

PN ACD-734

99623

**ASSESSMENT OF THE LEGAL, ORGANIZATIONAL
AND CORPORATE GOVERNANCE STATUS
OF ARMENIAN ELECTRIC AND NATURAL GAS
DISTRIBUTION UTILITIES**

**Contract No CCN-Q-00-93-00152-00
Delivery Order No 12
Improved Commercial Operation of Energy Sector
Distribution Companies in Armenia**

Final Report

Prepared for

United States Agency for International Development
Bureau for Europe and NIS
Office of Environment, Energy and Urban Development
Energy and Infrastructure Division

Prepared by

Hagler Bailly
455 Market Street
Suite 1420
San Francisco, CA 94105
(415) 882-1602

Contact

Dean White

September 25, 1998

A

CONTENTS

Executive Summary

1	Introduction	.	.	1
2	Background			2
3	Assessment Approach	.	.	5
4	Analysis of the External Environment			6
5	Analysis of the Internal Environment	.		13
6	Findings	.		22
7	Conclusions			24

References

Appendix A – Model Closed Joint Stock Company Charter and Mapping to Joint Stock Company Law

Appendix B – Copy of Collective Bargaining Agreement for Yerevan Distribution Company

EXECUTIVE SUMMARY

The energy sector of the Republic of Armenia has gone through a significant period of evolution from the day its Government achieved independence in September of 1991. Its two principal subsectors, electric energy and natural gas, have lost their status of Government-owned horizontal and vertical monopolies. The electric sector has been broken up along functional lines into a number of generating companies, a transmission company, a dispatch company, and four distribution companies. The natural gas sector has undergone a series of evolutionary changes until, in December of 1997, a joint-venture company was formed covering all transmission, storage, and distribution functions of the Armenian gas sector. The Government of Armenia will retain ownership of 45% of this new joint-venture company, called ArmRusgasprom, and the rest will be split between the Russian Gas Company Gasprom (45%) and its marketing affiliate Itera (10%). It is the purpose of this report to assess the legal and organizational status and the type of governance that the distribution sectors of the electric and natural gas industries have achieved.

For the purpose of this study, the largest of the four Armenian electric distribution companies was selected as a representative unit. That company is the Yerevan Distribution Company which is responsible for about half the distribution operations in Armenia. Since only two companies, the Yerevan Gas Company and the Haygas Company conduct the natural gas distribution operations in Armenia, both of these companies were chosen for a 100% coverage of the natural gas distribution sector.

The methodology of this study included a review of the legal evolution of the energy sector and of its corporate governance since independence, including a discussion of various pertinent laws and Government Resolutions, the development of a questionnaire designed to keep the discussion with foreign counterparts focused and internally consistent, and interviews of key personnel at the level of executive director and subdirector. The study differentiates between generic findings applicable to both distribution sectors and company-specific findings.

The discussion of generic findings includes a review of the Government Resolution 551 issued in December of 1997 which was of particular importance to all distribution companies. The Resolution re-emphasizes the Government's general commitment to privatization and, among many other issues, it specifically calls for the privatization of the electric sector distribution companies. Perhaps the most important generic document is the Joint Stock Company Law, since all of the distribution companies in Armenia are registered as joint stock companies (JSCs).

This law establishes the legal requirements and operating parameters of JSCs in Armenia. In particular, it stipulates that JSCs must have a Charter with certain minimum requirements. As it turns out, all state-owned JSC charters are identical except for certain company-specific features such as the name and location of the company and its assessed value at the time of its registration (Charter Capital). By and large, the JSC Charter provides for company rights and obligations that are not dissimilar from those found in the West. The generic findings also include a brief discussion of labor relations and employment compensation programs.

A conclusion section analyzes both generic and company-specific findings. This is the area where the report moves from a neutral descriptive mode to a judgmental stance. The report holds that the distribution companies lack a general understanding of the corporatization process, that there has been no opportunity to develop a sense of entrepreneurship among top managers. The report recommends that the distribution companies should each have their own Board of Directors, even though under the law they can elect, and have elected, not to have one. The lack of a sound planning process is also noted, as is the need for less convoluted human resource practices and for stronger and more transparent internal control and auditing procedures.

With regard to company-specific conclusions, the Yerevan Distribution Company has progressed farther towards corporatization than the two gas distribution companies. As to the gas companies, there has been a general lack of progress in the areas of commercialization and corporatization. However, this hesitation appears primarily due to the fact that the gas companies are waiting for the new owner, the Joint Venture Company ArmRusgasprom, to settle on its form of corporate governance, before any of the subsidiary companies (including the Transgas Pipeline Company) can or should attempt to establish their forms of governance. To be sure, the corporate organization of all gas subsidiaries is the JSC, but just exactly how these companies will interact with each other remains an open question that should become clearer by year-end.

Finally, the report notes the importance of continued work at the enterprise level on commercialization and corporatization but also stresses the need for work at the Ministerial level. Civil service reform is one such example cited, as long as Government officials are paid below subsistence level wages, it is difficult for enterprise management to pay the salaries necessary to attract and retain talented staff. The report closes with a recommendation that efforts should be redoubled to implement the admirable objectives noted in Resolution 551, especially those related to strategic investor privatization of the electricity distribution sector.

- / -

ASSESSMENT OF THE LEGAL, ORGANIZATIONAL AND CORPORATE GOVERNANCE STATUS OF ARMENIAN ELECTRIC AND NATURAL GAS DISTRIBUTION UTILITIES

1 INTRODUCTION

This report presents an assessment of the nature and extent of corporatization principles presently implemented within the retail electric and natural gas distribution enterprises in Armenia¹. The purpose of the report is to assess the legal status, organization and governance of the electricity and natural gas enterprises. Specifically, the report examines three distribution enterprises to determine

- ▶ The extent to which the entities have a form of corporate governance consistent with the laws, decrees and resolutions that make up the entities' external environment,
- ▶ The extent to which the corporate governance structure for each entity is consistent with proper corporate governance features and promotes commercialization of the utilities

Additionally, each organization was also reviewed to determine the extent of its commercial orientation. Indicators of independence and commercial orientation include such features as the extent of business planning undertaken within the organization (rather than imposed from elsewhere) and the type of flexibility the company maintains in employment and investment practices.

Based on the assessment, a number of generic recommendations applicable to all three enterprises (and more broadly, to the energy sector overall) are offered along with some specific suggestions for each enterprise.

The Government of Armenia (GoA) has represented that all of the state-owned energy enterprises (except for Armenergo, the Armenian Nuclear Power Plant (ANPP), and the Energy Institute) were converted to state-owned joint stock companies in late 1997 through early 1998. The assessment work embodied in this report was oriented to the expectation that the corporatization of the selected representative electric and natural gas distribution entities was well underway. Further, the assessment was conducted with the secondary expectation that the

¹ This report has been completed as part of Delivery Order no. 12 of Contract CNN-Q-00-93-00152-00 between the United States Agency for International Development (USAID) and Hagler Bailly.

corporatization of the energy enterprises support the stated goals of the GoA including (1) the improvement of the financial performance of the entities through the implementation of sound commercial policies and practices, and, (2) the denationalization of the energy sector

Yerevan Distribution Company was selected as the representative entity for the electricity distribution sector as it accounts for roughly half of the retail electricity sales within the country and is one of the four remaining consolidated distribution entities. The natural gas industry presently consists of two distribution entities, Yerevan Gas Company and Haygas². Both of these gas utilities were included in the assessment.

2. BACKGROUND

Prior to 1991, the Armenian electric and natural gas sectors were part of the Soviet Caucasus and Trans-Caucasus integrated network for the production, transmission and distribution of electric power and natural gas within the former Soviet Union. An immediate consequence of Armenian independence in 1991 was the inheritance by the GoA of all industrial enterprises within its territory, including the electric power and natural gas enterprises. The acceptance and continuance of the Soviet style institutional and management structure of these enterprises remain part and parcel of the Soviet legacy within Armenia. A characteristic of this legacy was that both electricity and natural gas were severely underpriced at the end user level. There was no framework for the concept of "full cost" pricing for either electricity or natural gas. Moreover, consumers were conditioned to view the availability of low cost electricity and natural gas as a social right instead of a commodity whose price in a free-market economy is determined by economic parameters.

Three events have in large part shaped the present characteristics of the energy supply and demand situation in Armenia: (1) the earthquake of 1988, (2) the gaining of independence in 1991, and (3) the energy embargo resulting from the Armenia-Azerbaijan conflict. The following tables illustrate the impact each of these events had on the generation of electricity and the consumption of electricity and natural gas within Armenia.

Table 1 shows that in 1988 the nuclear power plant accounted for about 31% of generated electricity. As a result of the earthquake of 1988, as a cautionary measure, the Government decided to shut down the nuclear power plant. By 1991, the net supply of electricity declined slightly from 12,592 GWh in 1988 to 11,815 GWh. However, during that period, the reliance on thermal generation increased from 57.7% of the total to 67.5%, imports rose from 1.1% to 14.4%, and hydro generation rose from 9.9% to 19.5%.

² Haygas is sometimes referred to as Armgas.

Table 1 Annual Mix of Electric Generation (GWh)

Source/Year	1988	1989	1991	1993	1995	1997
Thermal Plants	8,949	9,693	7,970	2,002	3,338	3,032
Nuclear	4,850	1,281	0	0	303	1,600
Hydro Plants	1,534	1,149	2,299	4,292	1,919	1,390
Imports	177	1,248	1,699	115	0	220
Sub-Total	15,510	13,371	11,968	6,409	5,560	6,242
Exports	2,918	330	0	0	0	7
Net Supply	12,592	13,041	11,815	6,409	5,560	6,235

Source Ministry of Energy

Table 2 Natural Gas Supply/Consumption (million cubic meters)

Consumer Class/Year	1988	1989	1991	1993	1995	1997
Imports	5,754 0	6,328 0	4,153 0	801 0	1,458 0	1,262 0
Internal Consumption	27 0	94 4	17 1	0 0	7 2	5 0
Losses	160 5	187 1	108 7	0 0	67 2	76 4
Export	266 6	308 5	349 8	0	0	0
Net Supply	5,299 9	5,738 0	3677 4	801 0	1383 6	1,180 6
For Electric Power	1,583 0	2,089 0	1025 0	692 0	1,175 0	906 6
For District Heating	523 7	462 0	275 7	0 6	56 9	97 9
Residential Usage	1,251 0	1,315 0	1207 0	12 8	3 8	8 0
Industrial Usage	1,668 0	1,582 0	993 2	59 8	136 8	148 1
Other Usage	274 2	290 0	176 5	35 8	11 1	20 0

Source Ministry of Energy

The breakup of the Soviet Union had a negative impact on the Armenian economy. Industrial consumption of electricity in Armenia declined from 4,554 GWh in 1988 to 2,780 GWh in 1991. Concurrently, industrial consumption of natural gas declined from 1,668 million cubic meters to 993.2 million cubic meters, Table 2. Over the same period, however, residential consumption of electricity increased from 2,440 to 2,974 GWh, while natural gas consumption remained virtually flat.

Under the best of circumstances, the transition from the centrally controlled Soviet system to autonomous control of the individual state economies would have resulted in the realignment of economic activity within each of the NIS countries and led to a certain level of disruption. The situation in Armenia was exacerbated by its conflict with Azerbaijan. Consequently, net electric supply declined from 11,815 GWh in 1991 to 6,409 GWh in 1993. More significantly, hydro generation accounted for about two-thirds of the net supply as the shortages of natural gas severely curtailed the thermal production of power and also resulted in a further decline in industrial production in Armenia. Industrial consumption of natural gas in 1993 was 59.5 million cubic meters, less than four percent of the 1988 level. Residential consumption of natural gas ended altogether in the second half of 1993, with restoration of supply only starting in any significant amount in the past year.

Since 1993, the GoA has instituted and continues to implement institutional and structural reforms within various sectors of the economy. Perhaps the most notable impact of such reforms has been in the energy sector. The net supply of electric energy has stabilized and, with the recommissioning of the nuclear power plant in 1995, the net supply of electric energy was 6,235 GWh in 1997, with thermal generation accounting for 48.6%, nuclear 25.6%, hydro 22.3% and imports 3.5%.

Some of the more noteworthy GoA actions in the energy sector include

- ▶ the unbundling of the electric sector into distinct and separately managed generation, transmission and distribution entities,
- ▶ the consolidation of electric distribution entities from over 60 to four such enterprises,
- ▶ the enactment of an omnibus Energy Law and subsequent formation of a national Energy Regulatory Commission,
- ▶ the enactment of Resolution 551 which represents the GoA blueprint for continued structural and financial reforms within the energy sector and its commitment to privatization of the sector,
- ▶ the conversion of all but three of the state-owned energy enterprises to joint stock companies

These major reform actions notwithstanding, recovery within the industrial sector of the economy continues to lag. Residential consumption of electricity presently accounts for about 60% of total consumption versus about 25% in 1988. Industrial consumption of electricity is at about 20% of the 1988 level and that of natural gas around 10% of the 1988 level. As discussed further in the next section, both the electric and natural gas sectors are in a high state of disrepair and are in dire need of investment capital for rehabilitation and upgrading with estimates as high as \$2 billion over the next 10 years. The GoA recognizes that the only viable source for such capital is the private market and has stressed its willingness to take the actions necessary to facilitate the privatization of the energy sector.

Since 1993, both the electric and natural gas sectors have been operating well below their design capacities and for different reasons have fallen into a state of extreme disrepair. As previously mentioned, the end-user price for both electricity and natural gas has been, and continues to be, below full cost recovery. Since 1993, the retail residential tariff for electricity has been raised in steps and is presently at about 20 drams per kWh (\$0.04). The estimated full cost tariff is in the range of 30 drams per kWh.³ The current residential tariff for natural gas is \$102 per thousand cubic meters compared to an estimated \$300 per thousand cubic meters at current consumption levels and \$150 per thousand cubic meters if consumption can be increased to pre-embargo levels.⁴

The tariff level is only one part of the picture. A more troublesome part with respect to the retail electric sector is the high level of commercial losses in the form of delivered but unbilled energy (i.e., theft) and billed but uncollected energy (i.e., customer non-payment). It is estimated that about 30% of the electric energy delivered to the distribution sector is "lost" and unaccounted for. At the present tariff this represents about \$60 million each year in lost revenue. The GoA attributes about 80% of this high level of loss principally to what it refers to as the "human factor" with the balance attributed to the poor physical condition of meters and other equipment. A similar collection problem exists within the residential natural gas sector, especially at Haygas.

Both sectors are presently characterized by less than adequate cash flow from operations. The problem facing the GoA is how to best position the energy entities to attract the needed private investment. In the natural gas sector, the investment problem may have been addressed somewhat by the formation of the ArmRusgasprom joint venture. However, as discussed below, the efficacy of this solution remains to be seen.

3. ASSESSMENT APPROACH

The approach used to complete this assignment consisted of the following

³ Hagler Bailly, 1997. Lahmeyer International, 1998.

⁴ Merklein & Associates, *Natural Gas Tariffs Design and Implementation* (July 1998).

- ▶ selection of representative entities for the electric and natural gas distribution sectors, including Yerevan Distribution Company, Yerevan Gas and Haygas,
- ▶ the review of pertinent GoA laws and resolutions. In this case, Resolution 551, the Law of Joint Stock Companies (JSC Law) and the standard Model Charter for joint stock companies,
- ▶ the development of a standardized questionnaire to define the information to be collected, reviewed and assessed from each representative distribution entity,
- ▶ interviewing key personnel at each represented distribution entity and the request for supporting documentation in the areas of inquiry,
- ▶ a review of the information obtained through the interviewing process and the documents received with respect to compliance with the intent and goals of Resolution 551 and the JSC Law,

Finally, there was an the assessment of the nature and quality of commercial policies and practices demonstrated by the representative entities in the areas of inquiry

4. ANALYSIS OF THE EXTERNAL ENVIRONMENT

To assess the commercial orientation of the enterprises, it was necessary to examine the external environment in which each enterprise operates. For purposes of this report, the external environment includes those resolutions, orders, laws, and general Government policies that impact the organization's governance and business practices.⁵ Specifically, the organization and governance of each organization were examined to determine the extent to which the organization is aligned with Government policies, laws and other external factors. The two documents that best outline the external environment for the companies are Order 551 and the Law on Joint Stock Companies. Another feature of the external environment is the company's interaction with its employees as characterized by the labor and trade union agreements. Although this part of the internal environment is usually well within the control of the utility, it is an important factor in assessing the independence and commercial orientation of the enterprise. In other words, to the extent that there are external factors impinging on the ability of management to hire, fire and reward employees, the commercial orientation of such an enterprise will be adversely affected.

Resolution No 551

In December 1997, the GoA enacted Resolution 551. Among other items the Resolution

⁵ This definition is rather restrictive. The external environment usually includes other factors such as the macroeconomy.

- ▶ indicates that energy sector privatization is a high priority of the government and that the government views privatization as a way to attract private capital to the sector,
- ▶ calls for the privatization of the 11 consolidated distribution networks (now further consolidated down to four distribution networks) of the electric power sector through international tender beginning in 1998, followed by the sale of the thermal and hydro generation plants. In each case, at least 51 percent of the shares will be offered to a strategic investor. The scope of the privatization program involves the sale of all energy sector companies by the year 2000, except for the Armenian Nuclear Power Plant (ANPP), Armenergo (at that time, the national transmission and dispatch utility)⁶ and the Institute of Energy, each of which the Government plans to hold,
- ▶ provides a candid assessment of the energy sector's financial problems and the reasons for them and calls for several measures to create an environment of financial discipline and transparency within the sector,
- ▶ outlines several concepts aimed at improving the financial condition of the sector, including the need to establish financial principles to rehabilitate the sector, the importance of accounting mechanisms, the reduction of power losses, regulation of cash flow, tax treatment of bad debts associated with the sale of power, efforts to improve cash collections, loan and debt restructuring, and tariff policy,
- ▶ identifies several potential sources to help improve the sector's financial condition, including the use of cost-based tariffs, improvement in the collection of accounts receivable, various forms of debt and tax relief, and debt restructuring,
- ▶ targets collection improvement goals (without so called "overplanned losses") of 86% in 1998, 93% in 1999, and by year 2000, full payment for electric power will be achieved,⁷
- ▶ promotes the active involvement of the banking system in the customer payment process,
- ▶ mandates that an equal number of authorized representatives from the Ministry of Energy, Ministry of Finance & Economy, and Ministry of Privatization be placed on the Board of Directors of the state-owned joint stock companies of the energy sector

With respect to the last item, though not specified in the Resolution, the GoA undertook the conversion of all the state-owned energy enterprises (except for Armenergo, the ANPP and the Energy Institute) to closed joint stock companies in early January 1998 pursuant to compliance with the Law on Joint Stock Companies

⁶ Armenergo was recently further restructured. The high voltage transmission function was divested from Armenergo and a new transmission joint stock company (ArmTrans) was formed.

⁷ Year-to-date collection rates for 1998 are about 55%. The 1998 target will not be reached.

Based on the assessment undertaken, it is clear that the organization and operation of the utilities are not consistent with achieving the objectives noted in Resolution 551 above in two main areas including corporate governance and financial improvement

As of the writing of this report, none of the three distribution enterprises has a Board of Directors. Only the Yerevan Distribution Company has a reporting requirement involving more than the Ministry of Energy. The collection targets are not being achieved but at the same time, utility management do not appear to have much flexibility in approaching the collections problem. Most initiatives emanate directly from the Ministry of Energy. In short, the present organization and operation of the three enterprises examined are not aligned with the Government's stated policy directions shown in Resolution no. 551.

JOINT STOCK COMPANY LAW

The Law of the Republic of Armenia on Joint Stock Companies (JSC Law) was enacted on April 30, 1996 and is the controlling law for all aspects of JSC's, including charters for state-owned closed joint stock companies (CJSCs). In this regard, it is an important component of the external environment affecting the corporate governance of the enterprises in the energy sector.

The JSC law is quite prescriptive by US standards. At the same time, many parallels can be drawn to the general principles of US corporate organization and governance, ownership rights/liabilities, stocks, bonds and payment of dividends/interest, accounting and audit provisions, procedures for corporate establishment and dissolution, and government reporting requirements.

Article 14 (Company Charter) of the JSC law is controlling and mandates that the requirements of the Company Charter are compulsory for the Company shareholders and all management bodies. This Article prescribes the minimum contents to be addressed in the Charter: statement of legal name, location and form, types, number and face value of stock, size of charter capital, structure of management organization, conduct of shareholders meetings, and other referenced provisions of the JSC law.

All three of the representative energy distribution companies are state-owned CJSCs as defined by the JSC Law. All state-owned CJSCs have a Charter that is identical in most respects (except for certain company-specific characteristics such as the value of capital stock, number and value of authorized shares, existence of subsidiaries) and that is patterned after a Model Charter. A general outline of the state-owned CJSC Model Charter is shown below (see Appendix A for a full copy of the Model Charter and a mapping of articles to the JSC Law).

The Model Charter is a document which establishes a general set of rules for how a JSC shall organize and conduct its business activities in Armenia. It is very comprehensive in its subject matter, which is probably due to the overly prescriptive nature of the JSC Law. In many ways the

Model Charter is a restatement of several pertinent sections of the JSC Law but is also tailored to the unique business characteristics of a state-owned CJSC (e.g., the Model Charter, under certain circumstances, allows that the Company Board need not be established in which case the prescribed activities and authority typically reserved for the Company Board by the JSC Law are transferred to the Company shareholders general meeting)

The Model Charter consists of twelve Articles. The first article simply certifies that the named company is a legal entity and provides a brief outline of its legal basis. This Article also states the name of the company, in full and in abbreviation, in three languages: Armenian, Russian, and English and provides the legal address of the company.

Article 2 deals with the scope and objectives of the company. The first objective listed "to earn profits through economic activities" reveals the intent to move toward commercialization. Only in the second objective does the Charter list company-specific activities such as, for example, in the case of the YerevanGas, "the wholesale purchase of natural gas and liquid gas, and its delivery to customers." A third objective reverts to the open embrace of the market again by allowing the company to "pursue any activity not prohibited by Law."

Article 3 deals with the rights and obligations of the company. A state-owned CJSC is given the right to (1) maintain bank accounts abroad, (2) escape liabilities with its assets for its predecessors' indebtedness (and vice versa), (3) observe certain defined liability rights and obligations vis-a-vis the state and local governments, (4) borrow domestic and foreign funds from banks or through trade credits, (5) issue securities on its own behalf, (6) develop and implement its own foreign economic activities, without outside interference, (7) acquire and possess foreign currencies, (8) develop and implement its own strategic plans, (9) create foreign and domestic representative offices and form subsidiaries. Several obligations are included such as (1) the obligation to record and account for its financial activities, (2) the obligation to publish annual reports and other documentation, (3) if permitted to have affiliated companies, the obligation to make public any participation in such companies.

Article 4 defines the state-owned CJSC Charter Capital in Drams, and shows the face value of each share (and by implication the number of shares). It also states that there will only be common shares. This is followed, in Article 4, with a detailed discussion of the procedures through which the CJSC may increase or decrease (to a limit) its Charter Capital.

Article 5 deals with shares and other securities. This Article outlines the conditions under which stocks and other securities may be issued (but the operational rules all refer to stocks). Two provisions that deserve mention are that only common shares may be issued and that the initial value of the shares is determined by the Government. There is a provision, required by law in certain European countries but non-existent in the US, that calls for the establishment of a reserve account (i.e., Reserve Fund) of 15% of the company's Charter Capital. This reserve fund is to be financed through a five percent levy on profits and, if applicable, through any difference

between the book value and the sales price of newly issued shares. The reserve fund can only be used to cover company losses or to re-purchase outstanding shares.

If at the end of a financial reporting period, the CJSC net assets are valued below its Charter Capital, it must reduce the value of its shares to the end-of-year value of its net assets. However, if that value is below the minimum charter capital prescribed by law, the company must go through liquidation.

Article 6 discusses the rights and responsibilities of shareholders, which, in the case of a state-owned CJSC, is the Government ("Founder"). These rights and responsibilities include the shareholders' right to elect the management team, to receive dividends, to receive relevant financial information including balance sheets and income statements, and others. On the obligation side, Article 6 lists as an obligation the shareholder's participation and vote at shareholder meetings, its responsibility to make investments as stipulated in the Charter, and its need to treat certain information as confidential.

Article 7 deals with dividend policies. It gives the CJSC the right to declare quarterly, semi-annual, or annual dividends, but it also provides that the company may retain part of its earnings (following a decision to that effect by the shareholders). No dividends may be paid unless the Charter Capital has been fully subscribed and value has been received by the company, or if indicators prescribed by law point toward imminent bankruptcy. Similarly, no dividends may be paid if such payment would reduce the net assets of the company below the value of its charter capital.

Article 8, the longest in the standard CJSC Charter, stipulates that the ultimate management body of the company is the shareholders. The shareholders must be convened at least annually at the Shareholders General Annual Meeting. Extraordinary shareholders meetings may be called to deal with arising emergencies. Through decisions taken at shareholders meetings, the company may (1) amend its Charter, (2) re-organize the company, (3) liquidate the company, (4) define principal activities of the company, (5) set and adjust the company's shares, (6) use the company's reserve fund, (7) elect the Financial Control Committee and the company's auditors, approve budgets and financial documents, (8) declare dividends, (9) appoint the company's Executive Director, and perform various other functions including approval of the company's organizational structure.

The Founding Shareholder (presently the Government) has sole authority and control over the Company's shareholders meetings. While a joint stock company may in general have a Board of Directors that acts on behalf of the shareholders, a CJSC may elect not to establish a Board. This is the situation with respect to the representative entities examined in this report. None of the three entities examined have an actual Board of Directors. In these cases, the company's Executive Director and other senior managers report to, and have advisory voting privileges at, the shareholders meetings.

Article 9 deals with controls over the CJSC financial activities. The principal vehicle to be used in controlling these activities is a Control Committee to be elected by the shareholders for a period of three years. The Control Committee has the usual rights to monitor the implementation of management decisions within the company, assure compliance with the laws of the Republic of Armenia, audit company documents, and report directly to the shareholders at regular or special meetings. The Control Committee, which may be headed by the company controller or by outside representatives, is guaranteed access to all company documents bearing on its responsibilities.

Article 10, dealing with the company's right to have branches and representative offices, is non-standard. Depending on the company, it either prohibits or permits the establishment of branches and representative offices. If such branches are permitted, the company is obligated to list all of its branches and representative offices at home and abroad.

Article 11 provides, among other items, for conditions under which the Charter may be amended. General amendments require a three-quarter majority vote of the shareholders to become effective, except for increases in the company's Charter Capital, which only need a simple majority.

Article 12 addresses issues regarding the reorganization and liquidation of a state-owned CJSC. This article describes procedures under which mergers, spin-offs, and other reorganizations may be effected. It also defines liquidation and lists various factors that may lead to it, including bankruptcy through voluntary Board action or judicial proceedings. However, and somewhat in contradiction with the provision regarding court-ordered liquidation, the liquidation of a state-owned CJSC can only be effected by the Founding Shareholder (the Government).

Overall, the Model Charter is quite clear in its substance, albeit quite lengthy, and addresses many aspects of corporate activities. It serves as a good starting basis for the corporate governance and commercial orientation of the three enterprises examined in this report. The Charter includes the provisions one would generally want to see to ensure adequate corporate governance, assuming that the provisions are in fact put into practice. Of concern to the project team is that none of the enterprises have set up Boards of Directors. Also, there should be some caution related to the fact that the enterprises are permitted to engage in any activities not expressly prohibited by law. Although this is common in many countries, in those economies lacking transparency and appropriate financial reporting (as well as auditing) in accordance with internationally accepted practices, this could be problematic.

Labor Relations/Trade Union Agreements

Another component of the external environment is the labor codes and laws and how these affect the organization and operation of the utilities examined. The trade union system within Armenia is a legacy of the Soviet system. By Armenian law, every enterprise must have a Collective (i.e., Trade Union) Agreement. A copy of the Collective Agreement for the Yerevan Distribution

Company can be found in Appendix B. As originally conceived, the primary purpose of the trade union was to manage the pension funds. It appears from the contract that the relationship between the enterprise and the trade union is intended to be collaborative, with each party having “equal rights” and reasonably well-defined responsibilities.

The trade union is represented at the enterprise by a Trade Committee which itself is within the structure of a National Union. For example, at the Yerevan Distribution Company, the National Union entity is the Amalgamated Trade Committee that is part of the Federation of National Electric Trade Unions.

Trade union representatives in the larger enterprises are generally appointed and paid by the unions themselves that are financed through company contributions set at one percent of employee salaries. In smaller enterprises the union representative is a part-time union official, on the payroll of the company itself, and performing company duties in addition to his or her employee representational work. Membership in unions used to be mandatory. Today, it is optional, but the existing employment culture still makes membership quasi-mandatory, under the penalty of being considered an outsider (“trouble maker”).

The unions appear to be more oriented toward issues of job security and working conditions for its members as opposed to salary levels per se or strict interpretation of division of labor or job classifications. Using Yerevan Distribution Company as the example, the Union acknowledges and agrees

- ▶ that the company may use a tender process for hiring,
- ▶ that the basis of employment may be by contract between the company and the employee,
- ▶ that there may be structural changes within the company which could result in the elimination of jobs and the lay-off of employees according to defined procedures and a prioritized job retention schedule.

Traditionally, the termination of a union employee by a company, even for cause, has been problematic as the unions and the Courts apparently side heavily with the employee. The representative enterprises believe that the use of a short-term revolving “employment contract” will facilitate the company’s ability to terminate an employee for poor performance or the violation of company policy. However, the issue has not been tested through the Court system and there is a difference of opinion as to whether or not the Courts would uphold the company’s position.

Employee Compensation

The issue of “official” salary levels was discussed with each representative enterprise. It was openly recognized that the present level of salaries is inadequate (to the extent of being below

subsistence level) and a significant contributing factor to the observed level of “theft” within the energy sector

Today, the average salary at the Yerevan Distribution Company is \$42 per month. It has been estimated that the subsistence level in Armenia today is about \$60 per person per month. With an average family size of 4.5 people, this comes to \$270 per month per family. Clearly, official salaries are presently well below what is needed to support a single-worker family.

Each of the representative enterprises stated that there is no legal reason preventing their company from raising salary levels. However, there are practical and political factors that mitigate against such action. First, it would be difficult to single out the energy sector for such treatment without incurring a reaction from all of the other state-owned entities. Second, the level of financial resources available to the representative enterprises could not support the payment of higher salaries. The situation is exacerbated by the present tax structure that would require any increase in direct salary to employees to lead to higher tax payments to the government by the company.

As previously noted, the poor financial condition of the energy sector is predominately due to the high level of “commercial losses” (i.e., the unbilled energy and non-payment problems). Yerevan Distribution Company illustrates this point in that the spread between the price of its purchased electricity and its retail selling price, as authorized by the Energy Regulatory Commission (ERC), is about 6 drams per kWh (the difference between 15 and 21 drams per kWh, respectively). In actuality, the spread is only 2.5 drams on average because Yerevan Distribution Company is only collecting the equivalent of 17.5 drams for each kWh it delivers versus the expected 21 drams. Even if one assumes that the billing and collection losses are totally eliminated, the tariffs presently authorized by the ERC are based on the current level of salaries. The ability of Yerevan Distribution Company to pay higher salaries is dependent, in part, on actions by the ERC to incorporate such increases in the ERC’s tariff setting methodology.

In short, at present, each enterprise is constrained in how it hires, terminates and rewards employees due to both financial reasons but also as a result of other factors (e.g., political pressure). With these kinds of constraint in place, the enterprise cannot necessarily bring on the kind of talent needed to properly enhance the business and improve its commercial orientation.

5. ANALYSIS OF THE INTERNAL ENVIRONMENT

Yerevan Distribution Company

Yerevan Distribution Company was converted to a state-owned CJSC on November 27, 1997 with a Charter Capital of 115,949,000 Drams (approximately \$332,000) as represented by 115,949 shares of common stock with a par value of 10,000 Drams per share (approximately \$20 per share).

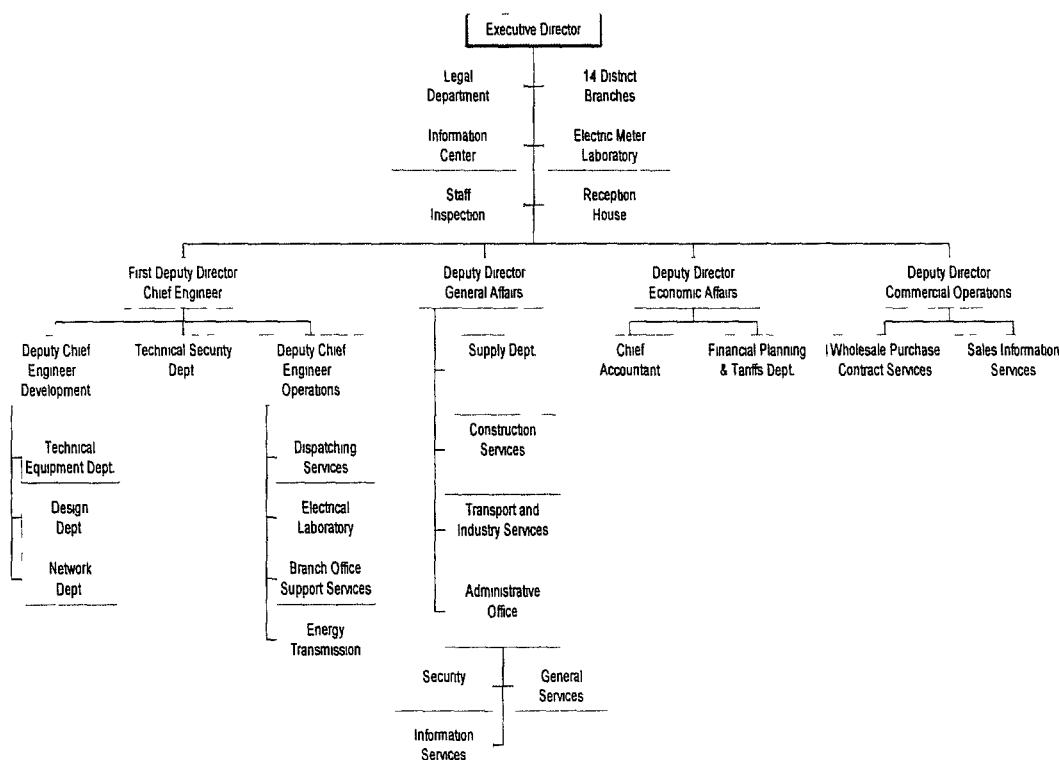
The GoA, as within the JSC Law, chose not to establish a Board of Directors for the company. Instead, the management of the company reports to the Ministry of Energy and the Ministry of Finance & Economy. The exact nature of this dual reporting requirement is unclear in its intent and operation. It is not clear if both Ministries are considered to be a shareholder and afforded the rights of a shareholder under the JSC Law and Charter.

Executive Management is selected by the "shareholders." The present director also holds the title of Deputy Minister of the Ministry of Energy. Of course, having a deputy minister serve in a role as director of an enterprise increases the likelihood that the enterprise will be more subject to political influence in its day-to-day operations.

Yerevan Distribution Company has a Control Commission consisting of company employees from various functional areas (including technical, legal, financial and contracts), using employees on the Control Commission appears to be in violation of the JSC Law. The company presently uses an outside firm, ArmAudit, to prepare its financial statements and tax calculations.

The company has 17 branches consisting of 15 district branches plus an Electric Meters Laboratory and a Reception House (a commercial hotel and restaurant). The company's Organization Chart (see below) shows that the branches report directly to the Executive Director of the company as does the company's Information Center, Staff Inspection, and Legal Department. There are four main functional or administrative Departments that are headed by a Deputy Director, this includes the Chief Engineer (who is also the First Deputy Director), the Deputy Director of General Affairs, the Deputy Director of Economic Affairs, and, the Deputy Director of Commercial Operations. There are written "Rules and Regulations" covering the operation of each of the four department heads, as well as for many of the second and third tier departments under the respective administrative line of reporting. There are also written Rules and Regulations for the operation of the Legal Department and the Electric Laboratory.

Yerevan Electric Network Organization Chart



The company has no subsidiaries or so-called daughter enterprises. The major contractual relationships of the company consist of

- a Purchase Power Agreement with Armenergo,
- individual customer contracts for the sale of power,
- a vendor service agreement with Electro Service Ltd, a private lease-operator for technical laboratory testing services (e.g., cables, transportation equipment),
- the company's Trade Union Collective Agreement

The company, through the office of the Chief Engineer, has prepared a one-year Operating Plan. The counterpart one-year Financial Plan is reportedly under development. However, there is no formal or written Strategic Plan for the company.

The company has written employee hiring and resignation procedures. The company maintains personnel files with written personal and employment data. There is no written employee manual or Code of Conduct.

For the most part, the Yerevan Distribution Company appears to have the basic concepts and elements of corporatization and commercial procedures in place. The question is to what extent do actual company practices reflect the written policies and procedures?

The legacies of the top-down organization and management are still in evidence but Yerevan Distribution Company has made discernable progress in the implementation of more contemporary commercial business practices. More importantly, within the areas of inquiry of this report, the company appears to be reasonably well postured for future improvement in what is likely to be a more market oriented business environment in Armenia.

Yerevan Gas Company

The Yerevan Gas Company is a state-owned CJSC and as mentioned earlier, the company has a standard CJSC Charter. That Charter recognizes only one class of shares, all of them to be owned by the state and to be held in trust by the Ministry of Energy. There are at this moment no outside share holders, nor are any of the shares owned by management or employees. The Yerevan Gas statutory capital is 356.89 million Drams (approximately US \$714,000). The Company has been authorized to issue 35,689 common shares with a nominal value of 10,000 Drams per share (US \$ 20/share).

However, no shares have been issued since the formation of Yerevan Gas as a CJSC in June of 1998. The delay in issuing shares is due to the evolving agreement to restructure the entire gas industry of Armenia into a joint-venture with 55% foreign participation as follows: 45% of the ownership will be held by the Russian gas giant Gasprom, 10% will be held by Gasprom's foreign marketing arm Itera (which has some American participation), and 45% of the ownership is to remain in the hands of the state.

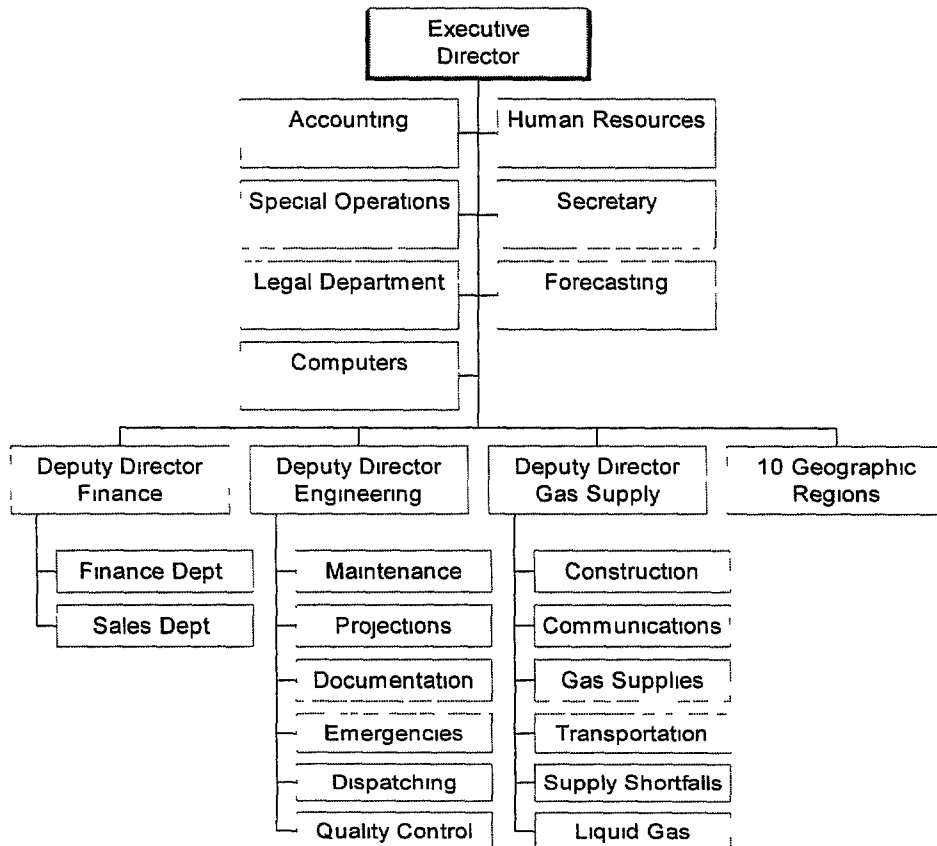
The Minister of Energy has appointed the Executive Director of the Yerevan Gas Company. The three Yerevan Gas Company Deputy Directors (Finance, Gas Supplies, and Engineering) were nominated by the Executive Director and confirmed by the Minister of Energy. There is no Board of Directors. Ultimate responsibility for the governance of the company rests with the Minister of Energy who is the recipient of all Yerevan Gas Company reporting.

There is an audit Committee as provided for in the Company Charter. The Committee uses both in-house and outside resources, but the auditing process per se is an outside process, done by a state-owned company ArmAudit (the same company that audits Yerevan Electric Company), ArmAudit reports directly to the Minister of Energy.

There is no Compensation Committee. Instead, the Executive Director has sole authority to set wages for all employees which, in theory, are not subject to approval by anyone. In practice, though, wages are severely limited by the current economic predicament of the company. Salaries average some 25,000 to 30,000 Drams (\$50 to \$60) per month for most employees.

A simplified organizational diagram of the Yerevan Gas Company is shown below. It is likely that day-by-day routine operations will continue as at present after the establishment and placement on an operational basis of ArmRusgasprom. These operations include the usual gas distribution functions such as gas acquisition, gas dispatching, system maintenance, procurement of non-gas materials and supplies, technical and financial operations, and others. Of note is a rehabilitation function not normally present in western distribution companies.

Yerevan Gas Company Organization Chart



Planning is mostly operational, on a monthly and annual basis. Monthly schedules for maintenance planning, dispatching, technical planning (mostly geared to the resumption of

residential gas deliveries) exist. There is a financial planning function which mostly consists of a projection of costs and revenues. There was no evidence of any long-term or strategic planning documents or procedures. Yerevan Gas Company prepares a three-year development plan, but at this stage, it is looking to the new joint venture, ArmRusgasprom, for the development of longer-term strategic plans.

Yerevan Gas Company has no subsidiaries, branches, or representative offices. The principal commercial contracts held by the Yerevan Gas Company are with Transgas for the physical delivery of gas and with ArmRusgasprom for payment of the gas received. ArmRusgasprom in turn makes payment to Transgas for gas delivered to the distribution company.

In the human resources area, the company maintains personnel files with written personal and employment data. There is, in addition, a written annual evaluation program ("attestation program") that essentially keeps track of outstanding or below-par performance. The employees have access to that record. If an employee disagrees with the written record, he can take grievance action by going past the immediate supervisor or directly to the trade union.

Beyond the attestation program, there are no formally scheduled feed-back or job performance counseling sessions. Instead, the employee is apprised of his performance through informal means. Hiring of operational personnel is done at the department level, more often than not on the basis of personal recommendations of respected in-house or outside professionals. Competitive applications do not exist at the Yerevan Gas Company.

Termination procedures are fairly elaborate, give the difficulty in firing personnel. The Yerevan Gas Company circumvents this difficulty by maintaining short-term renewable contracts with each employee. These contracts are one to three months in duration. The company maintains that they have had no problem with this system, but the procedure has not been tested in the courts. Trade unions, which are generally in a less adversarial position than in the US, can also be counted on to support employees subject to termination. In short, the issue of termination is going through an evolutionary process, with the final procedural and judicial outcome still undecided.

As previously mentioned, trade union representatives in large companies are generally appointed and paid by the unions themselves. At the Yerevan Gas Company, the union representative is on the payroll of the company and acts as a part-time union official. Under this arrangement, the employee-union representative does representational work in addition to her regular company duties. Membership in unions used to be mandatory. Today, although membership is optional, all Yerevan Gas Company employees, including the Executive Director and his three Deputies, are members of the trade union.

In summary, the Yerevan Gas Company has failed in many instances to implement the provisions of its own charter. There are two ways to look at this. This either reflects a slow response in a changing environment, reflecting protracted foot-dragging and turf fights, possibly to preserve the status quo. Or

else, change is coming so fast that the Yerevan Gas Company, while generally in support of change, has been unable to follow through as fast as it might have desired. Based on the assessment undertaken for this report, it appears that the latter case applies and the project team agrees with management of Yerevan Gas that it makes little practical sense to proceed now with the aggressive implementation of new measures while a team is working out the organizational and financial structure of the newly-created joint venture gas company ArmRusgasprom.

From the standpoint of corporatization and commercialization, a major deficiency of Yerevan Gas is the fact that the company does not have a Board of Directors. The ultimate decision power within this or any other company is the shareholder-owner, and that is at the moment the Government. Rather than working through a Board of Directors that might have had outside representation (a banker, a lawyer, an academician, for example) to inject diversity of thinking into the Board, the company is run by the Minister of Energy and, therefore, still very much subject to the centralized control regime that the Government is trying to do away with. However, this should be a short-term phenomenon since 55% of the company is in the process of being taken over by foreign interests, thus leaving others than the Ministry of Energy with ownership control of the enterprise.

At this time, it is not clear precisely how the new structure under ArmRusgasprom will be formulated. Hopefully, the constituent companies all will be given their own shareholdings and Boards, so that the decision-making power, while ultimately resting with the three incumbent partners, will nevertheless be moved down as far as possible to the organizations that run their individual and relatively divergent day-to-day businesses. These companies, the two gas distribution companies and the pipeline (Transgas), should be their own profit centers, and they should calculate, propose, and defend before the Energy Regulatory Commission their own cost-recovery tariffs, free from central and political interference. The executives of the subsidiary companies must be given decision-making powers and they must be exposed to the rigors of the market, and, most of all, they must assume an attitude of being in charge.

The suggestion has been made by various representatives of the Armenian gas industry that this is an inopportune time to do an assessment of the industry's commercialization status. Given the state of flux the gas industry is currently in, with ArmRusgasprom already established and registered as a joint-venture company in Armenia, but not yet really operational, there clearly will be additional changes occurring soon that should be closely monitored. A further view of the gas sector may be warranted towards the end of 1998, the time when ArmRusgasprom is expected to be fully established and operational.

Haygas

The Haygas Company is, like the others, a state-owned CJSC. Haygas has a standard CJSC Charter issued by the Government. As mentioned, that Charter recognizes only one class of shares, all of them owned by the State and held in trust by the Ministry of Energy. There are at this moment no outside share holders, nor are any of the shares owned by management or employees of Haygas.

The principal activity of Haygas, as stated in its Charter, is the purchase and sale of natural gas and natural gas liquids. A more detailed listing of specific company activities includes various functions inherent in gas distribution. And, like the Yerevan Gas Company, Haygas has a clause that entitles it to undertake any economic activity that is not prohibited by law. Beyond that, Haygas has legal rights and obligations virtually identical with those of the Yerevan Gas Company.

The Haygas statutory capital is 1,741 million Drams (approximately 3.48 million US dollars). 174,000 shares are valued at 10,000 drams each (or US \$20 per share). All shares are owned by the state and administered by the Ministry of Energy, and they are all common class shares.

Haygas is much larger than Yerevan Gas Company, by a factor of four. The Company's Executive Director has four Deputy Directors reporting to him, each in charge of a different Division. There is a Sales Division, a Technical Division, a Financial Division, and a General Division. The Sales Division is in charge of gas dispatching, actual sales, and metering, as well as construction. The Technical Division handles all technical and operating matters. The Financial Division is divided into an accounting department and an economics department. The General Division deals with supply and marketing issues, service management, and administrative matters.

The one difference between the two Armenian gas distribution companies is that Haygas has a number of subsidiaries. These include 10 local distribution companies located in various cities throughout the country, two district heating plants, and four technical subsidiaries. The four technical subsidiaries are a Training Center, a Research and Development Center, an Experimental Equipment Center, and a Compressed Automotive Gas Company.

Hiring and firing procedures are similar to those of the Yerevan Gas Company. To obtain employment, a candidate must submit a written application, along with relevant documentation. He or she will be informed about the Company's internal collective agreement and about the contract the candidate will be asked to sign. The candidate will also be given a detailed job description. All permanent hiring is done following an initial probationary period. Once hired, the employee is subject to a systematic evaluation procedure that monitors the development of his theoretical knowledge and professional skills. Haygas maintains a training program for line personnel and technical staff. Company rewards for outstanding services include public reward ceremonies with appropriate entries in the employee's workbook.

An employee who fails to perform in accordance with Company standards will not have his or her short-term contract renewed. As mentioned in connection with termination procedures at the Yerevan Gas Company, the technicality of not renewing employee contracts instead of outright firings has worked in the recent past, even though its legality has not been tested in the courts. The employee has the right to appeal adverse company decision through a grievance procedure that automatically involves the intervention of the trade union.

Haygas has several planning tools in operation. Development Plans are technical plans dealing with current and projected gas sales. Strategic Plans target long-term gas sales and increased capacity utilization. The current Strategic Plan covers the period 1998-2005. It was developed in a cooperative effort of company specialists and an outside management firm, the Institute of the Economy "NIIGASeconomica," in consultation with ArmRusgasprom. Projections included in the plan are that gas sales will rise from their current level of 1.6 billion cubic meters per year to 4.01 billion cubic meters in 2005. This increase in gas sales will be accompanied by a simultaneous increase in capital assets from \$28.2 million now to \$111.7 million in 2005.

A shorter-term three-year Business/Operations Plan provides details regarding the principal directions Haygas will be pursuing, develops options for the restoration of gas deliveries, and deals with the introduction of new gas metering systems, industry construction, communication systems, and social development issues. This is a comprehensive plan that involves the participation and support of all relevant personnel. It is the source document for the Haygas Annual Operating Plan that is being monitored on a quarterly basis.

Finally, a standard Financial Plan deals with all revenues and disbursements. The Plan includes the Company's annual budget, with features such as accruing tax liabilities, projected expenses, as well as profits and the allocation of profits to retained earnings or as dividends.

There is no internal audit committee. Instead, a Control Committee consisting of Company specialists undertakes physical on-site inspections and generally monitors and controls the Company's activities.

Formal external audits appear to be an important part of the Haygas Company's control system. An outside company, "Pharos Ltd.," has performed these audits on a contractual basis since November 1997. Pharos reviews the Haygas books, makes periodical site-inspections, searches for mistakes and weaknesses in its financial planning and reporting system and fulfills an instructional role in overcoming existing and potential short-comings.

Financial and other reporting procedures are in line with the terms and conditions laid down by the Ministry of Energy, the Ministry of Statistics, and the State Register of the Republic of Armenia, as reflected in the Haygas internal reporting manual.

Haygas is in the same transitional status as Yerevan Gas. Both distribution companies have been slow to implement provisions of their charters. In any event, like in the case of Yerevan Gas, we found no indication that Haygas was hesitant in embracing the forthcoming changes that ArmRusgasprom inevitably will bring about.

In summary, a major deficiency for Haygas is again the fact that the company does not have a Board of Directors. The ultimate decision power in corporate governance continues to be with the Ministry of Energy. As mentioned, not having a Board prevents Haygas from having the opportunity to

diversify its corporate outlook at the highest level. Strict central controls persist to this point, but the prospect for change is likely with ArmRusgasprom ready to assume independent leadership.

ArmRusgasprom's organizational structure is still under debate. It is clear that there will be a complete organizational restructuring of the natural gas industry and that this new structure will be developed within the next few months. What is not clear at this point is how this structure will be formulated. Again, hopefully the constituent companies will be given their own shareholdings and Boards, so that the decision-making power, while ultimately resting with the three incumbent partners, will be moved down as far as possible to the organizations that run their individual and relatively divergent day-to-day businesses.

6. FINDINGS

Overall, the corporate governance framework for the joint stock companies is in place but there has not yet been full adoption of the key provisions for effective corporate governance. Some of the major findings applicable to all three enterprises are shown below.

1 There is a general lack of understanding of the corporatization process

The electric and natural gas distribution companies share on common feature. They all need to further develop entrepreneurial instincts and behavior. This is an observation that is difficult to articulate, but in talking to company executives it is clear that they still very much exhibit a sense of being directed, of being led instead of leading.

The corporatization efforts to date notwithstanding, the energy sector remains under the "command and control" of the GoA and is still viewed by the government as a delivery system for social policy rather than autonomous, independent business entities.

No real shift to a more market oriented economy can take place unless it is supported by appropriate legislation. This phase of Armenia's move toward commercialization and corporatization has, on paper, essentially been accomplished. However, the major benefits derived from corporatization and commercialization will not have a chance to develop unless Company management has the responsibility and opportunity to develop business strategies and to implement those strategies. At present, the role of the Ministry of Energy is paramount and directs most of the major activities of the enterprises. Until this day-to-day operational involvement of the Ministry is significantly reduced or eliminated altogether, the enterprises will not develop the commercial orientation required to increase the likelihood of successful investment attraction.

2 There is a need to construct and maintain accurate corporate records

The energy sector has undergone major, rapid organizational and structural reforms (e.g., from the unbundling of the electric generation, transmission and distribution entities, to the most

recent consolidation of the electric distribution sector from 11 to four entities, to the “denationalization” of the natural gas sector via the ArmRusgasprom joint venture which is in progress) One consequence of this change is that the legal documentation, particularly with respect to the ownership of assets, has lagged far behind A characteristic, if not a mainstay, of corporatization is the perpetual maintenance of the legal form and sanctity of the entity’s ability to conduct business, including, among other things, the survivorship of ownership of assets and contracts

The future consequences for having less than complete and accurate corporate documentation are far reaching and will prove to be problematic as the GoA attempts to implement International Accounting Standards and pursue its privatization objectives

3 Boards of Directors should be established for each enterprise

By choice of the shareholders, the entities examined do not, at present, have Boards of Directors Although this is permissible under the JSC Law, the commercialization process for these entities would be much better served if the Board of Director style of governance were widely embraced by the GoA As it now stands, the representative entities still appear to be instruments of the government rather than true “for-profit” independent organizations Moreover, the command and control of these entities is still vested in the Ministry of Energy (except for the Yerevan Distribution Company, which also has a line of reporting to the Ministry of Finance & Economy)

Each representative company should have its own Board of Directors, in line with the general concept that decision-making power should be pushed down the operational level and away from central controls as far as possible This recommendation is more than cosmetic It goes to the heart of the corporatization process and the establishment of a commercial mind set within the entities Resolution 551 requires that a company’s Board have equal representation of the Ministries of Energy, Privatization and Finance & Economy This step is far more preferable than the present single line of reporting to the Ministry of Energy now taking place as it represents more diversification in the high level decision making processes for the entities, and establishes the Board of Directors as the operative style of corporate governance within the power sector

Moreover, with respect to the privatization process and ability to attract foreign capital, an investor would want to be represented on the company Board In addition, the companies would stand to gain from the injection of diversity at the highest corporate level by bringing on to the Board one or more external directors

In the case of the natural gas distribution industry, the establishment of a Board of Directors at the level of constituent companies would not dilute the influence or rights of ArmRusgasprom As noted above, ArmRusgasprom may well have its own Board, and by virtue of owning the

shares of the constituent companies, it will be in position to influence the operations and performance of these entities

4 A number of areas for continued improvement have been identified and should be acted upon

Planning processes

Ideally, the hierarchy of planning within a commercial entity starts with the Strategic Plan which establishes the broad parameters for the Business Plan which in turn establishes the specific goals for the Operating and Financial Plans for the organization. Given the state of institutional and organizational flux within the energy sector as the GoA has moved forward with its various reform programs, establishment of a Strategic Plan for a specific entity is difficult while the overarching strategy for the energy sector in Armenia is still in development.

Presently, planning at the entity level is predominantly short-term and operationally oriented. This is, of course, better than no planning at all. Within the limitations of the financial resources available to them, the management bodies of the respective representative entities appear to be managing the operating affairs of companies in a competent manner.

Internal control and auditing processes

The top down, command style of the management system is inconsistent with contemporary commercial principles of internal controls and does not embrace the notion of auditing as a necessary management tool or shareholder safeguard. The acceptance and implementation of IAS within the energy sector should significantly improve the present situation. Continued efforts to enhance the corporatization process should also help improve the commercialization of the energy sector.

However, it is important to note the distinction between the letter and spirit of the law, and, what is preached as policy and procedures versus the example set by actual practices. In this regard, it is incumbent upon the GoA to set the "tone at the top" and lead by example. The GoA must establish an environment in which the positive change can take hold and flourish. Further, the GoA, through the actions of the various Ministries, must clearly establish the level of expectations with respect to ethical conduct and standards.

7 CONCLUSIONS

To its credit, the energy sector has weathered a series of adverse events. Although it is difficult to focus on strategic and long-term planning when crisis conditions exist in the near-term, a number of important reform steps have positioned the sector for continued advancement. The implementation of improved commercial planning processes within the sector will help facilitate continuing progress.

What is clear from this assessment is that to promote improved commercialization and corporatization practices within the utilities is not enough. It is also necessary to continue work at the Ministerial level to try and provide the correct environment for commercialization. For instance, the utilities are “hamstrung” in their ability to properly compensate employees, as long as civil service reform is lacking and Government officials are also receiving below subsistence wages, the ability of the state-owned utilities to raise salaries and attract talent will be severely constrained. As long as the salaries are low, there will be continued resistance towards implementing the kinds of steps necessary to improve internal financial controls. The important, and ultimately quite critical, role of the private sector should not be overlooked. At this stage, increasing the role of the private sector in the management and operation of the utility represents the greatest opportunity for improving the commercialization of the sector, enhancing corporate governance and helping to further encourage reform in the energy sector. In this regard, there should be a renewed emphasis on implementing the worthy objectives cited in Resolution 551, especially those related to the strategic investor based privatization of the energy distribution sector.

REFERENCES

Yerevan Distribution Company

Corporate Charter
Organization Chart
Information on Changes in Organization Chart
Management Policy
Main Purposes and Ways of Improvement of Financial Operations
Personal Data of Key Employees
List of Employees and Salary Fund
Employment and Resignation Procedures
Admission (Employment) Examinations
Policy for Financial Planning and Tariffs Department
Policy for Judicial Department
Information on Joint Trade (Union) Committee Operations
Administration and Staff Policy
Policy for Distribution and Information Services
Policy for Special Department
Policy for Supply Department
Policy for Installations and Constructions
Policy fo Computer Center
Policy for Electro-Technical Laboratory
Policy for Safety Precautions Department
Policy for Electric Regime and Quantitative Changes Services
Policy for Operating Control Servicw
Policy for Projects Department
Policy for Substations
Policy for Communications Department
Policy for Technical Re-Equipment Department
Policy for Transportation Services
Policy for Electric Counters Laboratory Subsidiary
Policy for "Hall of Admittance" Subsidiary
Policy for "Erebuni" Subsidiary

Yerevan Gas Company

Corporate Charter
Organization Chart

Haygas Company
Corporate Charter

Lahmeyer International, Comments on the GoA's Cost Reduction Plan, July, 1998

Merklein & Associates, Natural Gas Tariffs Design and Implementation, August, 1998

Hagler Bailly, Review of a Model Charter for a State Closed Joint Stock Company, March 31, 1998

APPENDIX A
MODEL CLOSED JOINT STOCK COMPANY CHARTER AND MAPPING
TO LAW ON JOINT STOCK COMPANIES

Approved

199 _____

by # Mandate

Registered by Office of State

Registration of Enterprises

of the Republic of Armenia

_____ 199

Registration #

Certificate #

Chief of the State Register

Regional Department

CHARTER

OF THE STATE

CLOSED JOINT STOCK COMPANY

1 GENERAL PROVISIONS

1.1 " _____ " the state closed joint stock company (hereafter Company) is a legal entity, whose Charter Capital is divided into a certain number of shares verifying the liabilities of the shareholders towards the Company

The Company has been established through reorganization of the _____

state enterprise, pursuant to the # 538 Decision of the RoA Government, dated as of November 27, 1997, and accordingly to the # 192-GM Mandate of the Ministry of Energy, dated as of December 9, 1997

The Company is a successor of the _____ state enterprise (Registration Date _____, Certificate # _____)

1.2 The Company shall regulate its activities by the RoA Law on Joint Stock Companies (hereafter Law), other laws, legal statutes and this Charter

1.3 The relationships between the Founder and the Company shall be regulated by the RoA legal statutes and this Charter

1.4 The firm-name of the Company is

in Armenian (full) _____

(abbreviation) _____

in Russian (full) _____

(abbreviation) _____

in English (full) _____

(abbreviation) _____

1.5 The primary location and the legal (postal) address of the Company is

RoA, _____

2 SCOPE OF ACTIVITIES AND OBJECTIVES

2.1 The establishment of the Company is aimed to earn profits through economic activities (including _____)

2.2 To gain its objectives the Company shall carry out the following main economic activities

2.3 The Company shall carry out any economic activity not prohibited by the Law and other legal statutes

The Company shall carry out certain types of activities defined by the Law and the other legal statutes only if the relevant License (special permission) is available

3 RIGHTS OF THE COMPANY

3.1 The Company shall be considered to be established and start its activities since its state registration in compliance with the defined order

3.2 The Company shall be entitled to open bank accounts in the RoA and foreign banks either in Armenian or foreign currency

3.3 The Company shall have a round seal with its firm name in Armenian, Russian and English and the RoA Coat Arms, the stamps, the forms, as well as the emblem, commodity, trade and other marks, registered pursuant to the procedure defined by the Law

3.4 The Company shall be liable for its responsibilities with its whole assets

The Company shall not be liable for the Founder's responsibilities

The Founder shall not be liable for the Company's responsibilities

3.5 The state management and local self-management bodies shall not be liable for the Company's responsibilities

The Company shall not be liable for the state management and local self-management bodies' responsibilities

3.6 The Company shall have rights to

- purchase assets, including securities, possess, use and own them and benefits gained from them through all means not prohibited by the RoA legislation,
- independently form its financial resources, including involvement of the loans, receive bank and commercial loans in the RoA and abroad, including in foreign currency,

- issue and allocate shares according to the order established by Law,
- sign contracts and have responsibilities pursuant to the RoA legislation,
- independently determine the procedures for its foreign economic activities, implement that directly without the intermediary and other organizations,
- owe financial means in foreign currency, get them as a result of its foreign economic activities and purchase and independently owe by all means not prohibited by the RoA legislation, as well as sell them to the state, enterprises and organizations and citizens according to the order defined by the RoA legislation
- independently plan its activities, determine the volume of the goods to be produced, works and services to be provided, the price for their suppliers and consumers,
- establish branches and open representations according to the Law and other legal statutes,
- establish daughter enterprises and dependent companies and have participation there

3.7 The Company is responsible to

- carry out the accounting and submit the financial and statistical statement in compliance with the procedures defined by the Law and other legislative acts,
- provide the annual reports with regard to the Company documentation, Company Charter, asset rights, procedures of the branches and representations

4 COMPANY CHARTER CAPITAL

4.1 The Company Charter Capital is _____ drams, which is a common share, and the face value of the share is _____ drams

All common shares are allocated and depend to the Founder

All Company shares are to be common

4.2 The Company shall change the size of the Charter Capital upon the decision of the shareholders' general meeting, which is to become effective after the appropriate modifications to this Charter, registration by the body carrying out the state registration of enterprises and in compliance with the procedures defined by the Law and other legal statutes

4.2.1 Accumulation of the Company Charter Capital Size

The size of the Company Charter Capital shall be accumulated by increasing the face value of the Company shares or by allocating additional shares, if the shares allocated previously have been completely sold and paid

The Company shall take a decision on the allocation of the additional shares exclusively within the frameworks of the number of shares announced in the Company Charter and only if the previously allocated shares have been completely paid

After summarizing the results of its financial activities, the Company can

- invest a part of its profits in the Charter Capital by allocating new shares,
- transfer to the Charter Capital its own assets or part of them, exceeding the Charter Capital. The Company shall not issue shares to pay the debts occurred during its economic activities

4.2.2 Decrease of the Company Charter Capital

The size of the Company Charter Capital shall be decreased by

- decreasing the face value of the shares,
- reducing the total number of the shares, including the acquisition and cancellation of part of them in cases defined by the Law

The Company is not entitled to decrease the Charter Capital, if its size would be smaller than the Company Minimum Charter Capital defined by the Law and other legislative acts

The shares not returned within at least one year to the Company because of its Charter Capital decrease, may be considered invalid. The Company shall issue new shares in their place

The decision on decreasing the Company Charter Capital and on making the relevant changes in the Company Charter, shall be taken at the Company shareholders' general meeting

The payments caused by the decrease of the Company Charter Capital shall be made after the state registration of the changes in the Company Charter Capital

5 SHARES AND OTHER SECURITIES

5.1 The Company shall allocate securities defined by the Law and other legislative acts

5.2 The Company shall allocate only common shares

The Face value of the shares allocated by the Company shall be the same

5.3 The Company shares shall be allocated in the form of registering on the shareholder's personal account in the Company shareholders' register

5.4 The Founders shall be granted the share certificates only after the Company state registration and complete payment for the shares

The certificate shall be made on the printed form and include the requisites defined by the Law

The certificate shall meet the requirements of securities protection defined by the RoA legislative statutes

5 5 The share is indivisible

5 6 The Company additional allocated shares shall be paid within the time-schedule defined by the decision on their allocation but no later than within one year since the decision made

The payment for the Company shares and other securities shall be made by Drams, securities, other assets or assets rights or other rights, which have cash estimate

The Company shares and other securities, the payment for which is determined by non-cash, shall be paid fully while acquiring

During the foundation of the Company, as well as during the acquisition of the allocated additional shares and other securities by non-cash, the cash estimate of the assets paid against the shares shall be defined by the state management authorized body

The shares transferred into the disposal of the Company (not-paid or returned) shall not grant the voting right, shall not be considered during the calculation of votes and the dividends shall not be calculated for these shares. These shares shall be sold by the Company within one year since their transfer to the Company. In the contrary case, the Company shareholders' general meeting should take a decision on changing the Company Charter Capital through the cancellation of the stated shares

5 7 The Company shall have Reserve Funds

The reserve Funds shall be set up at the expense of allocations from the Company profit, which shall be not less than 15% of the Charter Capital

If the Reserve Fund is smaller than the size defined by the Company Charter Capital, the allocations to that fund shall be made at least 5% of the profit, as well as from the resources generated through the difference between the value of the issued new shares and their face value

The Reserve Fund shall be used to cover the Company losses, as well as to pay the Company bonds and to buy back the Company shares, if the Company profit is not sufficient to achieve that goal

The Reserve Fund shall not be used for the other purposes (except otherwise defined by the law)

5 8 Upon the decision of the Company shareholders' general meeting Consumption, Accumulation, Employee Corporatizations and other funds shall be established

5 9 The value of the Company net assets shall be evaluated according to the accounting data, in compliance with the procedures defined by the RoA legal statutes

If since the end of the second fiscal year of the Company existence, the annual accounting balance or the results of the Company audit submitted to the Company shareholders' general

meeting for approval, makes clear that the value of the Company net assets is smaller, than the Company Charter Capital, the Company shall make an announcement about the decrease of its Charter Capital, on the condition that the size of the Charter Capital does not exceed the Company net assets

If since the end of the second fiscal year of the Company existence or the results of the Company audit submitted to the Company shareholders' general meeting for approval, makes clear, that the value of the Company net assets is smaller, than the minimum size of the Company Charter Capital, defined by the Law, the Company shall make a decision on its liquidation

— If in cases defined by the present Charter the decision on the decrease of the Company Charter capital or on the Company liquidation has not been made, the Company Founders, creditors, as well as the bodies authorized by the state, are entitled to demand the Company liquidation by the court

6 RIGHTS AND RESPONSIBILITIES OF THE FOUNDER

6.1 Each common share of the Company shall grant the equal rights to the shareholder

The shareholder owning the common share shall be entitled to

- participate in the Company management,
- receive dividends from the profit generated from the Company activity,
- receive any type of information on the Company activity, except the confidential ones, including the getting acquainted with the balance, accounting statements, the Company production-economic activity,
- authorize the third person (persons) to represent his rights at the Company Constituent Meetings,
- in case of Company liquidation receive the Company assets,
- in case of the Company Charter Capital accumulation receive free of charge the relevant number of common shares, at the expense of the Company funds,
- use other rights, defined by the Company Charter

6.2 The founder is responsible to

- participate the Company general meeting with the voting right within its authorization,
- make cash and assets investment, according to the procedure defined by the charter,
- not to publicize the confidential information on the Company activities

7 PROCEDURES ON PAYING THE COMPANY DIVIDENDS

7 1 The Company shall have right to announce (take decision) about the payment of dividends quarterly, half-yearly and/or yearly

The dividends shall be paid out of the Company current net profit of the given year

The decision on the payment of yearly, as well as quarterly and half-yearly dividends, according to the types and forms of shares, on the dividend size and its payment form, shall be taken by the Company shareholders' general meeting

The Company shareholders' general meeting shall have right to take a decision on the non-payment or partial payment of dividends. The validity terms of these decisions shall be defined by the Company shareholders' general meeting, which cannot exceed one year

The date of payment of the annual dividends shall be defined by the decision of the Company shareholders' general meeting on the payment of the annual dividends

7 2 The Company shall not be entitled to announce (take a decision) about the payment of dividends for the allocated shares if

- the Company Charter Capital has not been fully paid,
- as of the date of the decision-making on the dividend payment, the Company economic state corresponds the insolvency (bankruptcy) criteria defined by the relevant law, or the criteria shall occur because of the dividend payment,
- the value of the Company net assets is smaller than the sum of the Company Charter Capital and the Reserve Fund, or it shall become smaller because of the dividend payment

8 THE COMPANY MANAGEMENT BODIES

8 1 The Company shareholders' general meeting shall be the supreme management body of the Company

Every year the Company is responsible to hold the shareholders' annual meeting, which shall be the Shareholders' General Annual Meeting

The Company shareholders' general annual meeting shall be held two months later after the end of the regular fiscal year within one month

Shareholders' any general meeting, held besides the shareholders' annual meeting, shall be considered as an extraordinary meeting. The Company extraordinary meetings shall be held to discuss the urgent problems

The annual, as well as the extraordinary general meetings of the Company shall be held by the Founder (except the provisions, defined by Article 77, point 6), which makes a decision about

- the date, place and time of holding the Company shareholders' general meeting,

- the agenda of the Company shareholders' general meeting

The Company shareholders' general meeting shall be chaired by the Founder or its authorized person

8 2 In compliance with the provisions set forth in the Article 86 of the Law, the Company Board shall not be established, its authorization shall be carried out by the Company general meeting

8 3 The authorization of the Company general meeting includes

1 making amendments and changes in the Company Charter, approving the new version of the Company Charter,

2 reorganization of the Company,

3 liquidation of the Company, appointment of the Liquidation Commission, approval of the Company liquidation balance,

4 approval of the main directions of the Company activities,

5 definition of the maximum size of the allocated share volume,

6 increase of the Company Charter Capital through the increase of the share face value and the allocation of the additional shares,

7 decrease of the Company Charter Capital through the acquisition and buy-back of the Company allocated shares,

8 usage of the Company reserve funds,

9 election of the Company Control Commission (Controller) and termination of its (their) authorizations ahead of the schedule,

10 approval of the person to carry out the Company audit,

11 approval of the Company annual statements, accounting balances, profit and loss, account, distribution of profit and loss, decision-making on the annual dividend payment and approval of the annual dividend size, as well as approval of the annual activity results of the Company branches and representations,

12 decrease and increase of the share face value,

13 conclusions of large transactions related to the divesting and the acquisition of the Company assets,

14 acquisition and buy-back of the Company allocated shares,

15 appointment of the Executive Director, termination of his authorizations ahead of the schedule, establishment of the executive board and the termination of its authorizations ahead of the schedule,

16 definition of payment terms for the auditors carrying out the audit of the Company officials,

17 approval of the Company managerial-organizational structure and the rates of salaries,

18 creation of the daughter enterprises by the Company and participation in daughter and dependent companies,

19 establishment of the Company branches and representations,

20 participation in other companies,

21 approval of the inter-company documents, regulating the managerial bodies' activities,

22 other issues, defined in the frame of authorizations of the Company general meeting and Company Board

8 4 The Company meeting authorizations shall be carried out by the Founder or its authorized person (persons) in the frame of authorizations defined by the Founder

Only the officials of the state management bodies shall be appointed as authorized representatives of the Founder

8 5 The decisions on the issues defined by the present Charter, point 8 3, sub-points 12, 13, 14, 17, 18, 19, 20, 21, shall be made by the shareholders' general meeting, upon the Executive Director's submission

8 6 If more than one authorized persons of the Founder participate the Company shareholders' general meeting, the decisions shall be made by the majority voting share owners participating in the meeting, except otherwise defined in Point 8 5 of this Charter The decisions on the issues defined by this Charter, point 8 3, sub-points 1, 2, 3, 5, 13 shall be made by the 3/4 of the voting share owners participating in the meeting

8 7 The Company Executive Director, as well as the members of the Control Commission and the person carrying out the audit shall have right to participate the Company shareholders' general meeting with the consultative voting right

8 8 The management of the Company current activity shall be carried out by the Company Executive Director

The Company Executive Director shall

1 dispose the Company assets, including the financial resources, carry out transactions on
behalf of the Company,

2 represent the Company in the RoA and abroad,

3 act without the letter of authorization,

4 provide letters of authorization,

5 conclude contracts, according to the defined order, including the employment contracts,

6 open deposit (including FX accounts) and other accounts in the banks,

7 submit proposals on size of dividends and payment procedures,

8 submit to the Company shareholders' general meeting for the approval the Company
employment regulations, separated units rules,

9 within its authorization issue orders, commands, instructions subject to compulsory
implementation and control their implementation

10 hire and fire the Company employees in accordance with the defined order,

11 apply encouragement and disciplinary amenability instruments towards the employees

9 CONTROL OVER THE FINANCIAL-ECONOMIC ACTIVITIES

9 1 The Company shareholders' general meeting shall elect the Company Control Commission
(Controller)

The Control Commission (Controller) shall control the implementation of the decisions adopted
by the Company management bodies, audit the compliance of the Company documents with the
laws, other legislative acts and the Company Charter

The Control Commission (Controller) activity procedures shall be defined by the documents for
the internal usage, adopted by the Company shareholders' general meeting, due to the Control
Commission (Controller) regulations

The Control Commission (Controller) is entitled to conduct an audit of the annual results of the
Company financial-economic activities, to check the financial-economic activities of the
Company at its own initiative, upon the decision of the Company shareholders' general meeting,
or upon the Founder's request

The Control Commission (Controller) is entitled to submit a request on holding at the Company
shareholders' extraordinary general meeting

All relevant documents, materials and the explanations on the financial-economic activities of the Company, its branches and representations shall be submitted to the Control Commission (Controller) upon its request

The Control Commission Members (Controller) shall be elected at the Company shareholders' general meeting for the period of 3 years

The Control Commission Members (Controller) shall be accountable to the Company shareholders' general meeting

The rate and terms of the payments or reimbursements for the Control Commission Members (Controller) shall be defined pursuant to the decision adopted by the Company shareholders' general meeting

Physical persons, not involved in the Company managerial bodies can be the Members of the Control Commission

The Chairman of the Control Commission shall be elected by the simple majority vote of the Control Commission Members

9 2 The authorities of the Control Commission shall be transferred to the Controller pursuant the relevant decision of the Company shareholders' general meeting

9 3 The Company shall attract the outside auditors (an organization or a physical person) to check the Company financial-economic activities by concluding the relevant contracts with them

The Company Auditor shall submit the final written conclusions about the audit held

The Company Auditor shall be approved by the Company shareholders' general meeting

The contract with the Company Auditor shall be concluded by the Company Board. The amount to be paid to the auditor for services shall be defined by the Company general meeting

10 COMPANY BRANCHES AND REPRESENTATIONS

10 1 In the territory of the RoA the Company shall not have any branches and representations

(or all the Company branches and representations shall be listed, including their names, place of location, registration data)

11 AMENDMENTS AND CHANGES IN THE COMPANY BY-LAW

11 1 The amendments and changes to the Company Charter, as well as the approval of the new edited version of the Company Charter shall be made upon the decision of the shareholders' general meeting by the owners of 3/4 voting shares present at the meeting and in case of the accumulation of the Company Charter capital - by the majority vote

11.2 The information with regard to the establishment or termination of the branch or the representation shall be included in the Charter. The Charter amendments caused by the above mentioned information shall become effective since notifying the state body carrying out the state registration of enterprises.

11.3 The amendments and changes made in the Company Charter, as well as the new version of the Company Charter shall become effective for the third persons since their state registration, in cases defined by the present Charter, since notifying the state body carrying out the state registration of enterprises.

12 REORGANIZATION AND LIQUIDATION OF THE COMPANY

12.1 The reorganization of the Company shall be implemented through merging, unification, splitting up, separation and restructuring in accordance with the procedures defined by the Law.

The Company is considered to be reorganized since the state registration of the legal persons newly created in the result of the reorganization, except the cases of reorganization through unification. In case of reorganization through the unification of the Company with another Company, the first Company is considered to be reorganized since the registration on the termination of its activity by the body carrying out the state registration of the enterprises.

The state registration of the Companies established in the result of reorganization and the registration on the termination of the activities of the companies, whose activity has been terminated in the result of the reorganization, are made by the body carrying out the state registration of enterprises, in accordance with the procedures defined by the Law.

12.2 The liquidation of the Company shall lead to the termination of the Company without transferring the Company's rights and responsibilities to another persons as its legal successor.

The Company shall be liquidated on the following basis:

- 1 by the lawful decision of the court was found
- 2 The Company shareholders' general meeting makes a decision on Company liquidation without any legal successor,
- 3 by the lawful decision of the court was found Court lawful decision on Company bankruptcy,
- 4 the lawful decision of the court on the Company liquidation is available,
- 5 other cases defined by the Law

The decision on liquidation of the Company and the establishment of the Liquidation Commission shall be made by the Founder according to the provisions defined by the present point, sub-point 2.

The representatives of the Founders shall be included in the Liquidation Commission.

Before the decision on the liquidation of the Company is made, the Company shareholders' general meeting shall approve the overall balance and the draft of the Company submitted by the Board

The liquidation of the Company shall be implemented according to the defined the Law and the other legal statutes

The liquidation of the Company shall be considered to be completed and its existence terminated since the relevant record has been made at the Enterprise State register by the State registration body

The table below references each Model Charter Section to the relevant and controlling Article(s) of the JSC law

Model Charter Section	JSC Law Controlling Article
1) General Provisions	
1 1 introductory statement	8 1, 14 3
1 2 recognizes JSC law applicability	RoA JSC law generally
1 3 Founder/Company legal relationships	RoA laws generally
1 4 legal name	5 1, 14 3
1 5 primary location, legal address	5 3, 14 3
2) Scope of Activities/Objectives	
2 1 earn profits through stated economic activities	3 3
2 2 main economic activities	3 3
2 3 other economic activities	3 3
3) Rights of the Company	
3 1 state registration required to commence activities	3 4
3 2 may open domestic and foreign bank accounts	3 5
3 3 description of Company seal	3 6
3 4 scope/limits of financial liabilities	4 1, 4 2, 4 3
3 5 liabilities of state/local management bodies	4 5
3 6 various authorized financial/management activities	
3 7 comply with financial/accounting standards and reporting requirements	96 1
4) Company Charter Capital	

4 1 Charter capital amount, common stock face value	14 3, 33 1, 33 2
4 2 changes to Charter capital size	36 1, 36 3
4 2 1 accumulation of Charter capital size	37 1, 37 2, 37 4, 37 7
4 2 2 decrease of Charter capital size	38 1
Additional para limits/procedure for Charter capital changes	38 1, 38 2, 38 4
5) Shares and Other Securities	
5 1 recognizes JSC law applicability	34 1
5 2 allocate only common shares, all shares equal value	14 3, 34 2
5 3 Company shareholders register	34 3, 41 4
5 4 registration/payment requirements	34 3, 34 5, 34 6
5 5 shares are indivisible	34 4
5 6 payment time and form limits, voting rights	45 2, 45 3, 45 4, 45 5
5 7 reserve funds	46 2
5 8 consumption, accumulation, employee corporatization funds	46 1
5 9 valuation of net assets, relationship to Charter capital	46 5, 46 6, 46 7
6) Rights/Responsibilities of the Founder	
6 1 Company management, dividends, access to Company information, other undefined rights	14 3, 39 1
6 2 make investments, protect Company information	44 1
7) Procedures on Paying Company Dividends	
7 1 requires approval at Company shareholders general meeting	52 1, 52 2, 52 3, 52 4
7 2 restrictions on payment of dividends	53 1
8) Company Management Bodies	
	14 3

8 1 Company shareholders general meeting authorizations/requirements	14 3, 69 1, 69 2 76 1
8 2 no Company Board authorized	86 1
8 3 1 amendments to Charter	70 1a
8 3 2 Company reorganization	70 1b
8 3 3 Company liquidation	70 1c
8 3 4 Company main activities	86 1, 87 1a
8 3 5 maximum size of allocated share volume	70 1e
8 3 6 increase of Charter Capital	70 1f
8 3 7 decrease of Charter Capital	70 1g
8 3 8 use of Reserve funds	86 1, 87 1o
8 3 9 election of Company Controller	70 1i
8 3 10 Company auditor	70 1j
8 3 11 approval of financial statements	70 1k
8 3 12 decrease/increase of share face value	70 1o
8 3 13 large acquisition/divestiture of assets	70 1q
8 3 14 acquisition/buy-back of allocated shares	70 1r
8 3 15 appointment of Executive Director	70 1h
8 3 16 Company audit payment terms	86 1, 87 1l
8 3 17 managerial-organizational structure, salary rates	86 1, 87 1p, v
8 3 18 creation of daughter enterprises	70 1t
8 3 19 establishment of branches and representations	70 1u
8 3 20 participation in other companies	86 1, 87 1s
8 3 21 regulating managerial bodies	70 1
8 3 22 other undefined but authorized activities	70 1v

8 4 implementation of Company shareholder meeting decisions by Founders	86 1, 87 1b, 89 2b
8 5 Executive Director authorities	71 3
8 6 voting requirements for certain actions	71 4
8 7 nonvoting members of Company shareholders general meeting	73 2
8 8 Executive Director delegated authorities	91
8 8 1 dispose Company assets	91 3a
8 8 2 Company legal representative	91 3b
8 8 3 may act without letter of authorization	91 3c
8 8 4 may provide letters of authorization	91 3d
8 8 5 execute contracts	91 3e
8 8 6 open bank accounts	91 3f
8 8 7 recommend dividends and payment procedures	91 3
8 8 8 recommend employment policies	91 3g
8 8 9 general management authority	91 3h
8 8 10 hire/terminate employees	91 3i
8 8 11 apply employee incentive/disciplinary orders	91 3j
9) Control Over Financial/Economic Activities	
9 1 Company Control Commission activities	94 1, 94 2, 94 3, 94 4
9 2 Company Control Commission authority delegated by Company shareholders general meeting	94 1
9 3 Company Auditor authority/responsibilities	95 1, 95 2
10) Company Branches and Representations	
10 1 must be listed and registered	6 1, 6 6, 14 3
11) Amendments to Company Charter	

11 1 requires 3/4 vote at Company shareholders general meeting 15 2

11 2 state body notification requirements 6 6

11 3 state body registration requirements 17 1, 17 2

12) Reorganization/Liquidation

12 1 merging, unification, splitting up, separation, restructuring methods allowed, state registration required 18, 19, 20, 21, 22, 23, 24, 25, 26

12 2 liquidation procedures 27, 28, 29, 30, 31, 32

APPENDIX B
COPY OF COLLECTIVE BARGAINING AGREEMENT FOR THE YEREVAN
DISTRIBUTION COMPANY

CERTIFICATE

ON PROCEDURES OF THE

AMALGAMATED TRADE COMMITTEE OF

YEREVAN ELECTRIC NETWORK CLOSED JOINT STOCK COMPANY

1 The Amalgamated Trade Committee (ATC) of Yerevan Electric Network Closed Joint Stock Company (SCJSC) is a free, independent and amalgamated Trade Committee in the structure of the Federation of National Electric Trade Unions (FNETU)

2 The ATC of Yerevan Electric Network SCJSC is acting in accordance with the Collective Agreement (CA) signed with the company, within the scope of the RoA Constitution, and according to the principles of the movement of International Trade Unions

3 The total number of members is 3250, including

laborers — 75%,

office employees — 25%

4 According to the Collective Agreement, the issues of rate units, associated with lay-offs, dismissals from office (upon the motion of the company), material and social issues, premiums, and others shall be reviewed at the ATC, keeping the administration of Yerevan Electric Network SCJSC informed

COLLECTIVE AGREEMENT

This Collective Agreement (CA) is signed between the management of Yerevan Electric Network SCJSC (hereafter Management), and the company employees, represented by the Amalgamated Trade Committee (ATC) of their Trade Union

1 GENERAL PROVISIONS

1.1 Parties Involved and the Objective of the Collective Agreement

The Management of the company (Management), represented by its President, Mr R Nazarian (hereafter Employer), and the Trade Union, represented by the Chairman of the Amalgamated Trade Committee (ATC), Mr Y Kharatian are signing this agreement, based on the 1997 Agreement between the Government of Armenia and Confederation of Trade Unions of Armenia (CTUA), the resolutions of the 2nd CTUA Congress, and the 1996 Tariff Agreement between the RoA Ministry of Energy and the Federation of National Electric Trade Unions

This Collective Agreement (CA) is a legal document regulating the labor, social, economic and trade relationships between the Employer and the employees, on mutually acceptable terms

The CA includes additional guarantees and privileges (apart from those provided by the acting Legislation) with regards to working conditions, payment, and social needs of the employees

The parties hereby agree that the economic growth and development of the company is closely related to the living standards of the employees. The parties share interests in the enhancement of labor productivity and creation of stable conditions at work place

This CA becomes effective from August 1, 1997. The effective period of the CA is one year. The CA shall remain in effect until the signing of a new agreement

If during the effective period of the CA any new laws are adopted in the Republic of Armenia (RoA), that may affect the subject of this CA, within one month corresponding amendments and supplements shall be introduced in this CA

1.2 Range of Application

This CA applies to all company employees, regardless of the fact whether they are or are not members of the Trade Union

1.3 Basic Principles

The Parties have signed this CA with equal rights, observing the legislative standards, and are hereby confirming the mandatory nature of this CA

The Employer hereby recognizes the ATC as the only authorized representative of the company employees, protecting the rights of the company employees and representing the trade unions of the company branches,

The ATC assumes the obligation to contribute to the efficient and normal functioning of the company

Taking into consideration the operating conditions of the energy enterprises (in a certain periodic regime), as well as the peculiarities of the incessant operation of the branches, for the purposes of providing uninterrupted power supply for the normal functioning of the Armenian capital's economy, the parties agree that strikes and interruptions of work throughout the entire system of the company in order to win solutions to various social and economic problems, is unacceptable, as well as impermissible

2 WORKING RELATIONSHIP

2.1 At the moment of hiring, the working relationships are handed to the employee formulated in a written document which is actually a contract between the Employer and the employee, within the framework of the acting Labor Law of the Republic of Armenia. The employee thereby assumes the obligation to perform certain activities in accordance with his/her education and professional qualification. The Employer, on the other hand, assumes the

obligation to pay the employee a salary, providing the working conditions specified in the RoA Legislation or the present CA

2.2 For those employees who have reached retirement age or have worked a sufficient number of years to be nominated for pension, and have been conscientious and reputable workers, the working relationships between the Employer and the employee can persist for up to two more years, in conformance with a new contract signed between the two. That contract can be terminated at the initiative of the Employer, in established procedures, with the consent of the Trade Union

2.3 The hiring of highly qualified employees can be performed by means of a tender. The tender procedures shall be approved by the Employer and coordinated with the ATC

2.4 The issue of structural changes that may take place in the company and may lead to lay-offs of employment positions and employees as well, shall be considered at the joint meeting of the company administration and the ATC

2.5 The parties hereby agree that in case of lay-offs, apart from the procedures provided by the RoA Legislation, the privilege of keeping the position shall be granted to the following categories

- a) employees who have up to 2 years left before their retirement age,
- b) single mothers or fathers who have two or more children under 16,
- c) participants of the military activities in defense of the Republic of Armenia, or persons holding an equal status to the above

2.6 The parties hereby agree that in the instance of lay-offs the employee should be notified about that at least two months in advance and should be given the opportunity to seek for alternate jobs

2.7 In the instance of expansion of activities and creation of new vacancies, the preference in hiring shall be given to the highly qualified and conscientious specialists that have been formerly laid off

3 THE WORKING DAY

3.1 In regulating the duration of the working day, the parties shall be guided by the requirements of the RoA Legislation stating that the working period in a week should not exceed 40 hours

3.2 The parties agree that the current 5-day working week with 2 days off does not really correspond to the imperative requirement of incessant operation for the electric network. Therefore, starting August 1 of the current year and until April of 1998, a 6-day working week with only 1 day off shall be temporarily adopted, taking into consideration the imperative need for continuous power supply process and reparation works in the course of that, as well as the

necessity of preparations for the winter season and the specific working conditions during that period, also, the employee's approach to the above issues

3 3 The parties agree that in the instances of emergencies associated with the indispensability of extremely urgent and nationally important activities, Sundays and holidays can also be considered working days, with the agreement of the Management and the ATC (payments shall be performed accordingly, in legislative procedures)

4 LUNCH HOUR BREAK

4 1 The beginning and the end of the working day shall be determined by the President of the company, with consent of the ATC

4 2 During the working day, a one-hour break shall be dedicated to the employee's rest and lunch

4 3 For all company employees a 24-working day minimum vacation shall be established, regardless of the length of service

4 4 Additionally (apart from the minimum vacation), supplemental vacation shall be given to the following categories

- a) female employees two additional days for each underage child,
- b) employees without a standardized working day up to 6 additional days

4 5 The parties agree that in the instances of family emergencies each employee shall be given the right of a 2-week unpaid leave

4 6 The parties also agree that the Employer shall grant the employees the right of short-term paid leaves in the following instances

- a) marriage of the employee — 3 days,
- b) marriage of the employee's child — 3 days,
- c) death of the employee's immediate relative or family member — 5 days

5 WORKING CONDITIONS AND PROTECTION OF EMPLOYEES' SAFETY RIGHTS

5 1 The Employer hereby assumes the following obligations

- a) to work out a system of working conditions corresponding to each individual employee and meeting the requirements of labor organization, safety provision, social and economic services for the employees' work and rest,

- b) to allocate annual funds for the employees' protection and safety activities, coordinating with the ATC in advance,
- c) while hiring new employees in established procedures, introduce the hazards of the job and instruct the employee accordingly,
- d) each year organize training sessions and seminars dedicated to the subject of labor protection and safety,
- e) given the hazards of the job, provide each employee with means of individual protection and a uniform
- f) at the expense of the company, sign Accident Insurance contracts for employees engaged in especially dangerous activities (list of specialties attached)

5 2 The Employee hereby assumes the obligation to carry out his/her work in compliance with the instructions received in advance, strictly observing the labor protection and safety requirements

5 3 In instances when the safety requirements are not appropriately met, the employee has the right to refrain from the accomplishment of his duties, until the elimination of hazards, notifying the company management and the ATC about that

5 4 With regards to the above, the Employer assumes the following obligations

- a) for the families of employees perished in the course of their duties to allocate one year's salary, apart from the reimbursement amounts specified in the RoA Legislation,
- b) for the employees who have become physically impaired or have acquired a professional disease due to the company's fault to perform payment of 25% of the annual salary to the 1st class disabled persons, and 20% of the annual salary to the 2nd class disabled persons

5 5 The Employer assumes the obligation to create the necessary environment and conditions for the ATC to carry out monitoring and control over safety conditions

6 SALARY SOCIAL ISSUES

6 1 The Employer assumes the responsibility to perform payment of salaries to the employees once a month, enduring that the payments are made before the 15th day of the month following the accountable one

6 2 If the employee is leaving for a vacation, his/her salary and vacation should be paid simultaneously, within 2 days, provided that a corresponding order on vacation has been issued

6 3 The parties agree that financial aids and other payments from the company's funds should be carried out via the ATC

6 4 The parties agree that the employees having a 25-year continuous employment history with the company should receive a one-time allowance of quintuple (5-fold) average salary upon their retirement from the company

6 5 For the purposes of cultural, athletic and other recreation activities for company employees and their families, the Employer assumes the obligation of transferring 0 15% of the funds intended for salaries to the ATC bank account, apart from other subsidies and financial investments made by the company aimed at the acquisitions of resort and sanatorium vouchers for company employees

6 6 The Employer will also provide appropriately furnished and equipped premises for lunch breaks

7 COOPERATION BETWEEN PARTIES AND RESPONSIBILITY FOR THE FULFILLMENT OF OBLIGATIONS

7 1 The Management shall not interfere with the ATC's activities and shall not issue orders and resolutions restricting the ATC's rights and actions The Management shall provide free of charge premises, furniture and equipment for the ATC's activities The Management shall also make sure that each company employee receives a copy of this CA signed by both parties and will provide means of internal and other communication at his disposal, copiers, technical and other assets for the ATC meetings and consultancies, as well as room for posting announcements and other information

7 2 The Management and the ATC shall be responsible for overseeing the implementation of this CA Also, every authority at the company, every branch manager and his deputy shall bear responsibility for the observance of this CA within the scope of his/her own jurisdiction

7 3 In the event of any disagreements during the effective period of this CA, the parties shall take actions of common consent Within three days of drafting a Disagreement Protocol, the parties shall negotiate and form a Consensus Commission

8 GUARANTEES OF RIGHTS OF THE TRADE UNION BODIES

8 1 Company authorities are obliged to observe the Trade Union rights, provided by the Presidential Decree of January 1, 1993 "On Supporting the Activities of Trade Unions During the Transition Period to Market Relationships "

8 2 Company authorities do not have the right to impede the access of Trade Union representatives to the enterprises where Trade Union members are employed, or hamper the accomplishment of their official duties

8 3 During the Trade Union training sessions or performing social duties for the protection of the workers' rights, the Employer assumes the obligation to relieve the non-dismissed Trade Union worker of his/her main duties, and shall preserve that employee's average monthly salary

8 4 As for the dismissed Trade Union workers and employees hired by the Trade Union, they will be eligible for all those premiums and supplemental payments from the company which are intended for the company employees

9 SUMMARY

9 1 During the effective period of this CA, neither of the parties can unilaterally terminate the fulfillment of his obligations

9 2 In the event of disagreements occurring during the effective period of this CA, the parties shall take actions of common consent by forming a Consensus Commission and trying to find mutually acceptable options within 10 days by means of negotiating

9 3 The signed and verified text of the CA shall be distributed among all company employees within no later than 14 days of the signing of the agreement

The ATC shall provide interpretations and explanations of the provisions of this CA to contribute to the best interests of the employees

9 4 Once a year the parties shall report to the company employees about the progress in implementation of this CA

President of Yerevan Electric Network SCJSC

Chairman of the ATC

R Nazarian

Y Kharatian

Signature

Signature

Seal

Seal