart 13 – Quality of telecommunications regulatory framework in Armenia (2008)

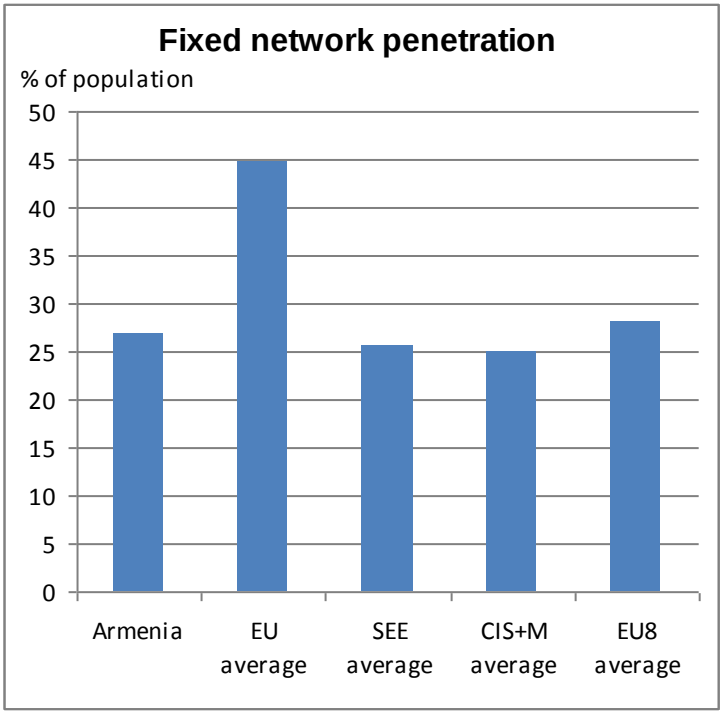


***Source**: EBRD Telecommunications Regulatory Assessment 2008*

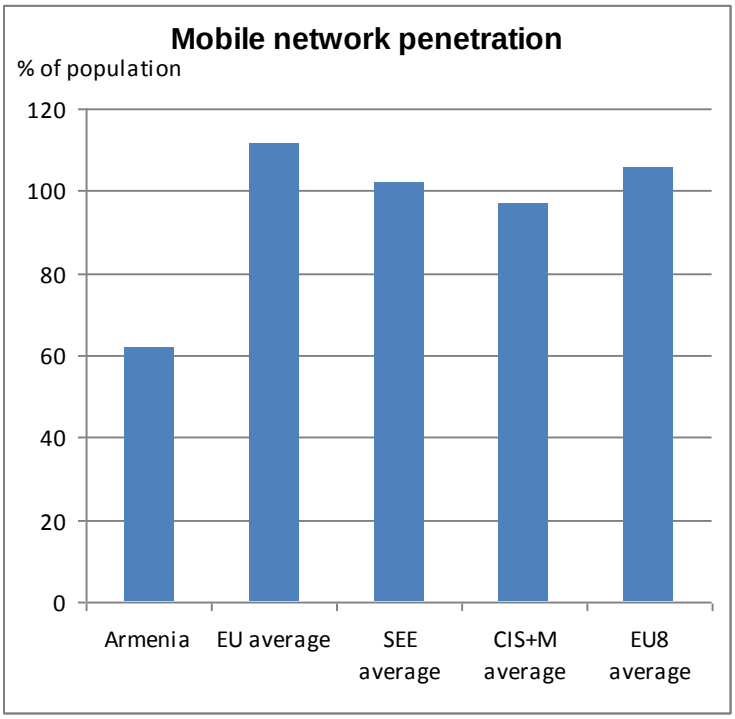
***Note**: The diagram shows the combined quality of institutional framework, market access and operational environment when benchmarked against international standards issued by the WTO and the European Union. The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the "web", the closer the overall telecommunications regulatory framework of the country approximates these standards.*

Chart 14 – Key indicators for Armenia (2008)

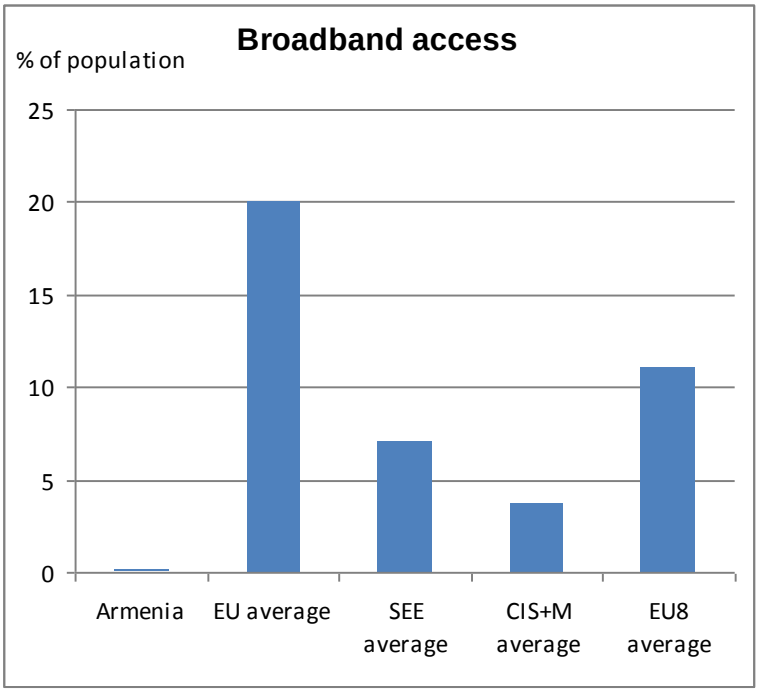
14(a) Fixed Network Penetration



14(b) Mobile Network Penetration



14(c) Broadband Network Penetration



***Source**: EBRD Telecommunications Regulatory Assessment 2008*

***Note**: Key indicators for Armenia provide the fixed network penetration defined as active subscriber lines as a percentage of population, mobile network penetration defined as active pre- and post-paid subscribers as a percentage of population and the broadband network penetration defined as the number of access subscribers with speeds of 144k/bits or more as a percentage of population (broadband Network Penetration less than 1% is not shown on this chart).*