

QUESTION	ANSWER	CITATION	COMMENT
The Responsibilities of the Board			
<i>Regulatory Framework</i>			
Please provide accurate <u>historical description</u> and analysis of the evolution and content of the regulatory framework	<p>Legislative Background (History):</p> <p>The first normative act on corporations in Post-Soviet Armenia was the Regulation 162¹ adopted by the Government of Armenia in 1991. The Regulation was a set of rules on corporations (joint stock companies and limited liability companies) – a model charter for companies. In a year, a revolutionary Law “On Enterprises and Entrepreneurial Activity” (the “E&EAL”) was enacted and provided for more organizational forms of legal entities, liberalizing the proprietorship in general. It set the first legislative framework for joint stock companies.</p> <p>The first Law “On Joint Stock Companies” adopted in 1996 (the “JSCL”) enhanced the legislative framework of corporate governance. It set detailed provisions on formation, reorganization, liquidation, capitalization, shareholder rights and governance of joint stock companies. The E&EAL lost its importance and was repealed later, on the 1 of January 1999, after adoption of the Civil Code. The Regulation 162 is stale even though it had not been repealed by the Government.</p>		

¹ Adopted on March 5, 1991 by the Decree of the Government of Armenia # 162, “On Approval of the Charter of Joint Stock Companies and Limited Liability Companies.”

	<p>In 2000 the National Assembly adopted the Law “On Regulation of Securities Market” (the “SMRL”). The Securities Commission established under the SMRL assumed the enforcement of the corporate governance rules of the JSCL along with the disclosure requirements of the SMRL.</p> <p>The JSCL of 1996 was revised in 2001 to reflect the changes introduced by the Civil Code and the SMRL. As a result the revised JSCL came into effect on the 6 of December 2001.</p>		
1. What are the principal normative acts and other sources of guidelines that make up the corporate-governance framework for Board responsibilities and structure?			<i>No other guidelines codes exist.</i>
1.1. Laws	<p>The principal laws in this regard are:</p> <p>The Civil Code, hereinafter also referred to as the “CC”</p> <p>Joint Stock Company Law, hereinafter referred to as the “JSCL”</p>	<p>The Civil Code, (RL-239) adopted on 05.05.1998, RA OG² 1998/17(50), 10.08.98, as amended as of 04.12.2001 (RL-270);</p> <p>Joint Stock Company Law (RL-232) adopted on</p>	

² **OG** stands for Official Gazette of the Republic of Armenia. Rules and regulations adopted by agencies are published in Gazette for Agency Normative Acts (“**GANA**”).

	Securities Market Regulation Law, hereinafter referred to as the “SMRL.”	25.09.2001, RA OG 2001/34 (166), 06.11.01, as amended as of 20.05.2002 (RL-366-N); “Securities Market Regulation Law” (RL-82), adopted on 06.07.00, RA OG 2000/17(115), 01.08.00; as amended as of 23.10.2002 (RL-246 and RL-421-N).	
1.2. Regulations	n/a		
1.3. Other normative acts	n/a		
1.4. Exchange Rules	n/a		
1.5. Codes of Conduct	n/a		
1.6. Other	n/a		
2. How is the term "director" defined?	The term ‘director’ is not defined in any of the laws.		The law mentions ‘member of the board of directors’ but does not define the term. <u>Note:</u> Traditionally “director” means an “executive officer” in Armenia. Now the term is also used sometimes within the meaning of “member of the board.” In corporate charters of a small number of companies members of the board are now referred to as ‘directors.’
3. Does the regulatory framework	No, it does not.		The law does not contain any provision

stipulate positive qualifications for a person to be appointed as a director? If yes, what are these qualifications?			setting forth any qualification for a person to be appointed as a director. However, under the section 5, para. 3 of Article 85 of the JSCL, the charter may set forth such qualifications. It reads as follows: “The Charter or the Board by-law approved by the Meeting may foresee other requirements and limitations in regards to Board members.”
4. Does it stipulate conditions under which a person cannot be appointed as a director? If yes, what are these conditions?	No it does not.	Criminal Code, Article 21, paragraph 1, point 5	Theoretically, a person may be banned from being appointed as a director by the court decision in case the person is held guilty for committing a crime. However, it is an additional criminal punishment, namely “prohibition of holding a specific position”. We are not aware of any case, where the court would specifically ban a person from holding a post of <i>a director</i> in a corporation.
5. What is the required board structure?	No specific structure is prescribed.	JSCL, Art. 85(4) ³	The only prescription is, that the board shall consist of no less than 3 persons. <u>Note:</u> Only companies with 50 or more shareholders are required to establish boards of directors (JSCL, Art. 83(1)). Otherwise, the general meeting of shareholders may carry out duties of the board.

³ Art. 85(4) means Article 85, numbered paragraph 4 (sometimes referred to as a Section of an Article).

<p>6. Does your company law prescribe a unitary or dual board structure consisting of a supervisory and a management board/director?</p>	<p>The board has a unitary structure, even though the charter may allow the board to create different committees.</p> <p>The law requires election by the general meeting of shareholders of separate supervisory committee⁴ or a supervisor as an internal auditor reporting to the general meeting of shareholders.</p>	<p>JSCL, Art. 91</p>	<p>1. We are not aware of any practice of establishing committees of the board in Armenia</p> <p>2. The supervisory committee is not a part of the board of directors, even though some lawyers prefer the members of the supervisory committee to participate at the board meetings and even sign the minutes or convey opinions on the decisions of the board. Supervisory committee reports to the general meeting of shareholders of the company.</p>
<p>7. If the company law prescribes a dual board structure, or if this is common practice in the articles of association, please respond to the following questions:</p>			
<p>7.1. Is a dual board structure compulsory or not?</p>	<p>Not compulsory.</p>		<p>The possibility of dual structure is not even stipulated in the law. Nor does the law prohibit it.</p>
<p>7.2. If not compulsory, can the use of a dual board structure be established in the articles of association?</p>	<p>Yes, as it is not prohibited under the JSCL.</p>		<p>Except for the supervisory committee, that cannot be the part of the board. The shares held by the directors may not even vote on the election of the members of supervisory committee. We believe, however, that theoretically the board could, if so allowed by the charter, create a committee with certain supervisory functions.</p>

⁴ Called 'Control Commission.' We think, however, that supervisory committee is the adequate translation of the Armenian version.

7.3.If so, is this option commonly used?	no it is not		This is not practiced because such a board committee would obviously duplicate the functions of the separate supervisory committee (a supervisor) required under the law.
7.4.What are the duties of the supervisory board?	The supervisory committee: -monitors the implementation of the decisions of Company management and checks the compliance of Company documents with laws, regulations, and the Charter; - inspects the results of the annual financial performance of the Company, the financial activities of the Company (“either at any time at its sole initiative, or based upon a decision of the Meeting or the Board, as well as at the request of the owner (-s) of at least 10 percent of the voting shares of the Company); - prepares reports on the financial performance of the Company for the AGM ⁵	JSCL, Art. 91	
7.5.What are the duties of the management board?	Duties of the management board not defined in the law. In general, such a board shall decide on all issues related to the Company’s “management,” except for matters that rest within the exclusive discretion of the Meeting and the Board of Directors.	JSCL, Art. 89	Management board is optional. If the charter provides for what is called collective management body, then it shall clearly define its functions and distinguish them from the duties of the individual manager. Note, even if there is a management board, there shall be an individual manager, which shall chair the board in this case.
8. Are there any legal requirements as to the composition of the board(s). If yes what are these requirements:	There are such requirements as described below:		

⁵ “The Annual General Meeting of Shareholders,” hereinafter referred to as the “AGM.”

8.1. in terms of size?	There shall be no less than three directors on the board.	JSCL, Art 85(4);	
8.2.in terms of qualifications?	No. However, the charter may set such qualifications. It is not the practice in general though.		see the answers above, QQ 3 and 4
8.3.in terms of seats designated to specific shareholders or constituents, including labour representatives?	<p>Yes:</p> <p>1. Any shareholder or a group of shareholders holding 10% of the shares may become a director or appoint a representative without elections. However, each shareholder may hold only one seat of the board.</p> <p>2. Members (“representatives”) of the management body may not comprise the majority of the board.</p>	<p>JSCL, Art. 85(2);</p> <p>JSCL, Art. 85(5)</p>	<p>1. There are practical difficulties in application of the provision. It is not clear, for example, whether a 10% shareholder elected as a director can appoint another director by the virtue of the section 2 of Article 85. I a number of cases, the Staff of the Securities Commission has taken a position, that an elected shareholder may not appoint a director by virtue of this provision of the law, as the provision specifies, that such an appointee would be his representative, while each shareholder may have only one seat in the board. However, there are no court rulings on this matter.</p> <p>Furthermore, it is not clear if such a shareholder or a group may appoint a director at all times or only when the board is being elected.</p> <p>2. The problems arise in interpretation of “representative of the management body.” In our opinion, for the sake of safety, the shareholders should refrain from situations when <i>persons participating in the management</i> of the company (such as executive officers, vice-presidents, chief accountants, chief financial officers, directors of departments, etc.) comprise the majority of the directors. No precedents are established so far.</p>

<p>9. Does the legislation prescribe the use of independent directors?</p>	<p>No or not expressly; see the comments</p>		<p>The law does not expressly mandate appointment of independent directors.</p> <p>It may be argued, that as a practical matter, if the term “representative of management body” is broadly interpreted in Art. 85(5), it seem to mandate appointment of “independent directors” by prohibiting managers to comprise the majority of the directors (see also the definition in Q 9.1). On the other hand, certain persons not falling even within the broad meaning of “representative of managing body” may still not qualify as “independent director” under the definition in Art. 64 of the Law (such as spouses and children of managers, that would not be considered to be neither representatives nor members of managing body), but may comprise the majority of the board without breaching the requirements of the 2-nd paragraph of Article 85(5).</p> <p>Furthermore, the board of corporation with 500 or more shareholders would not be able to approve an “interested transaction” and would have t refer it to the general meeting, if there are no “independent directors.” JSCL, Art. 64(2).</p>
<p>9.1.If yes, how is independence defined?</p>	<p>An “independent director” is a director, “that is not a sole executive of the Company (director, general director) or a member of an executive body (executive board, management board), and whose spouse, parents,</p>	<p>JSCL, Art. 64(2), 2-nd paragraph.</p>	<p>The definition of an independent director is provided only in the Article of the JSCL dealing with ‘transactions where conflict of interest exists’ (“self-</p>

	children, and siblings do not occupy management posts with the Company.		dealing”)!)
9.2. What are the exact provisions regarding their appointment?	None		
9.2. Is a concrete number or percentage of independent directors required?	Not expressly; see the comments to Q 9.		
10. Is a distinction made between non-executive directors and independent directors? If yes, please describe.	Yes.		An independent director shall, in addition to being a non-executive, not be a spouse, parent, child, or a sibling of person occupying any management post with the company. See also: Comments to Q 9
11. Is there a limit as to how many boards an individual can be represented on?	no.		
12. What are the rules and procedures for			
12.1. nominating,	Under the SMRL, every holder of 2% of total number of shares of the company may propose <i>inter alia</i> as many directors as there are seats on the board. Such a proposition shall be submitted to the current board for inclusion into the agenda of the AGM within 30 days after the end of the fiscal year (the same as the calendar year) or within such longer term as the charter of the company may provide. The current board shall grant or reject inclusion of the proposed candidates into the list of candidates (or proposal into the AGM agenda) within 15 days of expiration of the 30 day period. The current board shall notify the proposing shareholder(s) of the rejection within 3 days of taking a decision to reject.	JSCL, Art. 72.	

	Such a decision of the board may be appealed to the court. The law sets the grounds for rejection, such as incompleteness of the information in the proposal or lack of authority to propose (if the shareholder does not hold 2%).		
12.2. electing and	Companies with 500 or more shareholders elections of the directors shall be held by cumulative voting. In case of such voting each share may cast as many votes as there are seats on the board. Holders of the shares may distribute the votes among the candidates as they choose to. Elected are the candidates receiving more votes, e.g. if there are 5 seats on the board and 10 candidates, then the 5 out of 10 candidates receiving more votes will take the seats.	JSCL, Art. 85	
12.3. removing board members?	Any general meeting (annual and extraordinary) may remove any director and at any time. However, if the directors are elected by cumulative voting, then the general meeting will have to remove the entire board and may not remove only some directors.	JSCL, Art. 85(1)	
13. Does the regulatory framework stipulate a maximum election term?	No, it does not.	JSCL, Art. 85(1);	There used to be a one year limit for the election in the old law. However, the new law contains no limitation of the term. It states, that “the directors are elected by the annual meeting of shareholders... .” Some lawyers interpret this wording as limiting the election term – till the next annual meeting. However, the provision of the law seems to merely grant the power of electing the directors to the annual as opposed to extraordinary meetings.

14. For how long are board members generally elected?	The usual terms of election is one or three years.		<p>The Commission encourages the companies listed on the Exchange to limit the term to one year, so that each annual meeting has an opportunity to re-elect the directors, especially if there is a significant amount of fee-float shares in the market. The Stock Exchange now develops a rule limiting the election term of the directors of listed companies to one year.</p> <p>Inspections by the Commission have demonstrated, that many companies used to “forget” re-electing the directors. 2-year enforcement effort has rectified the situation to some extend.</p>
15. Are all board members re-elected at the same time or are staggered terms allowed?	Staggered terms are not prohibited. However, the election by cumulative voting seems to prevent application of staggered terms. Cumulative voting is obligatory for companies with 500 and more shareholders.		Staggered terms are rarely used. No such case had been encountered so far.
16. Does the regulatory framework specify the role of the Chairman? If so, what are the main duties of the Chairman?	<p>Yes, it does. Under Article 86 Chairman of the Board shall:</p> <ul style="list-style-type: none"> - coordinate the activities of the Board; - assemble Board sessions and chair them; - coordinate the filing of session minutes, and - chair general meetings of shareholders, unless otherwise stipulated by the Charter. 	JSCL, Art. 86(2);	
17. Does it require the separation of Chairman and Chief Executive	The JSCL requires separation of the Chairman’s and Chief Executive Officer’s Positions for companies with	JSCL, Art. 86(1), 3-rd paragraph;	Many companies act in violation of this section. The Securities Commission is the

Officer?	500 and more shareholders (holders of voting shares).		only enforcement agency, which closely monitors compliance of the companies (reporting issuers) with this provision. However, even formal compliance does not render tangible results as the boards remain rather passive in managing companies' affairs.
18. Does the regulatory framework prescribe the formation of any special purpose committees within the board:	No, it does not.		The JSCL is silent (no mention at all) on this matter. In practice boards are so passive, that barely any company's board has special purpose committees.
18.1. audit committees?	n/a		
18.2. remuneration committees?	n/a		
18.3. or nomination committees?	n/a		
19. If so, what are the requirements for such special purpose committees?	N/A		
19.1. audit committees?			
19.2. remuneration committees?			
19.3. or nomination committees?			
20. And what are their respective functions:	N/A		
20.1. audit committees?			
20.2. remuneration committees?			
20.3. or nomination committees?			
21. For example, are there provisions concerning the size of board remuneration and the possibility to offer stock options to board members?	N/A		

22. How is the form and level of board remuneration decided?	It is decided either as a fixed monthly compensation or reimbursement for expenses in connection to carrying out the director's duties.	JSCL, Art. 82(2);	Usually directors receive fixed monthly salaries. However, in most cases directors receive little or no compensation as their duties are not considered to be important, or large shareholders often sit on the board themselves.
23. Is this done by the general meeting or through other procedures?	Yes. The authority rests with the General Meeting.	JSCL, Art.67(1)(u); and Art. 83(2);	Under the above mentioned provision the GM shall decide the amount of compensation or remuneration.
24. To whom is the board primarily responsible?	The Board reports to shareholders or, rather, to the general meeting of shareholders.		The general meetings (mostly annual) elect and may remove the directors. <u>JSCL, Art. 85(1)</u> . Moreover, the directors pre-approve the annual report before the shareholders meeting approves it. <u>JSCL, Art. 94(3)</u> .
25. Is it clearly stipulated that the board's duty is to serve in the interest of all shareholders?	<p>The JSCL provides, that the directors shall act "in the interest of the company ... in good faith and in a reasonable manner."</p> <p>The SMRL provides, that the directors shall act in the interest of the company and holders of securities of the company. They shall additionally act in good faith and exercise due care, as would have been exercised by a person managing his/her own business in similar office and under similar circumstances.</p>	<p>JSCL, Art. 90(1)</p> <p>SMRL, Art. 40</p>	Most of the directors questioned at the Commission's hearings believed they were appointed to serve the interests of the shareholders, who had nominated them. Few were aware of the applicable standards of accountability and responsibility (as described here).
26. What is the board's field of competence and how is it expressed in the regulatory framework? (For example: "The board is responsible for the organisation of the company and	The board is responsible for general management of Corporation affairs, except for deciding on matters reserved for the exclusive discretion of the general meeting of shareholders. While the management is responsible for the day-to-day operation of the	JSCL, Art. 83(1); Art. 88(1) and (2);	

management of its affairs, while the managing director is responsible for the day-to-day business”).	company. The JSCL contains a separate article setting forth the exclusive competence (discretion or powers) of the board in a detailed and open-ended list.	JSCL, Art. 84(1);	
27. Is the division of power between the board and the management clearly specified in the regulatory framework? If yes, how?	The JSCL provides fairly clear guidelines on the powers of the board and the management. It sets forth the powers of both in a detailed, however, open-ended list affording certain flexibility for the charter of the company to reallocate non-exclusive powers/discretion.	JSCL, Art. 84 and 88(3)	
28. What are the general board responsibilities?			
28.1.Are boards responsible for the appointment of the key executive positions of the company	Yes, <u>if</u> the charter grants this power to the board. Otherwise, by operation of the default provision, such power will rest with the general meeting of shareholders.	JSCL, Art. 84(1)(j); see also Art. 67(1)(i);	
28.2.Are boards responsible for supervising and reviewing their performance and remuneration?	Yes. The Board, for example, pre-approves the annual report of the company (JSCL, Art. 94(3)), establishes remuneration for the key executive positions (JSCL, Art. 84(1)(j)), approves the organizational structure, annual budget and its execution [report] (JSCL, Art. 84(1)(v) and (w)).	JSCL, Articles 94(3), 84(1)(j), (v) and (w);	
28.3.Are boards required to periodically report to shareholders the status of the company affairs?	There is no separate requirement for the board report. However, the board pre-approves the annual report of the company. Even though the chief executive officer is the one responsible for preparation of the report, the pre-approval makes the board also responsible for the report.	JSCL, Art. 94;	
29. Does the regulatory framework specify the fiduciary duties of the	Yes. Articles 90(1) of the JSCL and 40 of the SMRL may be interpreted as establishing the fiduciary duties of	JSCL, Art. 90(1) SMRL, Art. 40	Note: Under Article 90 board members are responsible to the Company for the

board?	the board. However, there is no direct mention of the fiduciary duty in the laws. See also: Question 25.		losses caused by breach of the duty. Similar (or even stricter) liability is provided for by Article 143 of the SMRL.
30. Are specific duties of the board prescribed vis-à-vis:			
30.1. the shareholders?	Yes. See: Question 25		
30.2. the company as such or	Yes. See: Question 29		
30.3. or society at large?	No.		
31. Does the regulatory framework prescribe specific duties of skill? If yes, please describe.	No. Law does not require the board members (directors) to possess any specific set of skills.		
32. Or fiduciary duties? If yes, please describe.	Yes. Directors are obligated to act in good faith, exercise due care and act in the best interest of the Company and holders of its securities. See: Question 29.		
33. Are any administrative duties of directors specified? If yes, please describe.	No administrative duties of directors are specified.		
34. Are there any provisions on consequences of breach of duty?	Yes. Directors are liable to the Company for losses the Company has incurred as a consequence of breach of the directors' duties. Such a liability may be invoked by a shareholder (or group of shareholders) holding at least 1% of shares of the Company in the context of general Corporation Law, and <u>any shareholder</u> in the context of the Securities Law.	Shareholders' Derivative Suits:	

		JSCL, Art. 90(5) SMRL, Art 143(1), 2nd paragraph;	
35. Are:			
35.1.Criminal	n/a		
35.2.Administrative or	Yes. Directors' breach of duty may entail administrative liability under the general administrative penalty provisions of the SMRL. A fine of up to AMD1,000,000 (\$1,800) may be imposed by the Commission for each count. There should, however, be breach of the Commission's order, for the latter to be able to impose a monetary penalty. Therefore, the Commission issues a "cease and desist" order first, and only then resorts to penalties in the order is not complied with.	SMRL, Art. 137 and 138.	
35.3.Civil liabilities for breach of duty imposed?	Yes. Director at fault shall compensate any such loss to the company. In case the director voted for a decision in breach of his duty, lack of knowledge is not a defence, unless sufficient grounds for reliance (e.g. reliance on expert's opinion) are established.	JSCL, Art. 90 SMRL, Art 143	However, we are not aware of any court case where a director was held liable, nor are we aware of any such claim filed with the court.
36. Are there legal provisions mandating the representation of stakeholders on boards? If yes, please describe.	Yes. Any shareholder (or a group of shareholders) holding 10% of the shares may become a director or appoint a representative without elections. However, each shareholder (or group) may hold only one seat of the board.	JSCL, Art. 85(2)	See also: Comments to Question 8.3
37. How is the directors access to information regulated:			
37.1.Do directors have the explicit right to inspect corporate accounts?	Yes. The JSCL provides, that directors shall have access to the documents, including confidential documents of the company upon request.	JSCL, Art. 95(3)	
37.2.What other rights are	n/a		

specified in this respect?			
38. What are the requirements in terms of board meetings?	<p>Regularity - there is no requirement in the law that the board meeting be held regularly. The law merely sets forth who may require a meeting to be held. The rest shall be regulated by the charter or by-laws adopted by shareholders;</p> <p>Quorum – no less than ½ of directors present shall be present;</p> <p>Decisions – shall be adopted by at least ½ of directors present at the meeting;</p> <p>Minutes of meetings – shall be prepared within 5 days of the meeting and signed by all directors, who shall be responsible for the information the minutes contain.</p>	JSCL, Art. 87	
<i>Practical viewpoint on Boards</i>			
Please respond and illustrate by using case studies, brief examples and board statistics, as available.			<p><u>Note:</u> There has been no empirical study made in Armenia on boards. Nor is there any statistics available on the questions below. Most of the answers are based on my observations both as practicing attorney, and later, as an official of the Securities Commission.</p> <p>Our research with Economic Court and the Court of Appeals has not identified any court cases related to the functions of neither directors nor boards.</p>
39. How important is the board in corporate governance in your country?	Boards are of little or no importance due to great concentration of control in open joint stock companies.		Most of the companies are run by the controlling shareholders, who are unwilling to entrust the corporate affairs to any other group of individuals. This

			<p>coupled with the lack of traditions for corporate governance and management of property “in trust” often makes the boards completely redundant in the eyes of the large shareholders.</p> <p>Over 200 inspections of companies on the subject of compliance with corporate governance conducted by the Supervision Department of the Commission has shown, the boards do not play key role in corporate governance. Board meetings are neither regularly held nor properly recorded. Boards role is pretty much limited to approval of transactions, that would not be valid without such approval (even this requirement is not regularly complied with!).</p>
40. Is the existing legal framework successfully put into practice?	In practice even the large companies only formally comply with the legal framework.	See: <u>Annual Program for 2001, the Securities Commission of the Republic of Armenia, Part 1, Section 1.2;</u>	Not only many boards stand in the corporate structure as a pure formality, but also fail to comply with the laws in the way they are run.
41. Are board members enabled to carry out their duties in a professional and informed manner?	<p>In most of the cases boards do not carry out their duties in an informed manner.</p> <p>Weather boards act professionally in carrying out there duties is a difficult question as there would be no data supporting an opinion. In most of the cases we have</p>		In most of the companies meeting are not held in a way that would allow directors to take and informed decision. For example, drafts of decisions and related explanatory documents are not being distributed to board members in advance,

	<p>observed few or no board members are sophisticated in financial matters.</p>		<p>if are distributed at all.</p> <p>For example, a director nominated by the Government on the Board of ArmenTel, the telecommunications monopolist in Armenia (90% owner by OTE, a NYSE-listed largest Greek telecom operator), was not able to receive the documents on the issues included in the agenda. Only after the Government threatened to file a claim, were the respective materials provided.</p> <p>In a number of cases tried before the Securities Commission, the Commission has established, that the director was effectively prevented from participation in the board meeting.</p> <p>Low level of compensation (if any) discourages directors from dedicating sufficient time and efforts to the corporate matters.</p>
<p>42. Do boards fulfil their strategy setting and monitoring functions properly?</p>	<p>As a rule, they do not. Boards of banks are an exception to an extent.</p>	<p>See: Annual Program for 2001, the Securities Commission of the Republic of Armenia, Part 1, <u>Section 1.2.2(4)</u>;</p> <p>Resolution # 316 of the Board of the Central Bank of</p>	<p>Thus, according to the Annual Program of the Securities Commission for 2001, in 273 out of 404 studied companies (67.6%), the boards have failed to take steps required for organization of the annual meetings of shareholders. 84% of the companies failed to publish the annual financial statements and reports, which is also a result of failure of the respective boards to carry out the monitoring functions.</p>

		Armenia, Amended and Restated on the 11 th October 2002; GANA 31(117), 16 December 2002.	Banks are an exception in this respect. As the Central Bank (CBA) requires the commercial banks to prepare and submit Long Term Development Program (LTDP), boards of commercial banks are charged with greater responsibility in the matters of setting and monitoring performance under the LTDP submitted to the CBA. However, boards mostly carry out this duty as part of compliance with the CBA regulations and rarely to serve interests of all shareholders.
43. Do the boards and board members operate in a transparent fashion, consistent with the intentions of the Assembly General Meeting?	As stated above, most board members perceive they represent the private interests of the shareholders that have nominated them. They operate accordingly.		
44. The latter question also targets the nomination and remuneration of directors?	Negative.		Nomination process is rarely transparent. As a matter of rule, the majority nominates directors. Minority shareholders rarely participate in the process, even though the law sets forth provisions securing minorities ability to nominate directors. Directors remuneration is rare per se. In many companies directors receive remuneration as employees of the company supervised by CEOs.
45. Are boards truly independent from	No.		Boards are heavily influenced by the

management and major or controlling shareholders?			<p>management as most of the board members (directors) are also employees of the company performing other functions in its administrative structure.</p> <p>As stated above, most of the directors are nominated by majority shareholders and effectively controlled by them.</p> <p>Furthermore, most of the directors believe in good faith they are to serve the interests of the nominating shareholders.</p>
46. Is cumulative voting used and does it have an impact on enhancing board independence?	Cumulative voting is mostly complied by the companies. However, it does not impact independence of the board in any way.		In our opinion, this is also due to a great concentration of control in the hands of majority shareholders.
47. Do boards play an effective role with respect to conflicts of interest, related party or major transactions?	The Boards play only formal role in the process.		In our opinion, related parties successfully manipulate the value of properties or transactions as well as influence the directors to approve such transactions. Most of the companies only formally comply with the procedures.
48. Do companies have a sufficient number of independent directors?	No.		In our opinion, independent directors are far from being part of corporate culture in Armenia. Even the law does not signify independent directors.
49. Do board committees exist and if so, do they fulfil their role?	No.		We have not identified existence of any board committee. They may exist as a rare exception.
50. Are they instrumental in enhancing	No.		

board effectiveness?			
51. Do they have sufficient power and resources at their disposal?	No.		
52. Do board members possess adequate qualities and competencies?	There is no data sufficient to support an opinion.		According to my informal observations in most of the companies few or no board members are sophisticated in financial matters.
53. How do companies identify, select and recruit competent directors?	No specific procedures exist.		
54. Are board members adequately compensated?	Provided the general attitude towards boards functions, board members are rarely compensated		
55. Are there education and training programmes for directors?	No regular courses are available.		IFC attempted to organize few training programs for both the boards and management within the scope of Corporate Management Program in 1999 – 2001. We would not consider those attempts successful due to low level of attendance by the targeted group.
56. What are the perceived needs in this respect?	Generally perceived needs are low.		See the previous Question
57. What role do the bilateral and multilateral donors play in assisting such needs?	IFC is the only donor that had an assistance program referred to above. The only result the program has rendered was a Manual On Joint Stock Companies, which was a differently-systemized and somewhat more schematic restatement of the provisions of the JSCL.		In our opinion so far there is little interest to corporate governance issues in Armenia on the part of international donors. However, the need for such assistance and education is obvious. Armenia does not lack experts as much as it lacks public awareness and education.

58. What is the profile of board directors? Are there any statistics in terms of their spread among:	No data is available to support an answer.		
58.1.Financial professionals			
58.2.Legal professionals			
58.3.Retired industry leaders			
58.4.Retired senior government officials			
58.5.Other			
59. Do professional associations exist and what is their role in enhancing professionalism and board ethics?			
60. Please provide statistics, as available, or describe trends, regarding:	Answers are based on personal observations:	No specific statistics exist.	
60.1.Average size of boards of directors?	3 – 5 directors		Based on survey of over 400 companies.
60.2.Average number of executive board members.	usually majority		
60.3.Average number of non-executive (independent) board members?	n/a		
60.4.Number of companies with:		No specific statistics exist.	
- audit committee	Most of the companies have audit committees as required under the JSCL, however , not as a board committee. The committees rarely carry out their functions adequately.		
- compensation/remuneration	n/a		We do not think any of the companies has

committee			a nomination committee.
- nomination committee	n/a		We do not think any of the companies has a nomination committee.
- other committees	n/a		
60.5. Average size of committees:		No specific data exist.	
- audit committee	1 or 3 persons for a non-board committee		
- compensation/remuneration committee	n/a		
- nomination committees	n/a		
- other committees	n/a		
60.6. Attendance of directors meetings?	Majority of directors treat their functions as a “pure formality” and attend reluctantly.		
60.7. Average number of directors meetings per year?	Usually board meetings are held or recorded to be held once a month.		
60.8. Average board remuneration?	n/a	No specific data exist.	Most companies do not compensate their directors.
60.9. Number of companies with board training programmes?	n/a	No specific data exist.	In our opinion such companies for not exist or may be in a rare exception.

Stakeholders			
Please provide a description of the regulatory framework together with some empirical illustrations			<u>Note:</u> The notion of stakeholders (as a wider notion than shareholders, including the employees, suppliers and the community where the company operates does not exist in the Armenian law. Therefore, this section addresses the questions mostly in the shareholders' context.
61. Please describe which legal acts define the role and rights of shareholders and in what respective terms:			
61.1.company law	Sets forth the rights and obligations of shareholders in the corporate governance matters and sets forth civil remedies. Provides certain civil remedies.	Specifically, the Civil Code provisions on joint stock companies and the JSCL itself.	
61.2.labour law	No		
61.3.environmental law	No		
61.4.contract law	No		
61.5.insolvency law	Sets forth the limitation of shareholders rights in bankruptcy proceedings, as well as preferences and priorities in distribution of the proceeds of the sale of debtors assets.	Law on Insolvency of Legal Entities, Non-Legal Entities and Individual Proprietors, PL-101; adopted 3 December 1996 (hereafter: the “Insolvency Law”);	
61.6.other	Securities Regulations secure informational rights of the shareholders through disclosure & fair prise discovery requirements, as well as the enforcement mechanism,	Specifically – the SMRL;	

	and provide Administrative and Civil Remedies.		
62. What concrete provisions ensure the (proper) protection of stakeholder rights:			
62.1.in the company law	<p>The Civil Code contains only general provisions on joint stock companies. The Code sets forth dividend rights and the rights of participation in the management.</p> <p>JSCL sets forth all significant rights of the shareholders in the corporation context, Including rights to information, election of directors and internal auditors, participation in the annual and extraordinary meetings of shareholders, etc.</p> <p><i>We cite the following major provisions of JSCL:</i></p> <p>Art. 37 (rights and obligations of the shareholders – the enlisting of rights and cross references); Art. 47 and 48 (the rights of first refusal in case of additional distribution of securities); Art. 49 (the dividend rights); Art. 67 (discretion of the general meeting of shareholders (the “GMS”) – enlisting of powers and cross references); Art. 68 (the right to judicial review of the GMS decisions upon request (a suit) of an aggrieved shareholder); Art. 70 and 76 (the right to participate in a general meeting of shareholders); Art. 71 (the right to notice of GMS); Art. 72 (the right to propose issues for the GMS agenda); Art. 74 (right to initiate an extraordinary GMS);</p>	<p>Civil Code, Art. 114 and 115;</p> <p>JSCL, Art. 37, 67, 70 and 76, 71, 72, 74, 78 – 81, 85, 90, 95 and 96;</p>	

	<p>Art. 78 – 81 (proxy rights); Art. 85 (the right to elect directors); Art. 90 (the right to derivative suits against directors and officers in breach of their duties); Art. 95 and 96 (the right to receive information), etc.</p>		
62.2.in the labour law	n/a		
62.3.in the environmental law	n/a		
62.4.in the contract law	Provides for the compensation for damages and other remedies in general, applicable to the corporate context as well. We do not cite the latter provisions here as those are not “shareholder-specific”.		
62.5.in the insolvency law	<p>Insolvency Law addresses mostly the issues of suspension of shareholders rights (Art. 20), and sets the order of priority for shareholders (Art. 61).</p> <p><u>The Insolvency Law contains number of typical provisions for similar laws protecting creditors. Provisions of the Law on the automatic stay of actions against the debtor, grounds for relief from automatic stay and adequate protection for secured creditors (Art. 18), creditors meetings and formation of creditors board (Art. 15), voting on and approval of the reorganization plan (Art. 49, 51 – 54), avoidance of “fraudulent” transfers (Art. 35 - 39), pro rata distribution of the debtors assets (Art. 60 and 61) are relevant in this context.</u></p>	<p>The Insolvency Law, Art. 20 (suspension and control over the debtor’s activities); Art. 61 (distribution of the debtor’s assets – order of priorities).</p>	<p><u>As a matter of the law, creditors are treated as stakeholders of a corporation only within the insolvency context when, the classes of creditors actually decide on the prospects of financial rehabilitation of the debtor corporation. Furthermore, only here the law mandates equitable treatment of the creditors.</u></p> <p><u>As opposed to some European nations, creditors in Armenia are not seen to be stakeholders of a business in any other context, including in the corporate governance framework.</u></p> <p><u>The Insolvency Law has a poor record of application. Courts were not successful in striking the meant balance between the interests of creditors and debtors.</u></p> <p><u>Furthermore, some large creditors would get a preferential treatment at the expense of other creditors. At a point the Council of Judges recommended the courts not to</u></p>

				<p><u>apply the Insolvency Law on the basis of contradiction with the Civil Procedure Code, which was rather technical in its nature⁶. As a result the Law suspended in 2000 for over a year, till the courts were forced to start accepting bankruptcy petitions again upon failure of the effort to enact new insolvency legislation. To address existing problems in the insolvency legislation, the Ministry of Justice currently develops new draft-law on insolvency.</u></p>
62.6.in the other legal acts		<p>SMRL sets forth –</p> <p>Disclosure Provisions: Chapter II (disclosures related to public distribution of securities); Chapter III (Registration of Securities); Chapter IV (Reporting Requirements – ongoing disclosure rules);</p> <p>Duties of Directors and Officers: Art. 40 (duties of good faith, due care, and the best interests);</p> <p>Market Regulations: Art. 48 (prohibitions of price manipulations); Art. 49 and 50 (prohibition of insider trading and other manipulative devises); Art. 52 (proxy regulation); Art. 53 – 57 (tender offer regulation);</p>		<p>Over 200 companies are registered with the Securities Commission or the Armenian Stock Exchange and file current and periodic reports as “Reporting Issuers”.</p>

⁶ According to the Civil Procedure Code, which was adopted after the Insolvency Law, the rules of insolvency proceedings were to be governed by the Code itself, while the only available rules were set forth in the Law.

	<p>Consumer Protection Provisions: Art. 78 – 79 (consumer protection in brokerage services’ context); Art. 82 – 83 (consumer protection in portfolio management services’ context); Art. 87 – 88 (consumer protection in custodian services’ context);</p> <p>Administrative Liability: Art. 137 and 138 (general administrative liability); Art. 139 (administrative liability for disclosure of information related to customers account); Art. 140 (administrative liability for use of insider information);</p> <p>Civil Liability (Right to Private Action to Enforce the Law): Art. 12 – 17 (liability for misstatement or omission of material information in a prospectus); Art. 142 (liability for misstatement of material fact in any effective statement or report); Art. 143 (liability of directors and officers for breach of duties); Art. 144 (liability for price manipulation); Art. 145 (liability for insider trading); Art. 146 (liability of controlling persons);</p>		<p>The Staff of Securities Commission has brought about 400 refrain orders and over 60 administrative penalty cases before the Commission in 2002. Only 3 of them contained allegations of insider trading. The Commission has imposed over \$40 000 in fines (mostly directors and CEOs) last year.</p> <p>No court cases established.</p>
<p>63. Is judicial redress provided for by the existing legal framework? If yes, by which laws and in what terms?</p>	<p>The right to judicial redress is set forth in the JSCL as well as in the SMRL. The JSCL provides for judicial review of the decisions of the GMS upon an action of an aggrieved shareholder (who has not voted for that decision). It also grants the shareholders of 2% right to derivative action against a director or officer of a corporation in breach of his/her respective duties. The</p>	<p>See: Question 62.1 (Art. 68 – the right to judicial review of the GMS decisions upon request (a suit) of an aggrieved shareholder; Art. 90</p>	

	SMRL details and extends the limit of the right to all shareholders – irrelevant of the % of their shares.	– Liability of Directors and Officers for Breach of Duties); and Question 62.6 (Right to private action to enforce the Securities Regulations). See also: Questions 25, 32, 34 and 35	
64. Is redress by means of mediation and arbitration provided for in the current legislation on stakeholders?	Legislation on stakeholders itself does not proved for mediation and arbitration. However, the civil procedure law addresses the matter and provides for enforceability of arbitration clauses in a contract. For employees, see next Question,		
65. Do internal redress procedures for employee rights exist and if yes, please describe?	There are internal procedures for protection of employees’ rights. Employment disputes are usually handled by Commissions for Employment Disputes (CEDs) and/or trade unions. The CEDs are established internally for resolution of employment disputes under Article 230 of the Labour Code of RA. Trade unions have an active role and wide discretion in dispute resolution under both the Art. 250 of the Labour Code and the Law “On Trade Unions”.	Labour Code of the Republic of Armenia, adopted 16.06.72, as amended as of 11.10.00., Articles 230 and 250; Law “On Trade Unions” adopted 5.12.00 (PL-135, OG RA 2001/1	

		(133), 15.01.01, Articles 3, 15, 17 and 19 (discretions of the trade unions in providing redress for employee rights)	
66. Could you provide examples of cases related to stakeholder right violation?	Abovian Brewery Factory (ABF) is an open joint stock company controlled by two shareholders holding 97% of shares in the company. To squeeze out the minority shareholders the majority shareholders introduced a share consolidation plan, providing for exchange of 1000 existing shares for 1 new share of the ABF. Shares not exchanged for the new ones would be cancelled and certain compensation would be paid to holders of such shares.	JSCL, Art. 56, 57 and 59.	
67. Could you provide examples of cases of legal redress related to such violations or lack thereof?	The Commission has intervened upon complaint of a shareholder of ABF. After hearing the Commission held in its decision, that even though the plan was allowed under the JSCL, its implementation would violate the basic proprietary rights of the shareholders. The company is not allowed to cancel any interest in the company unilaterally merely because such interest constitutes only a fraction of a share. The JSCL does not allow the “squeeze-outs” per se. Therefore, the plan contradicts the JSCL as applied. Accordingly, the Commission ordered the ABF to refrain from implementation of the plan. The ABF appealed decision of the Commission to the Commercial Court. The Court upheld the plan and revoked the decision of the Commission. The Commission appealed the decision of the Commercial Court to the Court of Appeals. After the first session of the Civil and Commercial Chamber of	Decision of the Securities Commission # 426/01 (26 October, 2001). Decision of the Civil and Commercial Chamber of the Court of Appeals of the Republic of Armenia (docket number 3-118(CC), 2002).	

	the Court of Appeals, the ABF gave up (when the ABF representatives “felt” the attitude of the judges) and the parties settled the case. The Court revoked decisions of the lower courts and approved the settlement. The ABF refrained from implementation of the plan and agreed not to consolidate the shares. The ABF further agreed to pay additional compensation to the shareholders who had agreed to cancellation of their shares before, in reliance on the plan. The Commission agreed to refrain from further administrative actions against the ABF and the majority shareholders on the basis of the plan.		
68. Do performance enhancing mechanisms exist for stakeholder participation in corporate governance, such as:			
68.1.employee participation in corporate boards,	Not required, but widely practiced.		Participation of employees in the boards is a mere formality, and in practice impairs the independence of the directors as employees usually depend on the executive officers.
68.2.employee stock ownership plans or other profit sharing mechanisms,	Provided for by JSCL, but rarely practiced.	JSCL, Art. 41.	In the absence of active market in the shares of the companies, it is not considered to be an effective mechanism of incentives.
68.3.creditor involvement in governance in the context of insolvency proceedings?	Creditors vote on the reorganization plan. Furthermore, the creditors holding 1/3 of any class of claims may propose their own reorganization plan. Creditors are involved in other aspects of operation of the debtors estate in bankruptcy, such as notices of sale, approval of certain transactions not covered by the plan, etc.	The Insolvency Law, Art. 15 (creditors meeting and board); 49 (proposition of the reorganization plan); 52 and 53 (voting on the plan).	

69. How are the stakeholder rights applied in practice?	Generally the interests of the stakeholders are left at the merit of the controlling shareholders (owners). Judicial redress is available but rarely resorted to (especially in case of the shareholders).		See also: Question 72
70. Does the corporate governance framework recognise the rights of stakeholders as established by law?	Armenia is lacking corporate governance framework within the meaning of a set of standards and rules of good/best practice.		Recently established Centre for Corporate Governance (an NGO established by former Deputy Chairman of the Securities Commission Tigran Karapetian) maintains plans for development of a document setting forth the best practices of corporate governance (similar to the Russian Code of CG). We think this effort is worth serious attention, and in case of successful implementation may substantially improve the corporate governance practices in Armenia.
71. What are the main current pitfalls in addressing their rights by the corporate governance framework?	Lack of both such a framework and perception of its importance.		
72. At this stage of development of the corporate sector, which are the most important stakeholder groups in your country?	The most important stakeholder groups in our opinion are the shareholders and the employees of corporations. Interests of both are poorly served.		
73. Are institutional investors important stakeholders in the corporate governance landscape of your country?	Corporate governance framework evolves in the absence of Institutional investors. Few privatization voucher funds established in early 90's failed.		
74. Is there a practice by boards of disclosing how the interest of	No such practice exists.		The Commission and the Stock Exchange are working on a standard of reporting on

stakeholders are being protected?			material compliance with the requirements of the law to be applicable to a limited number of issuers (such as large issuers).