

LEGAL ASSESSMENT: AZERBAIJAN

For
USAID/Caucasus/Azerbaijan

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EXECUTIVE SUMMARY

This legal assessment examines three areas with critical implications for Azerbaijan's development - (1) rule of law generally, (2) commercial law impediments to small and medium enterprise development and (3) corruption. Based on the findings summarized in this assessment, this assessment contains programmatic recommendations for USAID to assist Azerbaijan in strengthening the rule of law, removing the impediments to small and medium enterprises and reducing corruption. These recommendations are based on an analysis of priority needs, current constraints to reforms and, in order to avoid duplication and leverage limited donor resources, the activities of other donors.

The assessment's recommendations particularly focus on suggestions to assist USAID/Caucasus/Azerbaijan in implementing the USAID strategy for Azerbaijan approved in May 2000. The assessment accordingly assumes the continuation of the current government and that the restrictions contained in Section 907 of the FREEDOM Support Act will continue to limit USAID's assistance to the Government of Azerbaijan. However, the assessment also identifies certain needs which are likely to involve assistance to the Government of Azerbaijan that is not permitted by the statutory exceptions to Section 907. Such assistance could be undertaken by other donors and USAID could track the implementation of such programs.

Pandemic corruption is the primary impediment to the rule of law and commercial development in Azerbaijan. Corruption exists throughout the public sector and private sector, including businesses and civil society. USAID cannot confidently work with government organs to build rule of law and commercial prosperity because USAID's goals will usually be in conflict with the private interests of corrupt officials. Furthermore, as USAID has learned in other countries in transition, the identification and implementation of reforms requires private sector involvement and monitoring rather than initiatives exclusively at the state level.

The most critical area of assistance by USAID - and an area that cuts through all three areas examined by this assessment - is to provide to Azerbaijani society desperately needed information regarding laws in force, the purposes of reforms, and specific legal rights. This should empower citizens to protest corruption in those situations where they are comfortable doing so and should contribute to reductions in corrupt practices that affect their daily business and personal lives. In coordination with this, work with the media and non-governmental organizations (including business associations) - though both may have limited impact in the absence of a strong commitment to reform by the Government of Azerbaijan - have the potential to raise awareness, transform that awareness into advocacy, and foster change in the long term. The increased dissemination of both laws and information regarding the purposes and practical benefits of new legal standards will also provide an improved basis for the implementation of law by (1) providing judges, lawyers and others charged with the interpretation, administration and enforcement of laws with the legal knowledge they need to perform their jobs and (2) providing the public sector with baseline knowledge so that it can

demand that the government become more accountable and implement the laws as written. Finally, USAID should examine all its programs to insure a maximum of transparency in order to overcome the deeply imbedded cynicism regarding the universality and inevitability of corruption in Azerbaijan.

I. INTRODUCTION

A. Purpose, Methodology and Approach

Recognizing the integrated nature of legal reform, this assessment examines certain legal issues pertinent to Strategic Objective (S.O.) 1.3: *Accelerated Development and Growth of Private Small and Medium Enterprises in Targeted Areas* and S.O. 2.1: *Civil Society Better Organized and Represented*. The Rule of Law section of the assessment relates directly to Intermediate Result (I.R.) 2.1.2: *Legal and Policy Advocacy Environment Supports Civil Society and Media Development*.

The US based core team members conducted a literature review, held extensive team planning meetings and met with appropriate personnel at USAID, US Department of State and the World Bank prior to departing Washington. The full core team was in Baku from June 13 to 23. The team met with over 50 individuals, including: representatives from the Azerbaijan executive and judicial branches of government; multilateral and bilateral assistance organizations; USAID implementing partners; non-governmental organizations (NGOs); international and Azerbaijani law firms; private businesses; and farmers. In addition to the meetings in Baku, the team visited the region surrounding Masalli.

This assessment report examines legal reform progress to date, discusses priority needs, identifies key constraints to reform, determines the extent to which donor assistance addresses these needs, and proposes recommendations for future activities. This report is organized with separate chapters addressing rule of law, commercial law constraints to small and medium enterprises and corruption, respectively. A final chapter emphasizes cross-cutting recommendations and supplements the recommendations of the three separate chapters. The report attempts to minimize repetition, particularly with respect to cross-cutting priority needs and recommendations. However, the reader will note certain common themes – particularly regarding public awareness of laws, reforms and legal rights – in the three sectoral chapters of this report and is asked to consider any repetition and redundancies as greater evidence of the priority needs for Azerbaijan’s future development.

B. Assessment Team

The core assessment team included Claudia Dumas, USAID/EE/DG, Senior Rule of Law Advisor, who served as team leader and had primary responsibility for the commercial law section. Ketti Kvartskhava, PMS Economic Restructuring Office, USAID/Caucasus/Tbilisi, assisted with the preparation of the commercial law section and led the analysis of the Azerbaijani court system. Beth Jones, USAID/EE/DG, was responsible for the anti-corruption section. Robert LaMont, a senior consultant with Management Systems International and former Chief of Party for a USAID legal reform project in Georgia, prepared the rule of law section. All core team members were

lawyers with extensive experience working in countries in transition. Extended members of the team, all with the USAID/Caucasus Mission, included Elchin Guliyev, Geoff Minott, Gene Gibson and Joakim Parker.

II. RULE OF LAW

A. Introduction

Any assessment of rule of law in Azerbaijan must be premised with an understanding of the motives underlying the state apparatus. In the words of one international donor, Azerbaijan is a classic kleptocracy, where the purpose of governmental position is not public service but personal enrichment. This applies from the highest level Minister to the police, school teachers and hospital orderlies. The rule of law has many advantages for society as a whole, but these advantages depend upon impartiality and lack of favoritism in its administration, which is inimical to the motive of most Azerbaijani officials including judges, police and prosecutors. The system of corruption is so pervasive as to have included in its mesh most “private” attorneys who long ago came to be viewed not as advisors on law, but as bagmen and interlocutors for the necessary bribes. For this reason, Azerbaijani business that can, dispense with legal services and pay bribes directly in most business matters.

A deeply rooted culture of impunity exists in Azerbaijan. The public expects corruption and recognizes the potential for arbitrary and capricious actions by state officials that underlies the need to pay for protection from them. A minor example observed by one member of this team occurred at the Patio Bar on the Esplanade shortly after midnight on June 18, 2000. Dan Matthews, managing partner of Baker & MacKenzie’s Baku office, Stein Iverson, the Consul of Norway in Baku, and Knute Kasperson, the assistant director of the Red Cross in Azerbaijan, were out with a member of this team. A group of un-uniformed police entered, turned off the music and announced that they were searching for drugs. Instead of doing so they said “You prostitutes, out.” They escorted all the Azerbaijani women (but not foreign women) outside and into busses. Azerbaijani men who attempted to interfere were beaten and also put on the busses. The Norwegian Consul asked why the women were being arrested he was told that the women were all drug addicts. When he protested, the policeman swung back to hit him, but stopped when friends shouted that he was a diplomat. No individual probable cause could possibly have been gathered with respect to the women. No prostitution or drug use was observed by any member of our party, and although our party was completely male, nothing approaching solicitation had occurred since we had arrived in the club. That most women went without protest seemed less proof of guilt than resignation to the ability of the police to arrest at will, “make a case” against anyone and demand a standard bribe for release.

Discussion of corruption and impunity belongs more properly in the “Key Constraints” section of this chapter, but it is raised here because it is impossible to understand other aspects of rule of law problems and opportunities in Azerbaijan without starting from that foundation.

B. Rule of Law Institutions, Supporting Institutions and Actors

1. Judges

Azerbaijan is in the process of testing all its judges and judicial candidates. Those who pass will form a pool from which all judicial positions¹ will be filled. The effort is based on the success of judicial testing in Georgia, but has several significant differences. Testing in Georgia took place after the Georgian Parliament enacted the Civil Code, the Civil Procedure Code and the Criminal Procedure Code.² Thus, the Georgian exams tested on the new reform laws. In Azerbaijan, the tests were based on the Soviet Codes, even though some of the new codes have now been enacted. In Georgia, the Council of Justice took elaborate precautions to prevent cheating and to insure a public perception of clean testing. The President of Georgia chairs the Council of Justice, which has equal representation from the executive, legislative and judicial branches. Professor Lado Chanturia took the potential questions to San Francisco where he made his selection of text questions and where the tests were printed by a high security financial printing firm which delivered the tests to the German consulate in San Francisco. The German consulate sent the tests by diplomatic pouch to their Embassy in Tbilisi. On the day of the exam, international monitors took the exam boxes to the test sites, broke the diplomatic seals on the boxes, and opened and distributed the exams under the gaze of television and the test takers. The testing transparency and low pass rate (little more than a third of sitting judges) convinced the public that money and politics did not play any role in the process.

In Azerbaijan the World Bank assisted in judicial testing.³ Pre-test secrecy and security for the examination was substantial. Western observers are convinced that the multiple choice section of the test was administered fairly. Several Azerbaijani lawyers have commented to the team that some candidates received the answers to the questions in advance. The official review of protests and appeals regarding the written test was well conducted and failed to document instances of cheating. However, it seems clear that the public perception of honesty has been compromised. The public lacks confidence in the ability of the judicial selection process to change corrupt practices in the courts. In Georgia, after the multiple choice test, essay tests were administered and the essay results were posted so the media and public could decide the quality of the essays to assure themselves that bias did not enter into grading. The Council of Justice then conducted

¹ Exceptions in the law exist for the Chair of the Supreme Court, the Chair of the Constitutional Court, the Chair of the Appeals Court, the Chair of the Nachiavan Supreme Court, the Chair of the Economic Court, the Supreme Court section on Grave Crimes, and Chair of the Military Court. In addition, anyone with a Doctor of Laws with Honors is exempt, however this exception applies to only one person.

² At the time of the Georgian tests the Criminal Code had not yet passed the Georgian Parliament, though most of its provisions were known and not controversial or likely to be changed. Parts of the Criminal Procedure Code had not yet come into effect, as they required enactment of the new Criminal Code.

³ International observers included ABA/CEELI, Soros and GTZ. In addition, Azerbaijani NGO's observed the written testing process.

interviews. Questions were on judicial demeanor and the selection criteria was published in advance.

In Azerbaijan the Juridical Law Council, a body of seven members appointed by the President, is responsible for testing. The members include the Minister of Justice, the Chair of the Supreme Court, the Chair of the Constitutional Court, the Chair of the Economic Court, the Chair of the Nachiavan Supreme Court, the Chair of the Military Court and the Chair of the Supreme Court Panel on Grave Crimes. Of the approximately 1,000 people who took the multiple choice examination, 603 passed. About 25% of the sitting judges failed. The Juridical Law Council did not use essay examinations, but is conducting oral examinations. The team heard reports that questions of family and political affiliation have been asked on such interviews. The team also heard reports that it costs \$30,000 to pass the oral portion of the examination.

The 603 candidates who passed the multiple choice section are being interviewed. There are between 310 and 330 positions to be filled. The number of positions to be filled has been expanded with the reorganization of the courts. Annex I summarizes the court system under the new law and contains a schematic diagram of courts and avenues of appeal. The President nominates candidates for positions on the Supreme Court and Economic Court to Parliament (the Milli Mejlis) for confirmation. All other judicial positions are appointed by the President without the need for confirmation.

The Supreme Court can ask the President to dismiss a judge who has committed a crime.⁴ The Juridical Law Council, responsible for selection, may also have disciplinary powers. The team was unable to discover any code of judicial ethics beyond the criminal code. While nominally independent, the judiciary is dependant on the Ministry of Justice for its budget. The President has the power to assign judges, possibly with the recommendation of the Juridical Law Council. It is not clear if separate bribes are necessary to pass the oral examinations and obtain a remunerative position, or if packages are available.

Judicial independence is guaranteed by the Constitution, though that did not prevent the dismissal of judges who did not pass the multiple choice test. Laws on removal of judges may also conflict with provisions on judicial independence. None of these concerns is as significant as the fact that the team understands that almost any judge could be validly arrested on a corruption charge on an executive branch whim, communicated through the procuracy. That judges are aware of this vulnerability is probably sufficient to keep them from considering any ruling that would not be in the interests of the state, the President and his party. There are reports that the Constitutional Court is less corrupt and more inclined to rule against the government. Its higher profile and the qualifications of its members seem to afford some degree of protection.

The Legal Training Center is a department within the Ministry of Justice responsible for training judges as well as prosecutors and investigators. ABA/CEELI is currently

⁴ Within the last year the Chair of the Supreme Court dismissed the chair of a Baku District Court without a Presidential decree. The dismissed judged was also subsequently barred from taking the written judicial test.

discussing with the Ministry the possibility of cooperation with this center. GTZ plans to work with this center, but has not decided on a detailed program. They are considering equipment donations⁵, providing in-country training with local and German experts and taking groups of judges to Europe for study tours.

Cases are registered with clerks and taken to the chief judge of the district court where they are registered. The chief judge has discretion to assign the case to any judge within the subject matter jurisdiction of the case (family law cases to family law judges, criminal cases to criminal law judges, civil cases to civil law judges, etc.)

A “Justice Police” force, now called “Court Controllers and Bailiffs”, has been created within the Ministry of Justice. Azerbaijan’s law on Court Bailiffs came into effect in December 28, 1999. These Court Controllers are responsible for the security of courts and witnesses in all courts, including the Constitutional Court, in Azerbaijan. They can take measures to secure the physical environment of the courts and maintain decorum in the courts. They can compel persons to appear in court. They can seek assistance from law enforcement and Ministry of Interior troops for their work. They can carry a gun and use it when necessary. Bailiffs are charged with enforcing court decisions, including entering buildings, and seizing property. Bailiffs do not have authority in criminal cases; they are limited to civil, economic and administrative penalty cases. In the past, the Justice Police were reputed to be corrupt, requiring bribes to carry out court ordered measures, and/or taking bribes to forebear from carrying them out. Justice Police had to split such income with the respective court chairmen. To the team’s knowledge, no foreign donor has yet attempted to work with the Court Controllers or Bailiffs.

2. Lawyers

Lawyers are divided between those allowed to practice as defense lawyers in criminal cases, “Advocates,” and those who can give advice and appear in civil cases only. The latter are licensed by the Ministry of Justice and the former are members of the Collegium of Advocates. While the President of the Collegium assured the team that the lawyers licensed by the Ministry of Justice were allowed to give legal advice and appear in civil cases, there is enough ambiguity in the Law on Advocates, adopted on December 27, 1999, to make those rights uncertain for non-Collegium members. ABA/CEELI reports that some lawyers complain of the necessity of bringing a Collegium member with them to any court hearing. New laws on prosecutors and notaries⁶ have also been adopted. ABA/CEELI and the World Bank helped draft the law on Advocates and draft regulations. Their recommendations were largely but not entirely followed. The Council of Europe held a seminar with respect to the law and regulations May 23-24, 1999. The President of the Collegium of Advocates, stated that the law and regulations won the approval of the Council of Europe. Under the law, the Collegium is structured as a body independent of government controlled by a meeting of the general membership which

⁵ GTZ has given equipment to the police academy.

⁶ In the former Soviet Union and most Continental legal systems notaries do much work associated with real estate lawyers in a common law system, as well as registration of contracts which is not considered necessary in most common law countries.

elects the Chair, Deputy Chair and other members of the “High Board of the Bar.” It has the power to determine the budget, set dues, create a disciplinary commission and adopt its regulations, adopt regulations for a qualification commission (but not determine its members), and adopt codes of conduct. The qualification commission consists of nine members; three advocates appointed by the High Commission of the Bar, three judges appointed by the Supreme Court, and three legal scholars appointed by “the appropriate executive authority.” In a significant shift away from Soviet practice, advocates can conduct their own investigation and retain their own experts.

All 500 existing Advocates and an unknown number of candidates will be tested under the new law. They will have both multiple choice and oral examinations. The exams will be based on the new laws. No date has been set for testing. The President of the Collegium did not know when tests would be given but ventured it would not be before 3 months (from June 2000). The President of the Collegium was emphatic that anyone who passed the tests and a three year apprenticeship would become an advocate, despite reports that the team heard that lawyers who had represented dissidents in the past had had problems becoming members of the Collegium and reports from human rights lawyers that they had no intention of applying for membership because the system was rigged. The President of the Collegium denied that there had ever been any interference with defense advocates by the state or prosecutors in the Soviet period.

The Collegium is responsible for assigning advocates to arrest facilities to represent the accused. They are to be paid from the state budget. However, the President of the Collegium could not tell the team how much they were paid or how they were paid despite repeated questions, thus indicating there may be some problems with implementation.

3. The Procuracy

The Procuracy has expressed interest in working with ABA/CEELI. The Procuracy traditionally is the most powerful and corrupt branch of the justice system in post-Soviet states. The Azerbaijani Procuracy has given up several of the powers it held in Soviet time including its supervision of the prisons and its role in civil cases. The new Criminal Procedure Code has taken the power to issue arrest warrants away from the Procuracy and given it to the Judiciary. These changes have been necessitated by Azerbaijan’s ambition to join the Council of Europe. The Procuracy continues to wield tremendous power, and many of the constitutional and criminal procedure code changes have not yielded better protection of human rights. In practice, the Procuracy does not prosecute cases of corruption by officials who have not been branded enemies of the regime. It reportedly remains one of the most lucrative branches of government for the extortion of bribes.

4. Law Students/Legal Education

The Muskie fellowships and other educational opportunities for talented Azerbaijani students to study in the United States is undoubtedly creating a small but highly talented

population that knows that Azerbaijan could be a very different country. Efforts to promote reform through this type of education are long term, but undoubtedly money very well spent.

Law is the most popular faculty in Baku State University. It continues to attract the most qualified students and hold the most prestige.⁷ However, professors at Baku State University are widely acknowledged to sell grades to some students, though good students do not necessarily have to pay bribes to get grades that they have earned. New universities are springing up and most would like to start a law faculty because of the popularity of legal studies, due to the lure of large salaries with foreign organizations.⁸ The private university law faculties are primarily staffed with moonlighting faculty from Baku State. Unlike Baku State, most of them admit students with little preparation for the study of law. The Xazar University has a reputation for attempting to maintain honesty. It has the only legal clinic in Azerbaijan⁹ and is open to innovation. For those reasons Xazar may be the most promising partner. Other private universities include Azerbaijan University and Western University. Annex II lists the major private universities and their contact information. ABA/CEELI has worked with most of the universities through its moot court competitions. It is promoting the formation of a law students association, being initiated by Baku State students. If the law students association is formed and is inclusive and independent, it would make a promising partner for cooperation.

5. Statutory and Regulatory Framework

A chart on the status of some of the most important legislation is attached to this report as Annex III. There has been little coordination among donors with respect to assistance offered on legislation, however, EU-TACIS, GTZ and the World Bank have taken the lead in legislative assistance. Though in many cases they report that significant portions of their advice was ignored, Soros and ISAR have had some input on the new NGO law, but generally private groups are excluded from the policy and drafting stages. IFES, NDI and IRI have been able to have input on election laws. There is therefor a small trend to hope that the secrecy of the legislative process may be opening up very slightly.

The Ministry of Justice is charged with responsibility for publishing all laws and decrees. It publishes “Legislation Journal” monthly which is distributed to the Ministry of Internal Affairs, Procuracy, and Supreme Court, primarily for internal use. However, it is for sale at the Ministry of Justice office of legislation. The cost is 6,000 Manats per copy and 1200 to 1300 copies are produced a month. Copies are available at the Ministry of Justice library. It has a monthly bulletin of the normative acts of executive bodies. It is distributed in a similar manner and can be purchased for 8,000 Manates. The Minister of

⁷ Generally state bodies only recruit graduates from Baku State University. For this reason many students at private Universities cross register at Baku State.

⁸ Legal studies are also popular because of the corrupt income available to prosecutors and investigators. Such offices were considered far more prestigious than being an advocate in Soviet times and remain so today in the minds of many people. Delaying military service is also a reason for being formally registered in a university faculty.

⁹ The clinic was sponsored by Soros.

Justice stated that “all citizens do have the right to come to the Ministry of Justice and be given information about the laws.” Comments by various lawyers suggested that most citizens would not be able to access the Ministry for that purpose physically or through the switchboard. The Minister’s statements that Ministry publishing efforts are satisfactorily comprehensive and accessible suggest that the Ministry might not be an interested partner in assistance to improve the publishing and dissemination of laws and decrees.

Several state newspapers - “Republic”, “Azerbaijan” and “Xalq” - publish new legislation and decrees of the President and Cabinet of Ministers. They are largely distributed to government offices. Their paid circulation could not be determined, but it is probably not large. Attaspr Company translates laws and distributes them on diskette, they do not physically publish them on paper.

6. Civil Society and the Media

NGO’s have experienced great difficulty registering, particularly under the prior Minister of Justice who reportedly conflated “non-state” with “anti-state” organizations. NGO’s with human rights aims have reported particular difficulties. The Young Lawyers Association was unable to register, and chose to operate under the registration umbrella of an association believed to be tied to the majority political party. This has hurt the credibility of the Young Lawyers Association and caused some idealistic members to leave. The public often confuses NGO’s with political organizations. NGO’s are often seen as vehicles for articulate individuals to obtain foreign funds without a real commitment to the purported goals of the organization. A new NGO law was recently read in the Milli Mejlis. Soros and ISAR report that the draft law represents a significant improvement and will explicitly separate political parties, religious organizations, and labor unions from NGO’s.

“For the Sake of Civic Society” directed by Eldar Ismailov was identified as a promising NGO which works with IFES on the parallel vote count project. Leyla Yunusova of the Institute of Peace and Democracy was very impressive in her presentation of her organization’s work on behalf of prisoners and the accused. Both would seem to be appropriate partners for work within their spheres. Other NGO’s could well prove effective partners for specific projects, but it would be wise to get current assessments of their efficacy and political orientation from USAID partners, grantees and other donors before beginning specific projects.

Procedures for obtaining broadcast licenses have never been implemented, such that all non-state broadcasters operate without a license, and this status makes them subject to state intimidation. A privately operated television station that went from a purely entertainment format to including news reporting, suddenly found itself taken off the air because of a regulation prohibiting foreign ownership (in this case Turkish) that had been ignored for years.

There is considerable diversity of opinion among the large number of newspapers, but most print runs are very small, few exceeding four figures. During the 1998 economic difficulties, most truly independent newspapers were faced with ruin as advertising revenue collapsed. Many were “rescued” by wealthy patrons with political ties and quickly lost their independence. All opposition parties have their own newspapers which generally have miniscule circulation. The quality of reporting is poor, and a number of defamation suits have been brought by government officials and won. If the judgments awarded were collected the newspapers involved would certainly be out of business. Several of the defamation suits are widely thought to be justified because of the poor quality of reporting. The law on the media makes reporters and publishers responsible for documenting the truth of their stories. Cases have been won against reporters who correctly reported statements by opposition figures, where the prosecution convinced the judge to hold the reporter responsible for alleged false statements made by the opposition, though identified as a quote.

7. Parliament

The Milli Mejlis is controlled by the Yeni Azerbaijan Party of which President Aliev is chairman. The Milli Mejlis is involved in drafting legislation through its committees. However, the close identification of the government, the President and the parliamentary majority make it difficult to discern how much real power and influence the Milli Mejlis has. The Milli Mejlis has been described as very secretive and the team was been told of votes that have been taken by agreement of the parliamentary majority and the President’s legal advisor of which most members of the Cabinet of Ministers were not aware. Any method of encouraging transparency and greater participation in the drafting and consideration of laws would be a great improvement. However – despite the success of some international donors in working with the Milli Mejlis on select laws - it is not clear if any strong will exists at this time to move towards greater openness. Parliamentary elections are scheduled for the Fall of 2000.

C. USAID and Other Donor Assistance

ABA/CEELI has been active since April 1999 in Azerbaijan. They have concentrated on legal education. They were observers during the multiple choice portion of judicial testing. They have not found work with local partners entirely satisfactory and prefer to conduct legal education seminars out of their own office and maintain a library and resource center there. Many NGO’s have political agendas which make them poor partners for long term projects, though useful for specific programs. ABA/CEELI experienced initial reluctance by the few well-trained lawyers to lead seminars owing to concerns about giving away their “secrets.” Government officials have also claimed that laws and regulations are freely available but have failed to actually provide them. Seminars so far have included the new Civil Code, conducted by the Azerbaijani drafters, one by the Chairwoman of the Baku City Court, one on Privatization by an official of the Ministry of State Property, and one by a SOCAR official on production sharing agreements. While the seminars attract 80 to 100 lawyers, ABA/CEELI estimates that only twenty attorneys may be making a living practicing commercial law in Baku, aside from the international firms. A significant number of these are engaged in providing

business registration services and acting as local counsel to international law firms, businesses and donors. ABA/CEELI is also preparing a commercial law workbook including articles, sample contracts and negotiations and corporate documents. This workbook will include relevant provisions of the new Civil Code. ABA/CEELI would like to form a commercial lawyers group. It would be less threatening to the state than other kinds of groups and there is a demonstrable demand for knowledge. ABA/CEELI maintains a resource center which currently receives about 200 visits a month, and the trend has been steadily upward.

ABA/CEELI has sponsored moot court competitions involving teams from both private and the state university law faculties. ABA/CEELI sent the winning team from its Jessup Moot Court Competition to the international competition in Washington, D.C. As noted earlier, students at Baku State have formed an as yet unregistered law society. ABA/CEELI hopes that it will expand into a non-political law student organization.

ABA/CEELI sent members of the Constitutional Court to the United States and one of the members who was drafting the Criminal Code and Criminal Procedure Code said that the experience was very helpful.

ABA/CEELI was an international observer of the multiple choice section of the judicial tests at the request of the World Bank. ABA/CEELI believes that reports of cheating in that section of the tests are untrue, but concedes that the public perception of the testing process is that it is unclean and that the oral tests are deeply flawed. ABA/CEELI will look to work with other donors on judicial training when the selection process has been completed, probably in September 2000.

The Soros Foundation has done extensive work in rule of law areas. They are working at distributing legal educational materials. They have published 5,000 wallet cards on what to do when stopped by the police, 5,000 on prisoners rights,¹⁰ 10,000 cards in Azeri on the rights of Azarbaijanis to trade in Russia, 5,000 motorist rights cards, and produced cards on voters rights in the Presidential elections. They will be producing similar cards for the parliamentary elections.

Soros has worked to improve professional legal skills over the last four years by sending law professors to the Central European University in Budapest for six month terms. Approximately 35 to 40 professors have participated to date. Ten or twelve faculty of the Police Academy have also participated, as have six or seven trainers from the Legal Training Center in the Ministry of Justice. Soros has distributed legal text books in Russian on International and European Human Rights law.

Soros funds a legal aid program for the indigent in Baku, and recently closed such a program that worked on a rotating basis among IDPs.

¹⁰ The cards were prepared by the Human Rights Center and distributed with the cooperation of the Central Prison Administration in 8 prisons. When the Milli Mejlis adopts a new penal code, Soros expects to revise this card and print a larger number.

Soros sponsored the drafting of an NGO law that was rejected by the Milli Mejlis and then worked with the Milli Mejlis to hold an open forum on the alternative draft.

Soros worked with the Police academy and the Ministry of Internal Affairs on police standards and community policing, but has not found the Ministry ready to fulfill its commitments to implement this work. In prisons, Soros brought the former Chief Administrator of Polish prisons in for an assessment. His work may be implemented when a Council of Europe team assesses Azerbaijan's prisons next year.

Soros would like to coordinate with GTZ and the World Bank to develop curricula for judicial training at the Legal Education Center in the Ministry of Justice.

Soros may work with Transparency International on their chapter in formation in Azerbaijan.

Internews works with the broadcast media in the difficult environment described in Azerbaijan.

ISAR is active in helping NGO's and it appears that the situation in the NGO sector has improved.

GTZ has long been active in Azerbaijan and has contributed to the drafting of the German patterned Civil Code, though GTZ was unable to participate in certain changes made at the level of the Cabinet of Ministers and the President's office. The Civil Code and Code of Civil Procedure will come into effect on September 1, 2000. GTZ participated in the drafting of the law on Advocates, sending members of the Collegium to Bremen and bringing Dr. Lauder to Azerbaijan to advise the Milli Mejlis. About half of their suggestions were adopted.

GTZ is currently financing the preparation of commentaries on the Civil Code by Azerbaijani experts. The commentaries are supposed to have practical information for practitioners and examples. GTZ will pay for the publication of the commentaries, but will not participate in their distribution. GTZ has no plans for an outreach to business people or the general public to explain the new Civil Code. GTZ is interested in being involved in training judges with the commentaries after they are finished and the judges are sworn in, presumably after September 2000. GTZ admits that it will be difficult to reach all judges on their budget. They will use the Azerbaijani drafters of the commentaries as instructors. A law on international private law (international contracts and arbitration) was prepared with the assistance of Dr. Knieper and is currently in the Milli Mejlis. GTZ has sponsored visits by justices of the Constitutional Court to the European Court of Human Rights in Strasbourg, and is interested in preparing commentaries on the Constitution. GTZ is contemplating a program to raise the skills of journalists reporting on legal issues. Dr. Kappler has been involved in the drafting of a law on small and medium businesses.

GTZ plans to work on judicial training through the Legal Training Center in the Ministry of Justice, but as mentioned above, has not arrived at a specific program.

The World Bank has provided two grants relevant to this assessment, one of which was funded by the Japanese Government for legal and judicial reform, including assistance in the judicial selection process. Their expert was used extensively in the design and implementation stage of the multiple choice testing, however, Government of Azerbaijan officials allowed her contract to expire before training for oral interviews could be conducted. The oral examinations are being conducted without World Bank assistance. The World Bank also provided an expert to design regulations for the advocate testing process, and the reform of the collegium. The experts report is kept in the Office of the President of the Collegium, and brought out to be admired by visitors, but the expert is not going to be involved in implementation. A second grant was for revision of the budget law and state budgeting process.

Future World Bank cooperation in Azerbaijan on rule of law and democratization is dependent on Azerbaijan meeting commitments the World Bank has asked it to make in the areas of: budgeting system; legislation on public procurement; licensing reform; external audit; a public service law; legal and judicial reform with respect to prosecutors and lawyers; financial management; and increased transparency and accountability in the Cabinet of Ministers. The World Bank is prepared to offer funds for implementation of reforms if legislation and decrees are put in place to facilitate reforms in these areas. Compliance with most of these efforts is supposed to have taken place by September 2000. Sources within the World Bank are skeptical that Azerbaijan will achieve real compliance, or that the World Bank board will approve further expenditure – including the anticipated public administration project components that would support judicial reform - without some significant level of compliance. As oil revenues increase, it is expected that incentives to make difficult reforms will decline.

The World Bank has prepared draft terms of reference for work on drafting commentaries to new laws, drafting a land code and assisting the conducting of judicial training through the Legal Training Center at the Ministry of Justice. The World Bank has requested comment from the Government of Azerbaijan on these terms of reference, but has had no response. The World Bank has received Danish funding for an assessment of the customs service in Azerbaijan – with an emphasis on regional reforms favored by the IMF - which should be conducted within the next few months.

The United Nations Development Programme has financed programs on business law aimed at small entrepreneurs. In essence, UNDP leads potential entrepreneurs through the business registration and licensing processes.

The Council of Europe has participated in the drafting and/or review of several pieces of legislation. It was noted by several lawyers that the Council of Europe focuses on enactment of laws and not their subsequent implementation. Compliance with laws and with the standards of the Council of Europe seems to be judged separately from the legislative checklist. Admission to the Council of Europe has been a primary motivating

factor in law reform within the Azerbaijani government. At the end of June 2000, the Council of Europe Parliamentary Assembly voted to approve Azerbaijan's application for membership to the Council and set out the commitments that Azerbaijan must honor, including Azerbaijan's ratification of the European Convention on Human Rights and guarantying of freedom of expression and independence of the media.¹¹ The Parliamentary Assembly's recommendation will be forwarded to the Committee of Members of the Council of Europe, which will decide whether to invite Azerbaijan to become a full member of the Council.

The World Trade Organization is a potential source of leverage for greater transparency in law and public administration. Azerbaijan has just sent its first memorandum to the organization and is receiving comments from member nations. Membership in the WTO is probably vital to Azerbaijan if it is to develop its non-oil sectors. WTO membership will involve many changes to law and regulations affecting trade, but which will also have broader application. The membership process often involves examination of laws, and not implementation, but even at that level, Azerbaijan will require much assistance. The progress of WTO accession may offer opportunities to leverage law reform, and should be monitored from a rule of law perspective as well as a trade perspective. EU-TACIS has indicated that it will probably work with Azerbaijan on WTO accession.

D. Key Constraints

Government will is the key constraint to further implementation of the rule of law in Azerbaijan. So long as most government officials regard their office primarily as a source of enrichment, it will be in their interest to prevent the rule of law. This does not mean that some incremental changes cannot be made and that foundations for long term change cannot be laid, but realism is required in assessing the near and medium term goals of USAID rule of law assistance.

One of the key constraints to advancing the rule of law in Azerbaijan has been the non-availability of current laws, decrees and regulations to the legal profession and the population. The secrecy and non-transparency surrounding the drafting and enactment process has hampered efforts to assist in law reform. Both of these problems are related to the underlying problem of a kleptocratic state. Where citizens and businesses do not know the law, they are at the mercy of bureaucrats who demand bribes for what would ordinarily be considered ministerial acts. Likewise, the best drafted laws can be amended in the Cabinet of Ministers or the Milli Mejlis to add ambiguity, extra layers of approval and discretion to empower bureaucratic clients with greater opportunities for rent seeking.

In some countries, internet availability is a means to make laws, decrees and other normative acts available to the legal profession as well as the public. However, internet is not widely available in Azerbaijan. The U.S. Embassy Economic Officer estimated that Azerbaijan had sales of 3,000 to 4,000 computers a year. While this is a beginning,

¹¹ The Human Rights Committee voted not to proceed with Azerbaijan's application, however, the legal committee voted to approve it.

it indicates that only a miniscule portion of the population has access to the internet. Massalli, and reportedly most provinces outside Baku do not have any internet access. Certainly low income precludes most private lawyers from obtaining computers. Shared internet access is a promising idea, but given the lack of independence of the Collegium and the absence of other nationwide lawyers' organizations, no partner organization currently exists to facilitate such access. In addition, as the team itself is painfully aware, even with the most modern computers, the two internet access firms in Baku provide only substandard connections. As Dan Matthews of Baker & MacKenzie said, "One is too slow and the other throws you off line every five minutes." The team did not see computers in any of the government offices, except for a laptop on the Minister of Justice's desk. Reportedly, the Ministry of Justice did not have internet access before the current Minister was appointed, two months ago. While internet publication of laws, decrees and normative acts should remain a long term goal, immediate assistance in that area would not result in substantially greater dissemination until the underlying problems of internet access are improved.

Legal education has likewise been handicapped by an ethic of non-disclosure. ABA/CEELI's attempts to recruit lawyers to lecture have been hampered by the perception that professionals do not give away "secrets" to the competition.

Impediments to NGO registration and operation have been key restraints to this sector which holds a great deal of promise for long term change. The new NGO law in the Milli Mejlis may signal a modest breakthrough in this area.

Section 907 of the FREEDOM Support Act does not appear to be a significant restraint to rule of law programs in Azerbaijan. This is both because most activities promoting rule of law would fall under the governance exception to Section 907 and because at the moment there do not appear to be public sector agencies with which USAID could work as partners without severe reservations regarding the motives and commitment of most public servants.

E. Priority Needs and Recommendations

1. Laws, regulations and decrees are often not available to lawyers and courts. Laws usually can be obtained with some difficulty, but regulations and decrees are often treated as secrets by the issuing ministries. Support for a legal publishing project that would gather decrees and regulations as well as laws, publish them and maintain a data base would be of enormous help to the legal profession, promote transparency, reduce opportunities for corruption and make government more responsive.
2. A related priority need is to publish more simple handbooks, cards and pamphlets describing existing rights and how to exercise them. These materials would be aimed at business people, farmers, students, NGO's etc. It should be possible to do educational programs in conjunction with the written materials on what is left of the independent media.

3. Improvement of the laws on the media, reducing the scope for abuse of defamation suits and at least making a theoretical possibility of independent broadcast media are important. This will require a demonstration of will by the government. However, it may be possible to make incremental improvements because the government ought to feel secure with its success so far in coopting the media. Both Internews and existing NGO's could form the basis of this work within existing constraints. The European Convention on Human Rights has been interpreted to prohibit types of defamation suits that are currently permitted by Azerbaijan law, and this may provide leverage for reform.

4. Continued support for the NGO sector (including business associations) is one of the most promising avenues for assisting long term changes within Azerbaijani society. Care must be taken in identifying effective NGO's for financial grants, but capacity building in this sector is a good way to promote multiple voices articulating from the bottom up, a novel trend in Azerbaijani society.

5. Legal education has a great role to play in building the rule of law in Azerbaijan. There is a thirst for information about the new codes and laws among attorneys and law students. By disseminating this knowledge to those whose profession it is to use the law, USAID can strengthen the rule of law, even in the most difficult circumstances. Without a grounding in the legal codes, lawyers will have no basis to challenge arbitrary and capricious decisions by judges and government officials. While the deck may be stacked against them, a well educated bar is far more likely to protect citizens' rights than a poorly educated one. ABA/CEELI has done a discerning and effective job of identifying opportunities for legal education and partners for particular programs.

6. Judicial education presents complex problems. Currently sitting judges have purchased their positions and the team understands that this practice is continuing in connection with the selection of judges under the new qualification procedure. Consequently, the majority of judges will of necessity have to recoup their investments¹² by selling their decisions. Ideally the training of judges, prosecutors or other government should wait until the government demonstrates sufficient commitment to an anti-corruption effort.¹³ However, a judge that knows the law is far more likely to make a contribution to the rule of law than one who is corrupt, subject to intimidation and ignorant of the law. At least knowledge of the new codes could lead to an understanding of the basis of a market economy and that the rights of individuals and associations are not inherently in opposition to the needs of the state. Currently it is credible to believe that many judges' understanding of commercial law is suffused with a background of Marxist training and their feelings for non-state actors guided by Leninist principles.

¹² Unlike Georgia, no provision has been made for increasing the salary of judges who pass the examination and appointment process. General salary increases for government employees are contemplated with the rise of oil revenue.

¹³ The *bona fides* of such an effort could be measured by a resolve to start putting people in jail. Such prosecutions must be of ordinary as well as powerful officials, not just ones who have lost political favor. Any effort before such time will just be trumpeted by the assisted institutions as a seal of approval from the US government, much as corrupt institutions now insist that they have Council of Europe and World Bank approval for the way they do business. Adding the prestige of the United States to such sorry claims can only encourage cynicism and hurt the possibility of reform.

Therefore, judicial training should be ranked among the priority needs, though with cautious expectations of demonstrable results in the short to medium term.

7. If there is evidence of political will, an Administrative Procedure Act, similar to the one developed in Georgia would greatly enhance transparency and accountability. It is possible that Azerbaijan's desire to conform to European and general western norms could encourage the Government to initiate such legislation. The components of an Administrative Procedure Act are discussed in more detail in the Recommendations section of the following chapter. USAID might find it possible to allow the Georgian drafters to visit Azerbaijan and share their drafting experience.

8. If there is political will to implement greater openness and participation in parliamentary proceedings, technical assistance could be of use to the Milli Mejlis. Without a commitment to opening up the legislative process, any such assistance would be counter productive. After parliamentary elections in November, USAID may wish to assess the leadership and composition of the Milli Mejlis and determine if assistance is warranted. The willingness of the Milli Mejlis to publish all draft legislation, to open debate to all interest groups publicize hearings and encourage a variety of opinions to be heard would be critical markers.

III. COMMERCIAL LAW

A. Introduction

This chapter assesses four commercial law areas - contract law, company law, secured transactions (pledge) law and bankruptcy law – and, in a more general vein, other significant legal and regulatory constraints to small and medium enterprises. The team spent time considering not only the extent to which the specified commercial laws are consistent with international standards, but also – and more importantly – matters relating to the transparent and efficient implementation and enforcement of the laws. The assessment below particularly reflects the team’s views regarding commercial law constraints to small and medium enterprises. However, the issues noted below are also relevant to Azerbaijan’s future economic growth, as the issues and constraints discussed below are relevant to Azerbaijan’s overall economic future.

Azerbaijan is in a period of significant reform of its codes and laws. A new Civil Code was signed by the President in May 2000, and is scheduled to become effective September 1, 2000. The enactment of the Civil Code is a particularly significant achievement in terms of its ramifications on the commercial law framework of Azerbaijan. The areas addressed in the over 1,300 articles of the Civil Code affect almost every aspect of an enterprise’s operations. The Code includes detailed topics on companies, contracts law (including various types of contracts) and pledge law.¹⁴ A new draft tax code is being prepared with assistance from the International Monetary Fund; some believe that the new tax code may be passed and become law by January 2001 or earlier.

Many of the matters identified by the team as significant constraints to the implementation of commercial laws, and discussed below, demonstrate the convergence of rule of law, corruption and commercial law/economic growth issues. Particularly striking aspects of the commercial law environment in Azerbaijan are: (1) the closed manner in which proposed reforms are considered and passed into law and, accordingly, the absence of a policy consensus between the Government, or public sector, on the one hand and the private sector (businesses and advocates) on the other hand; (2) the private sector’s absence of information regarding legal standards, and the rights, benefits and

¹⁴ The ten major topics of the Civil Code are:

- (1) General Part, Recitals (including application of civil law);
- (2) Persons (detailed provisions on natural persons and legal persons)
- (3) Property rights (ownership, use, pledges and mortgages)
- (4) Contracts
- (5) Time
- (6) Special Part, Law of Obligations
- (7) Contractual obligations (addressing various types of contractual obligations and practices, including franchising, factoring, commercial agency, leasing, concession and securities)
- (8) Legal Obligations (unsolicited representation, unjust enrichment)
- (9) Law of Torts; and
- (10) Law of Succession.

Provisions specifically regarding intellectual property are not included in the Civil Code.

obligations imposed by such legal standards; (3) absence of uniform implementation of law due in part to poor public administration practices, a legislative framework that is a pastiche of codes and laws in need of harmonization, and corruption; (4) a private sector that tolerates, and participates in, the implementation distortions; and (5) the absence of coordinated and cohesive assistance efforts by the international community, including international financial institutions, bilateral assistance efforts and international NGO's and PVO's.

Ironically, some of the most significant impediments to commercial law implementation constrained the team's findings and work. The absence of transparency in the lawmaking process, the poverty of information regarding laws and the rapid pace of legal reforms combined to make it difficult for the team to obtain definitive information regarding specific provisions of law and specific problems with the commercial law framework. Questions produced conflicting answers, vague responses and, at times, simple "we do not know the answer" expressions. When available, unofficial English and in some cases Russian texts of laws and decrees were reviewed.¹⁵ However, the team must caveat that some of the specific statements made in the following provisions of this section may be incorrect. The limitations and constraints experienced by the team only reinforce our conclusion that significant work remains for Azerbaijan to have a consistent, clear and complete legislative framework that its understood by its citizens and, based on that understanding, for its citizens to act to further the implementation and enforcement of such laws.

B. Reforms to Date and Donor Assistance

The team's overall opinion regarding the adequacy of commercial law implementation in Azerbaijan generally accord with the summary conclusions on Azerbaijan of the Legal Transition Survey conducted in 1999 by the Office of the General Counsel of the European Bank for Reconstruction and Development. The survey covered pledge, bankruptcy and company law, and provided ratings based on a scale of 1 to 4+. Despite a relatively high rating of 3+ for extensiveness of laws, Azerbaijan received a 2 for "effectiveness". To quote the EBRD's explanation of a 2, "Commercial legal rules are generally unclear and sometimes contradictory. Few, if any, meaningful procedures are in place to make commercial laws operational and enforceable." See Transition report 1999, European Bank for Reconstruction and Development, p. 45.

1. Background on Commercial Law Environment in Azerbaijan

An analysis of commercial law in Azerbaijan reveals certain key aspects of the legal reform and law making process that uniformly and significantly impede the implementation of commercial law. Because they are pervasive in their effect and apply to each area of commercial law described below, a summary of these matters should be made at the outset in order to provide appropriate background for the assessment of the

¹⁵ Without limitation, an unofficial English translation of the Civil Code did not yet exist at the time of the team's assessment. The team was only able to obtain a partial, unofficial translation of the Civil Code in Russian.

specific commercial law areas that follows. This section also provides a summary of the economic courts in Azerbaijan, as the economic courts are a fairly new institution and will play a significant role in the implementation of commercial laws. Further detail on the court structure of Azerbaijan is contained in Annex I.

a. Structure of Legal Framework

Azerbaijan's codes and laws have been adopted at various points in time and have not been harmonized with the enactment of successive legislation. Provisions of the codes and laws are inconsistent, creating ambiguities, gaps and outright conflicts. The President has issued various decrees intended to address specific problems, however, the regulations or other actions required to implement these decrees are frequently not adopted. By the time it emerges from the Cabinet of Ministers, legislation often contains provisions that deliberately add ambiguity or create opportunities for executive branch personnel to issue further rulings or exercise discretion (thus creating both uncertainty and opportunities for rent seeking).

The recent passage of the Civil Code provides a good example of the harmonization needs that Azerbaijan laws will require. As noted in more detail below, the Code contains provisions on a wide variety of civil and commercial legal areas - almost every one of which is presently governed by separate normative acts. Although substantial effort went into the preparation of the Civil Code, with assistance from GTZ, the existing laws will have to be harmonized with the Code - including on matters relating to company law and pledge law. Additional laws may also need to be harmonized. For example, the establishment of a consistent scheme of rights of various classes of creditors - including the claims of secured creditors and government claims for unpaid taxes - can implicate provisions of the Civil Code, pledge law, mortgage law applicable to real property, bankruptcy law, company law, tax code and tax regulations. Mortgage law and pledge law must be carefully coordinated, particularly with respect to goods that are affixed to land or buildings. Similarly, the treatment of types of leases requires coordination among the Civil Code, leasing law, tax code and tax regulations.¹⁶

b. Absence of Effective Public Administration within Ministries.

The line ministries represented in the Cabinet of Ministers do not operate in a coordinated manner, often as a result of their personal interests, and often lack the information flow required from the President's Office to perform their role. The overlapping functions between the President's Office and the Cabinet of Ministers - with the strong role played by the President's Office - also make it difficult for ministries to implement policy when they choose to, or are required to, do so. Among other areas, the absence of coordination and the difficulty with policy implementation have particularly strong implications for licensing and tax. The World Bank has extensively discussed the reorganization of the functions of the Cabinet of Ministers and the President's Office in connection with its public administration reform project. However, even the adoption and implementation of such reforms would not address the competing interests and the absence of coordination among ministries. In addition, such reforms would not address the practices of

¹⁶ Reportedly, the new Civil Code and the tax code do not yet adequately reflect the differences between true leases and financing leases.

ministries in charging high fees, and changing fee structures, to enable them to increase gross collections, as in the case of the notarization fees for contracts (including loan agreements) set by the Ministry of Justice.

c. Economic Courts.

As set forth in the law On Courts and Judges, the new Civil Procedure Code and certain decrees, Azerbaijan has reorganized its court system. Cases between two legal persons and bankruptcy cases are heard in the economic courts; cases between a natural person and a legal person are heard in the courts of general jurisdiction (including cases between a shareholder and a company); and tax cases are heard in the courts of general jurisdiction either as administrative cases or criminal proceedings. The new Civil Procedure Code will apply to the operation of the economic courts, however, it has been suggested that the economic courts will require further laws and rules for their operation. The new Economic Court dealing with Arguments of International Agreements will have jurisdiction over commercial matters involving a foreign entity or foreign natural person; the jurisdiction of this new court is set forth in Section 27 of the Civil Procedure Code.

Anecdotal evidence is that enterprises avoid the court system, preferring settling matters out of court to bribing judges and other court officials and risking incorrect decisions. The inability to expect a court decision in accordance with law is increased by inconsistent legal provisions, bribery in the court system and judges who do not understand the laws and legal principles they are responsible for applying.

2. Obligations Law

Until the September 2000 effectiveness of the new Civil Code, the Civil Code from the Soviet era is in force. This earlier code – which contains provisions on basic forms of contract, including sales, lease and service – is inadequate and not compliant with a market economy. The code is based on the Soviet theory of ownership rights, with primary importance given to the state ownership over means of production. Accordingly, the code does not provide for the essential rights and freedom of parties. Thus, contracting parties usually draft agreements within the scope of the existing code. Although some relevant post-Soviet laws have been adopted, such as the laws on leasing and leasing activities, the existing legal framework does not constitute a solid basis to the development of a market economy.

The new Civil Code contains general principles of contract law as well as provisions governing specific forms of obligations. The Code recognizes freedom of contract, is based on a higher standard of democracy by giving private parties equal rights with the State and introduces new forms of contracts. The new Civil Code enables parties to conclude any deals that do not contradict the provisions of law or violate other people's rights and interests. No discrimination based either on political power or market advantage is tolerated.

Despite the important fundamental changes made by the new Civil Code, it will not serve its purpose unless additional measures are taken. All prior laws must be harmonized with

the Civil Code to resolve inconsistencies. Also, new implementing laws and regulations will be necessary for certain provisions of the Civil Code to be operative. When asked questions, Azerbaijani lawyers were unable to apply the Civil Code to certain situations - some of the uncertainty surrounding which may be resolved by the preparation of implementing regulations. For example, Azerbaijani lawyers could not provide consistent information regarding the process of perfecting pledges of movable property including the notarization and filing process for perfection on different types of collateral.

It seems that Azerbaijani society is not prepared for the new concepts embedded in the new Civil Code. In large part, this appears to be associated with the lack of transparency in the drafting of the new Civil Code, in which GTZ worked with a small number of expert drafters and during which the Government of Azerbaijan reportedly would not agree to publish drafts of the Civil Code for a public review and discussion. This is consistent with the general closed nature and secrecy of the legislative process in Azerbaijan, in which the majority of lawyers are deprived of the opportunity to review drafts of laws and express their thoughts and concerns regarding the provisions of future laws. Similarly, hearings held on new laws in the Milli Mejlis are usually kept secret from the public. Judges as well as lawyers can be expected to lack the ability to work with the new Civil Code, since – as noted in the previous chapter – the judicial qualification examination was based on the old Civil Code and other old legislation. The challenges to lawyers and judges in dealing with this substantial new body of law will be compounded by the poor quality of the Azeri version of the Civil Code – an apparent result of the drafting process in which drafts were produced in German and Russian and then into Azeri – and the absence of commentaries that explain the new words, concepts and provisions of the Civil Code.

3. Company Law

Enterprises in Azerbaijan may exist as individual (family) enterprises, full partnerships, limited partnerships, limited liability companies, and joint stock companies (both open and closed). The primary laws that govern these entities are: the new Civil Code, the law About Enterprises (1994), the law About Joint Stock Company (1994), and the law on State Registration of Legal Entities (1996).¹⁷ The law About Enterprises sets forth provisions that apply to each of the forms of enterprises listed above.¹⁸

The new Civil Code reportedly contains detailed provisions on enterprises (including regarding enterprise registrations), and the Code and various laws will accordingly need to be harmonized. In general, the laws governing companies appear reasonably comprehensive and consistent with international standards. For example, by-laws are reportedly enforceable at law and shareholders have the legal right to sue to enforce voting and other rights. The responsibilities of directors and officers (for example, to

¹⁷ Azerbaijan also has enacted the law About Securities (1998) and the law About Securities and Stock Exchange (1992; amended in 1995). These will be particularly relevant to the formation of an exchange for the trading of securities in Azerbaijan.

¹⁸ The law “About Cooperation” (1996) governs cooperatives.

avoid conflicts of interest, fiduciary standard of care by directors) is apparently not as high as in some western European countries. However, (1) in those circumstances where statutory law does not establish a specific standard of care to regulate the responsibilities of directors, the charter of the enterprise or employment contract for the director may stipulate specific standards of care to which the director is bound and (2) a director or officer that disposes of enterprise assets on terms that are not sufficiently at fair market value may be prosecuted for an economic crime and sued by shareholders for compensation to the company.¹⁹ Due to the absence of internationally accepted accounting standards, domestic companies keep their books in accordance with statutory (tax accounting) standards. The law setting forth the statutory standards is mandatory for all enterprises and reportedly full of ambiguities.

The primary issues regarding the implementation of company/enterprise laws revolve around delays and confusion in registering companies and procuring licenses. Enterprise registrations must be made with the Ministry of Justice. Anecdotes abound of delays in securing registrations. Under the law, the Ministry of Justice reportedly must register an enterprise within fifteen days of submission of a filing and notify of deficient documents within five days of their submission. The delays are especially lengthy for agency and representative offices of foreign entities and entities which include the word “law” or “legal” in their names.²⁰ Once it registers, an enterprise must obtain numerous tax licenses and other licenses to operate its business.

The circumstances under which farmers must register are reportedly not clear. Farmers must register when they become a “farm business”, but there is reportedly no standard regarding what constitutes a “farm business”. Even if not required to register, a farmer must obtain a license from a trade department to sell his produce and, if he or she employs persons on the farm, apply with the tax office for a tax number.²¹ Depending on the rules applicable to the local marketplace, he may need to obtain from the manager of the marketplace an additional license to sell his goods there. An examination of the entire operational licensing, tax licensing and registration process for farm and non-farm enterprises is beyond the scope of this assessment. However, the process is lengthy, unpredictable in practice and creates opportunities for government officials to extort payments in exchange for issuing the registrations and licenses. The reported absence of published licensing requirements and standards by Ministries only increases the difficulty of the process.

¹⁹ Article 36 of the law On Limited Liability Enterprises reportedly specifically addresses the conflict of interest between shareholders and a director. The law On Joint Stock Companies does not contain specific obligations of a director to act in the best interest of a company, but does provide that the rights, responsibilities and liabilities of a director are governed by the director’s employment agreement. Due to the unavailability of an English translation of the new Civil Code, or a complete Russian translation of the new Civil Code, the extent to which the Civil Code will modify the responsibility of directors or officers under current law is not addressed in this report.

²⁰ Delays associated with the registration of NGO’s are set forth in Chapter II under the heading “Civil Society and the Media.”

²¹ The assessment team received conflicting information regarding the need of a farmer to obtain a license to sell at market produce raised on his farm. This may reflect varieties in local practice, absence of knowledge about licensing laws driven by the paucity of published legal standards, or the requirement of various licenses from different bodies.

GTZ's local legal consultant stated that GTZ plans to harmonize with the new Civil Code the other laws of Azerbaijan. However, harmonization of the entire commercial legal framework with the Civil Code probably exceeds the narrower program and strategic goals (and associated resources) of a single international donor. GTZ also plans to provide training to judges and lawyers in the provisions of the Civil Code and to assist in the preparation (but not to underwrite the publication or dissemination) of commentaries regarding the Civil Code.

4. Pledge Law.

Obtaining a security interest is one of the most basic and reliable ways for lenders to protect their financial position. With strong legal rights, secured creditors are able to recover their money efficiently when debtors become unable to repay credit. Consequently (and assuming the existence of a solvent banking sector interested in providing loans to small and medium enterprises), enterprises should benefit from secured credit in the form of wider credit availability, lower credit terms (both interest rate and fees) and longer maturities.

Azerbaijan reportedly has had two post-Soviet laws governing the granting of pledges of non-real property. The first law was accompanied by implementing provisions. The second law reportedly superceded the first law but contained no implementing provisions; and legal practitioners referred back to the implementing provisions of the first law. The new Civil Code contains provisions applicable to pledge law, including requirements of registering the pledge. The assessment team was not able to determine the extent to which the Civil Code includes provisions of the previous pledge law or previous implementing provisions. However, there is a consensus that harmonization of the Civil Code and the current pledge law will be necessary. Implementing laws and procedures will also be necessary for the establishment of the registry referred to below. These laws may need to address such fundamental and paramount questions as whether, in the case of conflicting pledges which have been filed in the registry, the secured creditor who was the "first to file" has priority. This question was met with conflicting answers, and even some confusion, by various Azerbaijani attorneys with whom the team met. The Chairman of the High Economic Court stated that he believed pledge law (including Civil Code provisions) would be the substantive area where judges would require the most assistance to understand Azerbaijan's new laws.

The major institutional deficiency involving pledge law is the absence of a registry for filing notices of pledge. A draft law regarding the registry reportedly is being prepared and will be considered by the Milli Mejlis this summer. In the absence of a pledge registry, pledges are being filed in various locations (including local notary offices), the efficacy of such pledges is uncertain and law firms struggle to provide legal comfort to their clients that their property interests are protected. Due to the absence of an effective pledge registry (as well as credit and market concerns regarding the adequacy of movable collateral), secured lenders are apparently relying primarily on land and, in the case of

pledges on movable property, gold and jewelry with respect to which the secured creditor protects his rights by taking possession.

The most significant problems faced by secured creditors is re-possessing real property and disposing of collateral. When seeking court decisions to proceed against collateral, incorrect legal decisions are rendered as a result of judicial ignorance of legal changes and conflicting legal provisions. Debtors pay judges to render decisions in their favor. Delays in the process of proceeding against property are lengthy and delays are common. The enforcement service charged with selling the property often engages in deals with potential buyers of property being foreclosed upon - selling the property for sweetheart prices far below the value of the collateral provided.

As part of its anticipated assistance in financial sector reform (discussed in more detail under the heading “Financial Sector/Banking Reform” below), the World Bank presently anticipates that it will provide a small amount of assistance to support the improvement of the bankruptcy and pledge law. World Bank staff has indicated that this project may also include some assistance relating to the establishment of the pledge registry. The entity that will administer the registry – including whether the registry would be privately or publicly run – is uncertain at this time. The EBRD (through its Office of General Counsel) may also be willing to assist with the establishment of the pledge registry if requested by the Government of Azerbaijan. GTZ’s planned assistance with respect to the Civil Code may support implementation of the pledge law provisions. This includes GTZ’s planned assistance to provide training to lawyers and judges in Civil Code and support the preparation of commentaries on the Civil Code. ABA/CEELI has sponsored several seminars on the Civil Code; a list of the seminars held to date is attached as Annex IV.

5. Bankruptcy Law

Based on the survey conducted by the EBRD’s Office of the General Counsel in July 1999 concerning the effectiveness and comprehensiveness of commercial laws in the EBRD’s countries of operation, Azerbaijan’s insolvency law was rated “inadequate”. As stated in a summary of the insolvency survey in EBRD’s Spring 2000 Law in transition, “Azerbaijan received a high rating for the extensiveness of its legislation. However, respondents noted that the implementation of the law was highly ineffective. Azerbaijan had by far the widest gap between its ratings for extensiveness and effectiveness, which points to an inefficient use and enforcement of its insolvency laws.” See “EBRD legal indicator survey: assessing insolvency laws after ten years of transition”, Law in transition, Spring 2000, p. 40.

On June 13, 1997, the Milli Mejlis approved the law On Insolvency and Bankruptcy, which gives a legal definition of “insolvency” and contains both general and procedural provisions. This law applies both to legal entities and individuals. However, there are some restrictions - namely, it does not apply to enterprises that are not aimed at gaining

profits or to organizations financed from the state budget. Reportedly, the World Bank and EBRD provided assistance in drafting the law.

The law describes the bankruptcy process, commencing with applications for bankruptcy and ending with sale of assets. All the claims and other actions against the property of the debtor are stayed until the final ruling.

According to the new Civil Procedure Code, bankruptcy cases will be filed in the Economic Courts. The court or the creditors appoint an administrator. The court may also appoint a provisional administrator, who insures that assets of the debtor are not illegally alienated before the actual announcement of bankruptcy, and carries out preliminary financial analysis of debtor's status.

A secured creditor has the right to fulfillment of his secured claims irrespective of whether proceedings on bankruptcy have been initiated. A secured creditor can demand sale of the collateral which secures his or her claim, as well as assignment of the ownership right to him/her. The law stipulates the ranking of claims of creditors (e.g., secured creditors, unsecured creditors, shareholders, state budget) according to which proceeds must be distributed.

If the court does not issue different instructions in a specific case, sales of assets are done by public auction. According to Azerbaijani lawyers, the rules of auction set forth in the law are not specific enough; this constitutes one of the obstacles to the use of the bankruptcy law and development of bankruptcy practice. In certain cases the law on bankruptcy permits the sale of assets by other means.

The law does not bar the debtor from amicable settlement with creditors even though the case is filed. However, such settlement is subject to approval by the court. The law on insolvency also recognizes an alternative measure to bankruptcy – sanation, defined as a method of reorganization of an enterprise-debtor.

There are several significant areas of concern regarding the bankruptcy practice in Azerbaijan and the law On Insolvency and Bankruptcy. Perhaps most significantly, unawareness and often ignorance of lawyers and public of the procedure and regulations on bankruptcy, along with sophistication and vagueness of language, leave a broad avenue for misunderstanding, that will negatively affect the development of bankruptcy practices. As one Azerbaijani lawyer stated, an entrepreneur would prefer to be accused in crime, rather than declare bankruptcy.

It is extremely difficult to obtain reliable information regarding the use of bankruptcy law. The team repeatedly asked whether any cases had been commenced under the law but could not obtain definitive information. Reportedly, debtors that are clearly insolvent are reluctant to declare bankruptcy. In addition, entities often initiate such proceedings without involvement of courts and ignore procedures stipulated by law.

There are no implementing regulations for bankruptcy proceedings to enable the bankruptcy law to be utilized in practice. In many cases the law is incomplete or unclear, and the regulations are necessary to clarify these gaps. For example, the existing law does not adequately regulate time limits for procedural activities, there are no sanctions for debtor non-compliance with procedures that are specified, and standards for the valuing assets are ambiguous.

6. Other Legal and Regulatory Areas

a. Financial Sector/Banking Reform

Domestically owned private banks play a limited role in financing small and medium enterprises in Azerbaijan. Private banks are severely under-capitalized, often provide loans largely to the organizations that founded them and, as a result of essentially lending from equity, charge high interest rates that reported range from 42% to 50% per annum.

Credit for small and medium enterprises is provided largely through international assistance programs, including direct loans and on-lending. Active participants in providing SME credit include Shorebank (working with both USAID and IMF funds), UNDP and LFS Financial Services. FINCA also provides unsecured loans to microenterprises in principal amounts with typical ranges of \$100 - \$137.

The World Bank anticipates providing approximately US \$8 million - \$10 million in technical assistance through an IDA credit to support financial sector/banking reform in Azerbaijan. The Bank is presently considering components of the assistance and hopes to have Board approval of the project by December 31, 2000. The financial sector technical assistance would help the Government of Azerbaijan satisfy some of the IMF's conditions for IMF assistance. According to World Bank technical staff, potential components of the Bank's financial sector reform project are assistance: (a) in restructuring the merged operations of Agroprombank, Promstroibank and Sberbank and providing a team that would help manage the restructured bank; (b) to strengthen the National Bank of Azerbaijan's off-site and on-site banking supervision; (c) to support the establishment of a uniform chart of accounts for banks prepared in accordance with International Accounting Standards; (d) to improve the implementation of real time gross settlement systems; and (e) in improving bankruptcy and collateral law, including assistance in establishing the pledge registry for movable property. World Bank staff in Washington has emphasized to the assessment team that the technical assistance with respect to bankruptcy and collateral law matters will be small.

b. Tax

Azerbaijan's current tax law is a patchwork of various laws and frequently unpublished regulations. Various tax licenses are required for an enterprise to commence business; once it commences business the burdensome task of tax compliance begins. Many businesses have reportedly shut down because they cannot comply with the filing requirements. Determinations by the tax inspectorate are inconsistent and reportedly lack any basis in the law for claims of payment. Random inspections by the tax inspectorate are common. Businesses are reportedly often prepared with envelopes for inspectors

prior to their arrival with the hope of minimizing the charges to be assessed. Numerous small enterprises have shut down with the explanatory statement, “I gave it up to the tax police.” One person described the tax system in Azerbaijan with respect to small and medium businesses as, “Every incentive is a negative incentive.” Illegal payments to inspectors are distributed throughout the chain, including downward to keep subordinates silent, and to outside patrons. The President’s office issued in 1999 a decree to curtail random tax inspections.²² The tax inspectorate has stated it will stop doing random inspections, however this statement has been greeted with skepticism.

The current tax code reportedly also contains provisions that are adverse to small and medium enterprises and that deter enterprises from accurately reporting their revenues and expenses. For example, the tax code allows an enterprise to deduct salaries only to the extent that they do not exceed three times the minimum salary required by law. This both acts as a double charge on the enterprises (who pay the higher salaries but cannot fully deduct them in computing their taxable revenues) and acts as a disincentive for enterprises to report fully their revenues and expenses.

Azerbaijan is working on reforming the tax code, with assistance provided by an IMF advisor. The new draft tax code reportedly reduces the number of taxes and generally lowers tax rates. The draft code allows tax collectors to increase their salaries based on their collections, with tax collectors who collect in excess of a specified amount reportedly being entitled to an amount equal to 10% of the additional collections. Courts, rather than tax inspectors, will make determinations regarding the imposition of fines. The international business community has, by weight of its influence, been able to review drafts of the tax code and provide comments. These comments include matters of interest specifically to the foreign investor community, including proposed changes intended to incorporate the terms of PSA’s. The tax code may be submitted to the Milli Mejlis this summer.

The IMF is preparing to place a resident expert on tax administration in Azerbaijan for one year. However, the new tax code apparently does not address the fundamental organizational structure of the tax inspectorate.

²² The apparent text of the decree – Presidential Decree on Updating the System of State Control and Removal of Artificial Impediments in Entrepreneurship Development (January 7, 1999) – contains a variety of Presidential instructions relating to the removal of registration and licensing delays and limiting the activities of state bodies with respect to enterprises. Paragraphs 1 and 11, respectively, essentially require reforms “[to] order all central and local administrative bodies, including law enforcement bodies, to put an immediate end to ungrounded intervention in the field of entrepreneurship and business and secure favorable conditions for development in these fields” and “[to] instruct the main State Tax Inspectorate not to carry out any amendments not related to its authority as determined by law”. The introduction to the decree states that President Aliyev promulgated the decree in recognition of the fact that many of the provisions of the earlier “Presidential Decree on Updating the State Control over Industrial, Financial-Credit Activities, Service and Prohibition of Ungrounded Revision” (June 17, 1996) had not been implemented. The need for a new decree to accomplish the goals of the previous decree in removing impediments to small and medium enterprises, and the apparent absent of any significant positive changes since in the almost eighteen months since January 1999, are evidence of the absence of broad political will to undertake reforms to eliminate rent-seeking opportunities of executive branch personnel.

c. Customs

The assessment team did not examine the customs law framework. Customs is administered by the State Customs Commission. However, the customs administration was uniformly cited by both small businesses and larger businesses as corrupt and one of the most significant constraints to enterprise growth. Small agricultural businesses complained that customs officials allow imported produce into Azerbaijan through Iran at less than the full duties, making imported produce cheaper than locally grown produce. Documents issued by customs officials mark down the actual value of imported goods to mask illegal payments made to customs officials. The amount of illegal payments to customs officials are commonly known and are non-negotiable. Interest groups use predatory tactics to strengthen their interests, including by bringing in goods cheaply and excluding competing goods such as beer and tobacco. Construction materials and steel are among non-agricultural goods that are entering Azerbaijan without full customs duties being assessed.

The American Chamber of Commerce has pursued cases of concern to its membership. However, AmCham's efforts to date should not be viewed as creating changes in practices or precedents that will be of a more general benefit. By AmCham's own admission, it generally approaches senior customs management – sometimes with the assistance of the U.S. Embassy – on well documented, specific cases involving its members and the results are not likely to have a broader ramification. Indeed, several voices suggested that AmCham's membership, and particularly those involved in the oil industry, did not want to jeopardize their business relationships by pressing for reforms of benefit outside the oil sector in customs or other areas.

d. Licensing

As discussed above under “Company Law”, once an enterprise actually registers, it must obtain numerous licenses and certificates. Ministries require licenses but in many, if not most, cases do not publish the requirements for obtaining the licenses. One source has estimated that over 50 different licenses are required in Azerbaijan. The Azerbaijani newspaper Zerkalo ran in May 2000 a story titled “Circles of Hell” which recounted the steps – both official and required in practice – an Azerbaijani entrepreneur would have to go through to register and start running his business. That article detailed over 26 “instances” of registration, licenses, permits and similar transactions the entrepreneur would need to accomplish to run a small trade business, including “pay[ing] his respects” to the police department and registering his cash register with the Fiscal Department's District Office.

C. Key Constraints

One of the most critical constraints to commercial law reform in Azerbaijan is the absence of knowledge by legal professionals and the business community of the provisions of the laws - an absence of knowledge that is intertwined with the non-transparent manner in which laws and regulations are promulgated. A private sector cannot demand reforms, accountability of government officials, and implementation of laws - and cannot protect its rights – if it does not have information regarding current

reforms and its rights. Similarly, an understanding of the policy, concepts and detailed provisions of law is critical for government officials, judges, lawyers, and others involved in the implementation and enforcement of the law to apply the law correctly, create predictability in the legal system and check the other branches of government. The veiled secrecy of the legislative process, combined with the absence of a dialog between the public and private sector regarding laws, precludes the formulation of a policy regarding the purposes of specific commercial laws that can act as a common baseline for the public sector, businesses and legal professionals.

Clearly the provision of information will not immediately or by itself solve the concerns addressed in this assessment. The constraints to reform in Azerbaijan are numerous. For example, additional reasons account for the failure of the private sector to push for the transparent and efficient implementation of reforms, including its own complicity in corruption, the nascent state of civil society development in Azerbaijan, a desire for political stability, and a society based on a complicated set of social and patronage relations. However, a society which lacks knowledge of the law and its rights lacks a fundamental tool to demand that those in power implement the law.

Another significant constraint to the commercial law reform in Azerbaijan is the apparent absence of political will by the Government of Azerbaijan and other key stakeholders to take strong and decisive action to begin to break the chain of corruption within the public sector. Although some suggest that there is evidence of certain improvement and positive change during the past year, the Government has not yet taken a decisive step indicating it will not tolerate corruption. The implementation of commercial law will be diminished – if not severely threatened – to the extent that the private sector and the public sector uniformly engage in practices that evade the written law.

D. Priority needs

There are numerous needs with respect to commercial law environment in Azerbaijan, more than USAID can be expected to fill. The small businesses with whom the team met emphasized that credit was their most pressing need. The EBRD's Business Environment and Enterprise Performance Survey has concluded that more critical barriers for start-ups in the Europe and Eurasia region are: issuance and renewal of licenses, tax regulations, corruption, anti-competitive practices, and inflation. However, as the EBRD notes in its 1999 Transition report, "access to finance is likely to become more important as the private sector becomes further established". See Transition report 1999, European Bank for Reconstruction and Development, pp. 151-153, 158.

The priority needs for commercial law reform in Azerbaijan – and particularly the reduction of commercial law impediments to small and medium enterprises – in Azerbaijan include the following.

1. Private sector awareness of reforms – for protection from corruption, ability to utilize new provisions, and to facilitate demands for implementation of reforms (i.e., application of law in accordance with letter of the law).

2. Understanding of judges, lawyers and others charged with the implementation and administration of the law of the philosophy, concepts, and provisions of the commercial law framework.
3. Change in public sector attitudes toward corruption, including an understanding of what it is and methods of combatting it.
4. Simplified and transparent processes for business licenses, tax registrations and business registrations.
5. Harmonization of the legal framework, including in particular conflicts that relate to the provision and securing of credit. This includes consistent treatment of rights and priorities of secured creditors and the provisions applicable to a pledge registry.
6. Reform of the tax system, including in particular elimination of the rapacious demands by the tax inspectorate on the revenues of enterprises.
7. Reform of customs system.
8. Defined policy for bankruptcy reform and private sector's understanding of purposes (including positive benefits) of bankruptcy reform and bankruptcy proceedings.
9. Private sector participation in policy dialog and legal reform process such that laws reflect needs of private sector and private sector understands reforms.
10. Application of laws as written by courts.
11. Enforcement of court decisions as entered, including transparency in the disposition of collateral.
12. Adoption of implementing regulations for the bankruptcy code and implementation of the same.
13. Establishment of pledge registry, including development of implementing regulations for pledge law, implementing regulations and rules for operation of registry, and institutional strengthening for the body that administers the registry.

E. Recommendations for USAID

1. Current environment

As set forth below, there are several areas where USAID/Caucasus/Azerbaijan can and should consider expanding its activities at the present time. These areas are:

- a. Assist in providing information to enterprises (farmers and other businesses) regarding reforms, including the specific rights, benefits and obligations that the reforms provide to such persons. This can be done by distributing information that summarizes:
 - (I) rights of enterprises (and farmers) vis-à-vis the public sector, including limitations on the rights of the tax inspectorate to conduct random inspections; and
 - (II) concrete accounts regarding how reforms are of practical benefit to enterprises.
- b. Assist in providing to lawyers and judges information, knowledge and skills regarding the Civil Code and reforms regarding commercial laws. This can be done by encouraging ABA/CEELI to sponsor continuing legal education programs to supplement those provided by GTZ and others.

- c. Assist in the dissemination of texts of laws, commentaries and textbooks. Lawyers and judges require access to legal standards to be able to perform their roles
- d. Be alert to opportunities to assist interested private lawyers and businesses in the legal reform process. At a minimum, foreign assistance providers should be encouraged to include the private sector at various stages of the legislative reform process, to solicit the input of lawyers and businesses, and to require specific increased legislative transparency by the Government of Azerbaijan as a condition of assistance. Assistance may also include well-structured exchanges, including trips by Azerbaijani lawyers to Georgia to participate in the upcoming workshops regarding bankruptcy procedure and other fora in which Georgian lawyers can share their experiences regarding bankruptcy reforms and practice with Azerbaijanis.
- e. If the Government of Azerbaijan is willing to support administrative procedural reform, provide assistance in the establishment of an administrative procedural code. An administrative procedural code can assist in creating additional transparency in executive branch operations and reducing unbridled executive branch discretion. Illustrative provisions of an administrative procedural code include those: requiring the issuance of written decisions of executive branch employees in matters involving individual enterprises and natural persons; setting forth rights of appeal within executive branch bodies from such decisions; providing a right of appeal to the courts for executive branch decisions contrary to the standards of the administrative procedural code; requiring the publication of proposed and actual regulations; and establishing a process for enterprises and persons to request information from executive branch bodies (freedom of information act provisions). However, given the current reluctance of the Government of Azerbaijan to reorganize and increase the transparency of the President's Office and the Cabinet of Ministers, USAID must be particularly circumspect in analyzing the true willingness of the Government of Azerbaijan to implement an administrative procedural code.²³

2. Looking forward

In addition to the items set forth above, there are additional areas where reforms are necessary to reduce impediments to enterprises. The items listed below involve assistance to the Government of Azerbaijan that the team understands do not fall within the democracy and governance exceptions to Section 907 of the FREEDOM Support Act. These areas of reform are included below due to the significant constraints that current practices in these areas pose to small and medium enterprise formation and growth. In the absence of any change in the statutory exceptions to Section 907 and their interpretation, USAID/Caucasus/Azerbaijan should identify and support opportunities for other donors to provide assistance in these areas and explicitly consider the impact of

²³ The assessment team did not conduct a detailed analysis of tax accounting and auditing standards, but understands there may be an Azerbaijani professional association of accountants and auditors. Subject to further USAID diligence regarding the bona fides of such an organization, the primary interests, sophistication and capabilities of that organization, and the willingness of the Government of Azerbaijan to consider and promulgate changes in accounting and auditing standards (including the role of the State Chamber of Auditors), USAID may wish to provide modest assistance to such an organization. Such assistance however, should supplement – and not reduce – assistance supporting the capabilities of small and medium enterprises to articulate their own needs and advocate for reforms.

these constraints in analyzing the anticipated effects of USAID and other donor assistance to support small and medium enterprise growth in Azerbaijan.

- a. Assist in simplifying business registration, business licensing and tax registration procedures for enterprises.
- b. If the Government of Azerbaijan is willing to support such reforms, provide assistance in the restructuring of the tax administration and in institution building of the tax inspectorate, including assistance in developing internal rules, practices and procedures applicable to the inspectorate. Such work would include assistance in the development of tax code regulations to the extent that the IMF assistance does not include this. All tax reform assistance will need to be coordinated with the assistance in administration to be provided by the new resident IMF tax advisor.
- c. If the Government of Azerbaijan is willing to support such reforms and key stakeholders in the work of the State Customs Service are supportive of such reforms, provide assistance in reforming the customs administration with an emphasis on the development and implementation of internal organization, practices and procedures that will create checks and balances on practices at border points.
- d. To the extent that World Bank and any EBRD assistance in the establishment of the pledge registry contains significant gaps, provide assistance with the establishment of the registry, including the development of implementing regulations specifying substantive pledge law provisions, the formulation of internal practices for registry personnel, and institution building assistance to enable registry personnel to perform their roles efficiently and in accordance with law.
- e. Assist in preparing bankruptcy code implementing provisions, harmonization of bankruptcy codes and laws, and related institution building assistance.²⁴
- f. Any necessary work to harmonize the rights and priorities of secured creditors and other claimants on the real and personal assets of enterprises, including harmonization of the Civil Code, mortgage law, pledge law, bankruptcy code, bankruptcy regulations, tax code and tax regulations.

²⁴ The exact components of bankruptcy and harmonization assistance described in subparagraphs (e) and (f) will need to be structured to complement any assistance provided by the World Bank regarding collateral law and bankruptcy law as well as any other assistance in these areas that may be provided by other donors.

IV. ANTI-CORRUPTION

A. Introduction

Corruption is endemic in Azerbaijan and this fact is acknowledged by all elements of society. Additionally, the individuals that we talked with were aware of corruption's contribution to the country's economic and social problems. Furthermore, Azerbaijanis are aware that corruption is recognized as an international issue and are familiar with the literature and the strategies recommended by international organizations and conventions.

Most importantly, the team learned that corruption is so firmly entrenched that new laws do not force systemic changes in the conduct of government business. The situation was described as, "personalities override legal requirements" and "the President has done many things to update our external image but internally, nothing has changed." An example of this "external image" is the speech given by the Azerbaijan Delegation to the 1998 Global Conference against Corruption in Washington. The Delegation discussed the importance of the independence of judges and cited the enactment of new laws as examples of anti-corruption initiatives in Azerbaijan.

In fact, new laws only become new opportunities for government officials' increasing the costs of bribes for government services. The team was told that "every innovation means that the bribe will be higher." While the government can demonstrate that new, western requirements are in place, systemic changes are not carried out and the status quo remains the same and in some cases better because of pressure from the west.

The team identified no ongoing incentives or initiatives -- top down or bottom up --- which are effectively exposing and/or halting: (1) embezzlement, theft and fraud in procurement of public assets; (2) sale of government positions; and (3) the routine giving and taking of bribes for all government services. The root causes of these behaviors are high societal values on patronage, nepotism and personal loyalty and the failure to implement new transparent laws that replace the Soviet system. Nor did the team believe that the efforts it did observe will alone significantly change the status quo.

1. Overview of Specific Practices

The team's interviews confirmed that corruption exists at the lowest and highest levels of government service, including education and health care. The team was told that a former Justice Minister asked a western organization, "How much will you pay me to work with you?" Most individuals choose professions and jobs in this country not for the work, but for the financial opportunities available from bribes and extortion. This is at a high social cost, as this country needs trained doctors, lawyers, engineers, and government professionals for future development.

Government Service. Traditionally, citizens pay bribes to receive an additional benefit such as expedited services in a time period shorter than that prescribed by law or to

circumvent government requirements. However, in Azerbaijan it appears that citizens must pay a bribe simply to receive governmental services. At the same time, citizens are aware that corruption contributes to poor or no government services, underpaid government employees, and excessively high taxes. The team was told, “If you have no money, you are marginalized.”

One lending organization told the team that the police came to its meetings with loan applicants. The police advised the lenders that they would help to “collect loans” and market operators have offered to “bring” loan applicants to the lenders. In both cases, the lenders are certain that bribes would be involved. The lenders told us that only one of 100 of their borrowers are registered. The aggregate cost of registration – including bribes - far exceeds the average loan. Once registered, taxes become another expensive issue because of corruption.

Health care. The average cost in a hospital for the birth of a child is \$400-\$600 depending on the Hospital. Rather than pay, many women have children at home or go to the countryside for midwife services. However, only children born in hospitals are eligible for birth certificates. So, the cycle continues, as parents must pay a bribe for birth certificates.

Today hospitals have 2/3 fewer beds than in Soviet times, because the Minister of Health has adopted western standards mandating fewer beds per room. Although government policy is to provide health care for citizens, the reality today is that patients must pay bribes for hospital beds and health care. As a result, the Minister of Health is in a position to receive more bribes because of western standards and the informal health care payment system.

Decentralization. The government passed new laws for municipalities that comply with Council of Europe standards. However, concern was expressed to the team that implementation will purposely be structured in a way that the municipal governments are guaranteed to fail.

2. Existing Data and Initiatives

a. What Exists Now to Work With?

- a. Local surveys and research which might be the basis for setting priorities and citizen action plans.
- b. At least two NGO’s – Entrepreneurship Development Foundation and ANKOR have access to international anti-corruption initiatives. Both NGOs told the team that they publish and distribute their materials.
- c. A June 2000 Presidential decree requires the Council of Ministers to prepare a draft law on anti-corruption for the President in 6 months. This could be an opportunity for local NGO’s and parties to recommend anti-corruption initiatives. However, one person interviewed commented that parliamentary elections, not anti-corruption, will be the main focus of public life for the next six months.

b. Discussion

A 1999 survey conducted by the Entrepreneurship Development Foundation, an Azerbaijani think tank funded by Center for International Private Enterprises (CIPE), reported that 86% of respondents found corruption comes in the form of direct bribes. It found extortion by most government officials at all levels. The survey found that corruption is often discussed in newspapers and that both the government and opposition political parties acknowledge it as a problem. The most corrupt agencies identified were Customs, the Traffic police, the Ministry of Interior, the Tax Service and the State Committee on Privatization. Corruption payments make up a significant portion of private business earnings. Most respondents thought that the overall corruption income is commensurate with the income of the state budget. Those responding to the survey indicated that judicial reform was important for change.

c. Recommendations for USAID Anti-Corruption Strategy

USAID anti-corruption strategy should focus on:

Coordinating with other international donors on monitoring and supporting anti-corruption activities.

Providing educational opportunities for younger generations.

Increasing the flow of information about basic rights and government services to civil society.

Incorporating anti-corruption education activities into all USAID existing programs.

Supporting viable NGOs and coalitions (if they emerge) working on the issue.

Support, to the extent possible, the World Trade Organization (WTO), World Customs Organization and/or the United Nations to reform the customs service. These organizations may have the leverage to motivate change inside the Government of Azerbaijan.

B. Reforms to Date and Donor Assistance

Many international organizations have evaluated corruption activity in Azerbaijan; all conclude that corruption is a serious impediment toward progress in this country. No international organizations have established anti-corruption programs in Azerbaijan.

1. International Rankings

Transparency International's (TI) Corruption Perception Index for 1999 rates Azerbaijan with Indonesia at 96 out of 99 countries surveyed. The United States Human Rights Report 2000 states "corruption pervades most government organizations. It is widely

believed that most persons in appointed government positions and state employment purchase these positions. The judiciary is corrupt, inefficient, and subject to executive influence.” The Economist Intelligence Unit 2000 Report finds that, “Azerbaijan is long notorious for corruption during soviet era and as an individual state.” The publication, Nations in Transit 1999 ranked Azerbaijan in “Category D” the highest level of corruption.

2. Key Legal Markers

A review of key legal markers generally recognized as necessary for fighting corruption reveals the following in Azerbaijan:

1. Such good news as exists is not effectively communicated, reinforcing cynicism and resignation. While World Bank and ABA/CEELI monitoring of the multiple choice portion of the judicial testing process probably insured fair initial testing, the results were not communicated well via the media, and a wide spread belief in their fairness was not achieved. Foreign grant making organizations such as Soros and Eurasia struggle against the perception that their procedures are not clean.
2. Government anti-corruption initiatives. The Executive has issued decrees touching on anti-corruption in the past. However, they have do not appear to be effective.
3. Civil Society anti-corruption initiatives. In the NGO sector, there is at least one Azerbaijani NGO, working exclusively on anti-corruption activities and one think tank, working on surveys. Both appear to be one person, foreign-donor operations rather than grass roots initiatives.
4. Adoption of international conventions. Azerbaijan has not adopted the Organization for Economic Cooperation and Development (OECD) Anti-Bribery Convention or the Council of Europe Bribery conventions.
5. Accounting standards. Azerbaijan has not instituted International Accounting Standards.
6. Anti-corruption statute. Azerbaijan does not have a specific anti-corruption statute, although a June 2000 Presidential Degree requires that a draft law be ready by December 2000. The criminal code punishes active and passive bribery in the governmental and private sector. Under accepted international standards, active bribery is considered the attempt, promise, giving or solicitation of a bribe; passive bribery is the acceptance of a bribe. See “Promotion and Maintenance of the Rule of Law and Good Governance Action Against Corruption”, Report of the United Nations Secretary General, E/CN.15/1997/3, 5 March 1997, p. 5.
7. Public Employee Definition. There is no law defining public employee. Among international organizations, there is consensus for the need of an efficient professional and neutral civil service. However, no draft laws or decrees are in place to begin the process of reorganizing the civil service to be more efficient and responsive to the public.

8. Public official financial disclosure law. Does not exist.

9. Code of Conduct for Public Employees. Does not exist.

10. Public Procurement Law. Azerbaijan does not have a comprehensive legal and institutional framework to govern state procurement. We understand that two main legal instruments govern state procurement, Presidential Decree 524(December 19, 1996) on state procurement and a Law on Tenders (enacted by the Milli Mejlis February 11, 1997.) However, the Government has not enforced them because of serious inconsistencies and contradictions, there are no enabling regulations and the institutions responsible for developing and enforcing the system have not been named.

11. Independent Judiciary. Article 127 of the Constitution sets forth the basic requirement of judicial independence, and various decrees and laws have been enacted governing the judicial qualification process. However, as discussed in more detail in chapter II, the team was told that most judges have purchased their positions and that most decisions require the payment of a bribes. Judicial positions are being assigned after a second step, an interview process, the public and the bar widely believe positions are being assigned on the basis of bribes.

12. Independent press. While the press in theory is independent it is harassed. The press is discussed in more detail in chapter II under the heading “Civil Society and the Media”.

13. Transparent budget process. Does not exist.

14. TI Index and Chapter. Azerbaijan is ranked as 96 on the TI Corruption Perception Index. A TI/Berlin staff member visited the country the week of June 12,2000. A group convened, although I was advised that the Azerbaijanis attending the two meetings represented mostly political interests. While it was agreed there would be a “Chapter in formation,” it appears that this effort is being pushed from TI/Berlin rather than in response from citizens here. Soros Foundation will hire and fund a staff person to assist with this process by August 2000. The TI Berlin staff person hopes that the international donor community serve as an advisory board will help with the selection of the staff person and to get the ‘right sort of folks’ on the TI Chapter Board here. USAID will need to determine if it wants to participate in this process.

15. The World Bank has conducted a number of assessments and has a resident representative in the country. The World Bank Washington has not completed its final report and recommendations regarding its anticipated public sector reform project. It does not currently have a specific formal anti-corruption plan for Azerbaijan. It should be noted that oil revenues available to the government might mute the influence international organizations to mandate change in government institutions.

3. Government Decrees and Legal Codes

To date, the government has issued several decrees touching on the corruption issue. None have impacted the issue. The latest decree, issued June 8, 2000 outlines the economic and social problems that corruption presents. It requires that the Cabinet of Ministers and the President's Executive Office prepare draft legislation and present it to the President by December 2000. There is no indication that there is real political will now to implement the systemic changes necessary to stem the endemic corruption.

Previous Decrees include, the President's Decrees on "Measures for fighting corruption and enforcing the rule of Law and Order" dated August 9, 1994; on "State control over industrial, financial and service sectors and prohibition of illegal revision (auditing)" dated June 17, 1996; on "Updating the System of State control and removal of impediments to entrepreneurship" dated January 7, 1999; on "Certain Measures in fighting crime in the economic sector in Azerbaijan Republic" dated January 27, 1998. All these recognized anti-corruption struggle as one of the main objectives of the government's policy but resulted in no action.

Creation of a specific anti-corruption agency would be a palliative reducing the likelihood of the fundamental changes that would root out corruption. Indeed such an agency in the current environment would simply sets up another opportunity for extortion and bribery. Only citizens empowered to defend their own rights can be expected to make a dent in the system of corruption that exists in Azerbaijan. To be successful, the Government's anti-corruption plan should include direct citizen access to government services without an intermediary "anti-corruption" agency. If the political will really existed to set up an effective anti-corruption agency, one would have expected to have seen attempts to enforce existing laws against corruption, to reform procurement and government employment. These areas have greater potential for impact than a special anti-corruption agency.

Criminal Code. Under existing law, receipt and giving of bribes is a criminal offence and the law applies to "official persons" defined as government officials and directors of enterprises. The law punishes receipt directly or indirectly for performance or non-performance of actions using official position in the interest of a bribe giver. It punishes conspiracy, extortion, and intermediaries and provides for confiscation of property.

In a speech given at the 1998 Washington Global Forum against Corruption in Washington the government Delegation reported, "During the last 3 years law-enforcement bodies disclosed more than 5,000 crimes in economic sphere, more than 2,000 crimes connected with misappropriation, and about 200 crimes connected with bribes. In 1998, courts convicted about 350 persons committed malfeasance in office and more than 400 persons committed misappropriated of public property."

4. Civil Society

The NGO ANKOR (Anti-Corruption Center) funded by the Open Society Institute publishes monthly booklets on international anti-corruption initiatives. Its director attended the 1999 International Anti corruption Conference in Durban. The Analytical Information Bulletin included in its August 1999 issue articles on the 1997 Lithuanian

anti-corruption law, an article on public health and corruption, and a commentary on the importance of an independent judiciary. The October 1999 issue included articles on the “Formation of the systematic corruption” and “Law and corruption” and translations from “Corruption and Democracy” and “Transparency International”.

Another NGO, the Entrepreneurship Development Foundation associated with CIPE, also looks at anti-corruption issues. In November 1999, it published the results of a yearlong survey of the obstacles facing private business; survey participants identified corruption as the top problem. The Foundation’s four activities are the publication of special bulletins, creation of small business information packets, corruption research, and polling. The special bulletins focus on topics relating to corruption and are distributed to both universities and policy makers. The corruption research monitors articles in 24 newspapers for anti-corruption coverage, opinion polls, and informs the business community informed of its activities.

Several part time attorneys and businessmen will analyze 16 existing laws to identify areas of discretion by government officials, that often-leading corruption. Four laws have been reviewed and the results will be released in July 2000. Second, beginning in October 2000, the Foundation will conduct 20 weekly economics sessions, focusing on corruption, for business journalists.

Finally, the Foundation held a small anti-corruption conference last year. It was attended by academics and foreigners and called on the government to adopt the OECD anti-bribery convention.

C. Key Constraints

In Azerbaijan, citizens expect to pay bribes and fees to receive government services. Corruption is a parallel system of government that works seamlessly and effectively for its beneficiaries. The damage to Azerbaijani society as a whole is not seen, because it largely consists of losses as measured against a hypothetical less corrupt society. Azerbaijan has never known such a society and the diffuse beneficiaries are poorly informed of their options and dubious about achieving such benefits. The primary beneficiaries of the current system of corruption are politically well organized, powerful and seem unconcerned with concepts of the greater good. The government lacks true political will to change or to allow the status quo to change. As one person told us, “Great needs, little receptivity.”

Changes in the law, rather than creating systemic change, have simply contributed new opportunities for corruption. In some cases, government officials charge for services that the law has permitted since Soviet times. For example, then, families could provide food to prisoners every two weeks. Now, families must pay a bribe to provide the food that they could previously give legally. In other cases, new western models and standards became new opportunities for government officials to collect bribes. Human rights groups told us they use to have some success in working with individual prosecutors. With legal consolidation, these groups now must work with less success with the more

powerful Minister of Justice on human rights complaints. Western funds have made a prison available for TB patients to be segregated from the general prison population. It was reported to us that this has become a new opportunity for officials to extract bribes from healthy prisoners not to be sent to these hospitals.

The impact of any foreign influence may be limited. One person that we talked with pointed out that the western NGOs come to Azerbaijan teaching western capitalism in much the same way that Russians came from Moscow teaching the soviet system. Both groups are viewed as outsiders, having no real impact on fundamental assumptions and behavior of ordinary Azerbaijani citizens.

Civil society does not have information on government services such as taxes and police powers and the government does not make it easily accessible. For the most part, civil society does not believe that it has the power to change things and has never seen government work in their interest. Azerbaijani civil society is very politicized. Most NGO's are associated with or perceived to be associated with political parties. Individuals who challenge the government may be at personal risk.

D. Priority Needs

The Entrepreneurship Development Foundation (EDF) survey found that the most important areas of work were: institutional reforms, strengthening of state control, modernization of the state personnel, policy modernization of legislative systems, reform of state salaries, and broad monitoring of the problem of corruption. This is consistent with the needs identified in the team's interviews.

The EDF recommended three specific activities for broad public monitoring. These are

1. Establishing an ombudsman to listen for and investigate citizen complaints regarding government procedures.
2. Stepping up the work of "public" organizations (i.e., NGO's) combating corruption including a national coalition of public institutions combating corruption.
3. Adopting a freedom of information act so that citizens can have access to government actions and decisions.

However, based on the team's investigations, before civil society in Azerbaijan can undertake initiatives of the type listed above, more fundamental education must take place. There must be more civil society support for enhanced public transparency and accountability. For example:

1. Brochures or public service announcements detailing government services. Information could include - office hours, the timeframe for each service, the government office to be contacted and the remedies available to citizens.

The team was advised that collecting the information to do this may be difficult. Soros has supported the publication of 100,000 citizen brochures on laws relating to the traffic police. They advised us that collecting the various laws, regulations and procedures was

difficult and time consuming. The team was told that laws are frequently overruled by presidential decree and that distributed laws, procedures, or practices could be overruled or changed soon after any brochure was distributed.

2. Information Centers where citizens can obtain information, conduct practically oriented research, and organize to increase public awareness of the damage caused by corruption

E. Role of International Donors

In anti-corruption activity, international NGO's should not be the main actors. A national anti-corruption agenda must be locally set and driven. However, any significant changes by the government or NGO activity that address the systemic problems outlined here should be reinforced by the international community.

Some actions that the international community might take immediately include:

1. Establish a Donors Council to monitor government efforts, coordinate donor activity on this issue, prevent duplications, look for opportunities to leverage donor resources. An organizing issue might be monitoring the content and implementation of the June 2000 Presidential decree on corruption.

2. Enforce NGO rules and regulations and publicize government and local NGO non-compliance with these rules. This may be more important than pursuing NGO registration approved by the government. The team was advised that one international organization gave the government funds that included reporting requirements but that the government now refuses to account to this international NGO for its spending. The team was told that the responsible government official has responded to requests for accounting with, "What is the problem? It is not your business how we spend our money." This does not give a public impression that international donors value accountability. Many groups have told us that NGO registration, granted by the Ministry of Justice is arbitrary and dependent on bribes.

Follow Azerbaijan law on NGO's including registration and taxes when possible. If bilateral treaties exempt international organizations and/or their grantees, this should be disclosed. There appears to be some public perception that international NGOs or those they fund do not comply with the law.

3. International donors should publicize their own rules, record keeping, and reporting requirements known to all local grantees. For example, one Azerbaijani with whom the team met was concerned that the UN worked only with its own organized group of donors and that this group included government unions. Concern was expressed that the UN would only work with government registered NGO's when it is well known that the government NGO registration is very arbitrary. There did not seem to be an understanding that the UNDP rules require that that organization only to work through the government and government authorized organizations.

4. USAID should conduct due diligence of groups that it works with in anti-corruption activities. For example, the team was told that a consumer activist group was organized and that it attracted a large membership---of former Soviet shop inspectors. These individuals, as members of the newly formed consumers union, went to the stores and demanded bribes in order for the stores to obtain a favorable rating by the new “consumers organization.” The team was also told that western organization support openly political NGO’s that are simply political organizations. Likewise, given the informal systems that govern most transactions in Azerbaijan, it is critical that international donors carefully screen grantees. All grantee organizations should be held to public, strict, prompt, and transparent financial accounting.

V. RECOMMENDATIONS

A. Current Environment

USAID can maximize the impact of its limited resources by focusing on (a) dissemination of information regarding legal standards, the purposes of reforms and the rights, benefits and obligations associated with reforms and (b) improving the understanding, knowledge and skills of the legal community, the business community and the general public regarding these reforms. As the team experienced first-hand during its assessment, there is little understanding among the legal community and private sector generally regarding legal standards. The private sector will not be in a position to demand implementation of reforms if it does not understand the purposes and provisions of enacted reforms. Although various donors are assisting with the reform of laws, there is at the present time only a small amount of assistance focused on public awareness and legal institution building support. Specific approaches that can be utilized to support USAID/Caucasus/Azerbaijan goals in rule of law, commercial law/enterprise growth and anti-corruption include the following.

- Dissemination of guides to businesses and general public. Simple guides can be prepared and provided to the private sector, appropriate to citizens in their various capacities, including as voters, farmers, entrepreneurs engaged in trade and manufacturing, motorists, students and NGO's. USAID should coordinate with Soros to avoid duplication and to identify complementary or joint projects. USAID may be able to locate locally drive topics and authors (including private lawyers with good references and NGO's) for such publications through its implementing partners, including ABA/CEELI, Eurasia Foundation and ISAR. NGO's supported by international assistance efforts (including the Confederation of Entrepreneurs and its member associations), SME lending programs and business advisory centers are all candidates to assist in the distribution of such materials. Government offices are also possible distribution sources for certain publications.²⁵

Such guides should have, depending on their topic, several purposes. Certain guides can provide basic information regarding rights to the private sector. Others can explain the basic purposes – and the corresponding rights, benefits and obligations – of reforms, including practical guidance for businesses.

- Public awareness campaigns through media and other public outreach events. The media can be used to complement the reach of public awareness campaigns. In addition, separate public awareness campaigns regarding reforms can be supported through the media, particularly regarding recently enacted reforms from time to time in order to avoid any time lag associated with the preparation of written materials.

²⁵ Prisoners rights booklets have been distributed with the assistance of prison authorities with Soros funding.

- Distribution of laws and other legal standards. Given the absence of accessible copies of laws and legal standards throughout Azerbaijan – and the apparently less than strong efforts by the Ministry of Justice to date to support the broad dissemination of such information, USAID should support the publication and dissemination of laws and other legal standards. The codes themselves should be made available in an inexpensive form accessible to Azerbaijani lawyers, judges, law schools, and government officials. USAID could work through private publishing houses, and with ABA/CEELI to print and distribute this work. Subject to diligence regarding these houses, including any political affiliation that they may have, such publishing houses include Minimax and Bulletin for Businessmen. The laws to be disseminated include the Civil Code, Civil Procedure Code, Criminal Code and Criminal Procedure Code.
- Assistance in the preparation and distribution of commentaries and similar practice guides. Given the wealth of new legal standards and laws being promulgated – and the new legal standards and concepts embedded in the laws, judges and lawyers need commentaries, manuals and practice guides which provide concrete guidance regarding the application of laws. USAID could try to work with GTZ which will be paying for the preparation of commentaries on the Civil Code and Code of Civil Procedure and obtain the right to reproduce and distribute them. In addition, commentaries on the Criminal Code and Criminal Procedure Code will be required. Coordination with the Council of Europe should be sought on that project, but experience suggests that Council will not fund such work.
- Continuing legal education for lawyers, judges and others charged with administration, interpretation and enforcement of laws. Legal education for lawyers, judges and law students is critical. Continuing legal education for lawyers and particularly judges is an area which is often flooded by donors with duplicative and competing assistance. However, this has not yet happened in Azerbaijan. ABA/CEELI plans increased work in the areas of legal education and continuing legal education and should be encouraged to pursue promising opportunities for professional education. Ideally, course topics and content should be locally driven and should be accompanied by useful handouts that attendees can take back to their offices. Business and other organizations with interest should be invited to attend appropriate topics to produce as broad a dissemination as possible and to encourage the development of a societal tendency to share information and knowledge regarding the law.

USAID/Caucasus/Azerbaijan can periodically refer to the Annex III chart as a guide in determining legal areas where USAID or other donor assistance is appropriate to support implementation of statutory reforms. That chart sets forth, for each of certain primary rule of law and commercial law reform areas, (1) the status of post-Soviet legislation, (2) across the top axis various steps to promote the implementation of each such law, and (3) the donor providing assistance with respect to each such step. As is evident from a quick

review of the chart, present and planned donor assistance is largely concentrated on the enactment of basic post-Soviet laws, with much significantly smaller attention on harmonization, institution building assistance, continuing legal education, preparation of commentaries, dissemination of laws and commentaries, and public awareness. To help reduce the fragmented nature of legal reform assistance in Azerbaijan, USAID/Caucasus/Azerbaijan should also support the formation of one or more coordination groups composed of international assistance providers to discuss actual and planned donor activities, leverage each other's assistance and support a more unified vision of reform for Azerbaijan.

USAID must be particularly attentive to transparency into each of its programs. Technical assistance should be provided in a manner that encourages private sector participation and does not limit assistance to work with public sector actors. Given the prevalence of corruption, USAID must at all times take steps to avoid any appearance of corruption in its programs and must design transparency into every program. Transparency in publicizing program and grant criteria must be explicitly designed into every program – not simply to make certain that funds are not siphoned for purposes other than those for which they are programmatically intended, but to support a public perception that there is at least one part of Azerbaijani society that is reasonably clean.

B. Sector Specific Recommendations and Looking Forward

Each of the preceding three chapters contains specific recommendations for assistance that are deliberately not repeated here, various of which are recommended for USAID attention at the current time.

Due to the dynamic nature of reform in Azerbaijan, USAID/Caucasus/Azerbaijan will need to be alert to opportunities to support the identification and implementation of reforms through close communications with its implementing partners and with members of the donor community.

Azerbaijan's desire to be a member of the Council of Europe and to join the World Trade Organization may open up opportunities for reforms. In addition to other reforms, USAID should be particularly alert for genuine willingness of Azerbaijan leadership to pursue an administrative procedural code reform. Since an administrative procedural code, once enacted, should require each executive branch ministry and agency to implement regulations and practices to bring it into compliance with the code's requirements, this reform has the potential to sow the seeds of greater transparency and predictability behind the back of more recalcitrant stakeholders. The Council of Europe and EU Tacis may be interested in encouraging the Government of Azerbaijan to consider such legislation. Assistance to the Government of Azerbaijan in preparing such a code would probably fall into the democracy and governance exception to Section 907 of the FREEDOM Support Act.

If the Government of Azerbaijan should show a demonstrated commitment to anti-corruption efforts, it would be worth investigating additional opportunities for

cooperation. The severe constraints on enterprises posed by corrupt practices involving customs and tax authorities make institutional reforms in these two sectors priority areas. However – particularly given the restrictions imposed by Section 907 - the IMF, the World Bank and the WTO should probably have the lead roles in these areas at the present time. In the event of a change in the applicability of 907 and a genuine support by Azerbaijani stakeholders for reform in these areas, separate assessment regarding each of tax and customs administration should be undertaken. The purpose of each such assessment would be to: examine in detail the applicable statutory framework; determine priority needs for changes regarding current practices, powers and organization structures of governmental bodies charged with the administration and enforcement of such substantive area (including banking sector and law enforcement personnel), identify constraints to the implementation of reforms, specify regional practices to be promoted, and enable USAID and any other USG assistance to be structured such that the conditions, goals and approaches of any such assistance program are appropriately set and structured.

C. Follow-up Suggestions for USAID/Caucasus/Azerbaijan

As noted above, close monitoring of the WTO accession process may provide opportunities for USAID/Caucasus/Azerbaijan to suggest programs supporting reforms that will be required for WTO accession and that may consequently identify reformist counterparts within the Government of Azerbaijan. In addition, USAID/Caucasus/Azerbaijan – with assistance from USAID/W and USAID’s representative to the EU in Brussels, should follow the anticipated formulation over the next several months of EU-TACIS’ legal assistance program. The EU’s determination of the content of its assistance should reveal opportunities to leverage limited resources and perhaps give USAID an opportunity to shape a complementary program. Similarly, cooperation with the Council of Europe will give rise to opportunities to provide assistance that will help Azerbaijan in complying with its accession requirements. This will provide one of the few positive motives among key Government of Azerbaijan stakeholders for implementation of reform legislation.

Annex I.

THE REPUBLIC OF AZERBAIJAN COURT SYSTEM

I. The Court System

Courts of First Instance: Regional (City) Courts, Court of Grave Crimes (collegium in the Supreme Court of Republic of Azerbaijan), Military Tribunals, Military Tribunals on Grave Crimes, Local Economic Courts, Economic Courts dealing with Arguments on International Agreements, and the Collegium on Grave Crimes of the Supreme Court of Nakhchivan Autonomous Republic.

Courts of Appeal: Appellate Court of the Republic of Azerbaijan (RA), Economic Court of the RA, Supreme Court of Nakhchivan Autonomous Republic.

Supreme Court of the RA: The highest court in Azerbaijan.

Constitutional Court: Reviews normative acts to determine compliance with the constitution. Only the Supreme Court can submit cases to the Constitutional Court.

II. Courts of First Instance

Regional District Courts: These courts hear civil cases (except economic matters), criminal cases (except grave crimes), and cases of administrative violation.* There are 85 Regional (City) Courts countrywide, including Baku District Courts and Regional (City) Courts of the Nakhchivan Autonomous Republic. Usually these courts have one to two judges, but a few regional courts may have up to five judges. There are eleven District Courts in Baku and the number of judges in each varies from three to six. The Nakhchivan Autonomous Republic has eight Regional (city) Courts with one or two judges sitting on each.

Local Economic Courts: These courts hear cases on economic disputes as a court of first instance. The four Local Economic Courts are located in Baku, Ganja, Ali-Bayramli and Nakhchivan. Up to six judges serve on each of these courts.

Economic Court of the RA dealing with Arguments on International Agreements (ECAIA): Established pursuant to the presidential decree of June 17, 1999, the ECAIA has three judges. The team was unable to verify the exact number of ECAIA courts and their specific responsibilities. The Chairman of the Economic Court said that the

* An administrative violation is a violation of the rule, stated by the administrative laws, or wrongful application of the laws by administrative bodies.

Azerbaijani judges lacked the appropriate expertise to hear cases connected with international agreements.

Military Tribunals of the RA: There are nine Military Courts in the RA, with two to eight judges sitting on each.

Military Grave Crimes Tribunals: Established pursuant to the presidential decree of June 17, 1999. Twelve judges will sit on such tribunals. The team was unable to determine the exact number and responsibilities of these tribunals.

Grave Crimes Court of the RA: Established pursuant to the presidential decree of June 17, 1999. 26 judges will sit on these courts; but, the exact number of such courts and their responsibilities could not be determined.

Collegium on Grave Crimes of the Supreme Court of the Nakhchivan Autonomous Republic: The team was unable to find any additional information on this court.

III. Courts of Appeal

Appellate Court of the RA: The presidential decree of June 17, 1999 mandates the establishment of an Appellate Court. This court will be located in Baku, but facilities are not available for it to begin operation. 38 judges will sit on the court, but their specific responsibilities have yet to be defined.

Supreme Court of Nakhchivan Autonomous Republic (SCNAR): This court serves as both a court of appeals for cases decided by the regional (city) courts within the Nakhchivan Autonomous Republic and a court of the first instance for cases stipulated by law. 14 judges serve on the SCNAR. The SCNAR consists of a Presidium, a Civil Appellate Collegium, a Criminal Appellate Collegium and an Administrative Appellate Collegium. The Presidium consists of the Chairman of the Court, the Deputy Chairman and the Chairmen of the three Collegiums. The Presidium is primarily responsible for court administration and case management.

Economic Court of Appeals: This court hears cases decided by the lower Economic Courts and the Economic Court dealing with Arguments on International Agreements. The Economic Court of Appeals consists of the Presidium and a panel of judges. Eleven judges sit on this court. The economic court system (including the lower Economic Courts and the Economic Court dealing with Arguments on International Agreements), while theoretically a new system and still in formation, is based on the former Soviet court system known as Arbitrage Courts. The Law on Courts and Judges, the Civil Code, the Civil Procedure Code and several decrees govern the establishment and operation of Economic Courts.

The economic courts hears civil, administrative and economic disputes between legal entities and individual entrepreneurs. The type of issues the courts hear can include: disputes over contract terms, amendments to contracts and termination, state services

claims (if the amount cannot be claimed without a court proceeding), claims for back amounts withdrawn from the budget, bankruptcy, and tax issues. Reportedly, the judges on the economic courts lack an understanding of market principals introduced by the new laws.

Supreme Court of the RA: The Supreme Court is the highest judicial body. The court has a Plenum and five Cassation Collegiums, which respectively hear: civil cases, economic cases, criminal cases, administrative violations and military cases. In addition to court administration and case management responsibilities, the Plenum will hear cases stipulated by law (i.e., Civil Procedure Code and Criminal Procedure Code). This jurisdiction includes cases submitted by the Chairman of the Supreme Court, protests by the Prosecutor General of the RA or the defense, cases that have already been heard by the Supreme Court, and cases initiated after the Supreme Court reached a final decision of the Supreme Court due to the new circumstances.

IV. Operation of the Court System

In a court of first instance either a single judge or a judge and two lay judges will hear a case. On the Court of Appeals and each Cassation Collegium of the Supreme Court, three or more judges will hear a case.

In Continental Europe legal parlance, civil law refers to contract, secured transactions, property, family, copyright, banking, financial (except taxation), economic, and company laws and often labor disputes. However, due to the jurisdiction of the Economic Courts (i.e., hearing economic disputes between two legal entities) in Azerbaijan, the term “civil law” should not be used to refer to an organizing principle for the common courts’ jurisdiction. Specifically, the common courts will hear economic cases when the dispute is not between two legal entities.

The enforcement of court decisions poses a serious problem. To address this issue, the GOA may form a special law enforcement body, which would be known as the justice police. This body would have the responsibility of maintaining order and security in courts and executing court decisions. The Justice Police, while purportedly independent from the Ministry of Justice, would receive funding from this ministry.

Unlike the judges on the courts of the first instance, whose terms run for 5 years, judges on the Supreme Court, Economic Court, Court of Appeals and the Supreme Court of the Nakhchivan Autonomous Republic serve for 10 years.

The legal authority for the rights and obligations of the judges can be found in the Constitution of the RA, the Law of the RA on Courts and Judges and various regulations. Article 127 of the Constitution provides for judicial independence and Article 107 specifies that judges cannot be removed during their term of office. But the law also states that judges who do not pass the judicial qualification examination can be removed from office.

Article 93 of the Law on the RA on Courts and Judges specifies the qualification requirements for judicial candidates. Additional qualification requirements are found in the regulation pertaining to the Juridical Law Council, and the President's decree On Organization of Courts and Support of Their Activity.

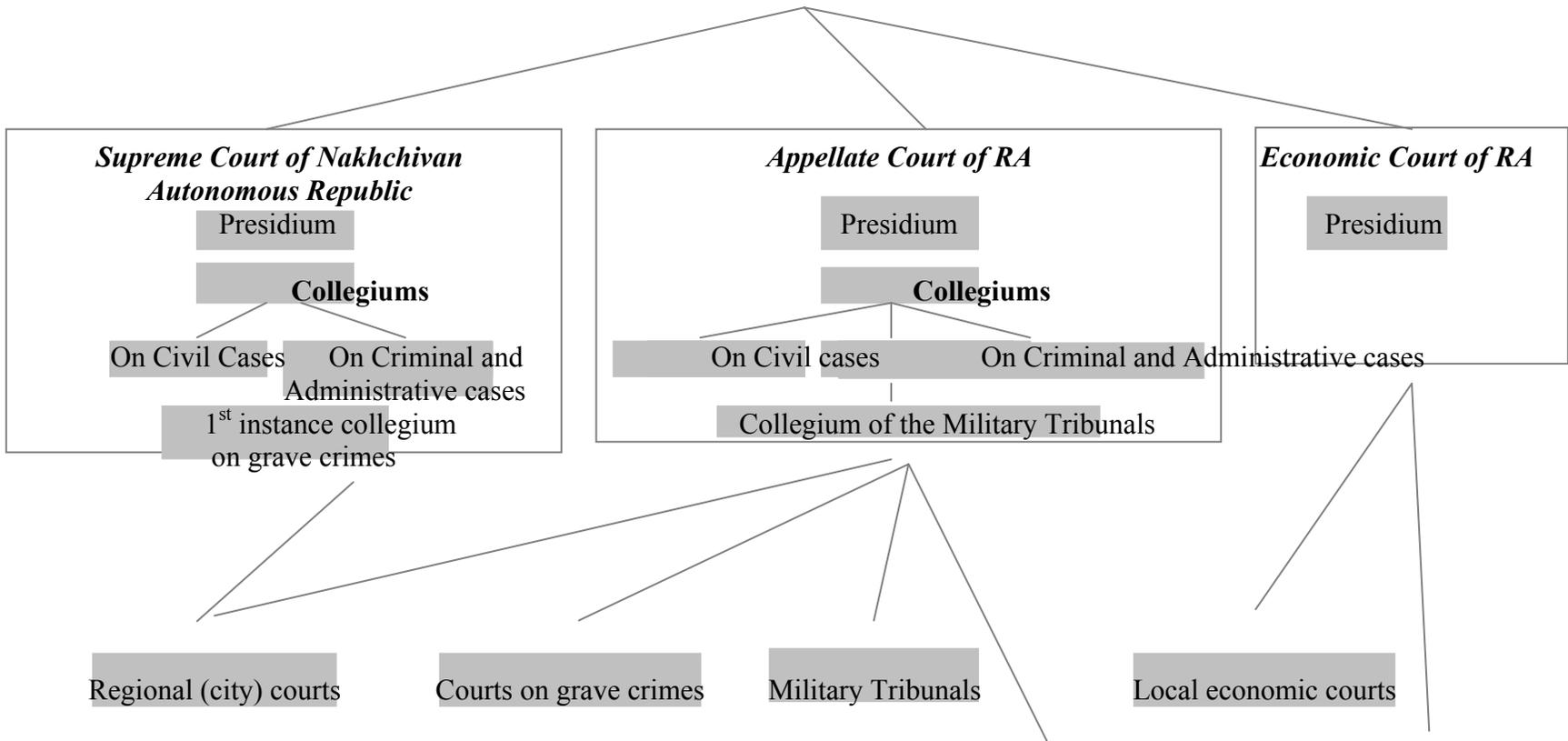
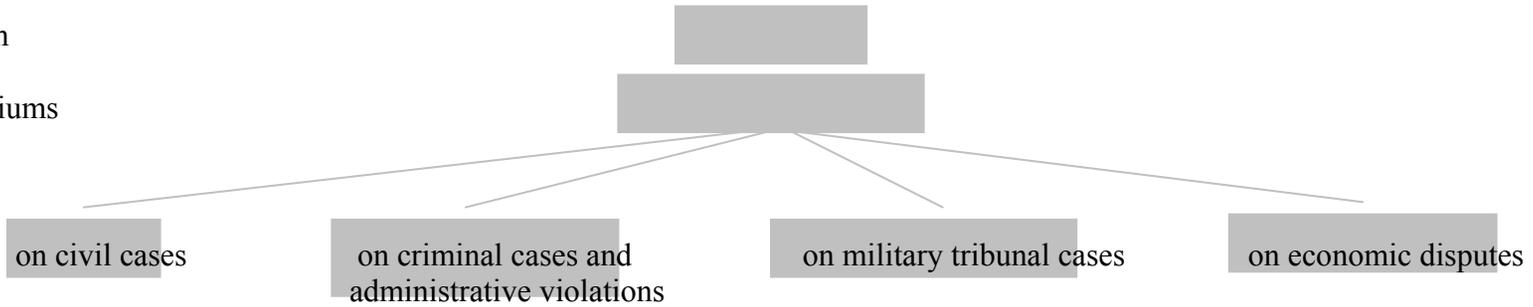
C

COURT SYSTEM OF THE REPUBLIC OF AZERBAIJAN

a. Supreme Court of the Republic of Azerbaijan

Plenum

Collegiums



Annex VIII

PERSONS INTERVIEWED

Azerbaijan Judiciary

Khanlar Hajiyeu, Chairman, Constitutional Court

Raouf Guliyev, Chief of International Relations Department, Constitutional Court

Jafar Veliyev, Chairman of Economic Court

Azerbaijan Executive Branch

Vahid Akhundov, State Advisor on Economic Policy, Office of the President

Namiq Nasrullayev, Minister, Ministry of Economy

Fikrat Mammadov, Minister, Ministry of Justice

Teymur Yakhyayev, Governor of Masalli Province

United States Government

Stanley T. Escudero, US Ambassador to Azerbaijan

Dr. Craig Dicker, Public Affairs Officer, US Embassy

Sherri Holiday, Political Officer, US Embassy

John Adams, Economic Officer, US Embassy

William McKinney, Coordinator, USAID/Caucasus/Azerbaijan

Steven Szadek, Deputy Coordinator, USAID/Caucasus/Azerbaijan

USAID Partners

Gregory Brown, Liaison, ABA/CEELI

James R Hargreaves, Liaison, ABA/CEELI

Farid Abasov, Legal Advisor, ABA/CEELI

Trefor Owen, Project Manager, International Foundation for Election Systems

Peter Van Praagh, Director, National Democratic Institute

Kim Perlow, Country Director, ISAR/Azerbaijan

Derek Norberg, Country Director, The Eurasia Foundation

Marina Titova, Regional Lending Manager, Shore Overseas Corporation

Tina Ohmann, Country Director, FINCA Azerbaijan

Aaron N. Bornstin, Director, Citizens Democracy Corps

Shahin Abbasov, Massali Project Coordinator, ACDI/VOCA

Law Firms

Ibrahim Zeynalov, InterJurService Ltd.

Nariman Ramazanov, InterJurService Ltd.

Ilgar Gourbanov, InterJurService Ltd.

Aslan Z. Ismailov, Attorney at Law, VIZA Advocate Firm

Farzali G. Aliyev, General Director, VIZA Advocate Firm

Jamal N. Bagirov, President, BM International Law Firm

Frangiz Bagirova, Vice-President, BM International Law Firm

Dunyamin Khalilov, General Manager, Vnesh Expert Service Consulting Company

Daniel Matthews, Partner, Baker and McKenzie

Dr. John Vafai, Baker & Botts

Michael Walsh, Resident Director, Ledingham Chalmers

Alum Bati, Salans Hertzfeld and Heilbronn

Non-Governmental Organizations and Private Voluntary Organizations

Eldar E. Zeynalov, Director, Human Rights Center of Azerbaijan

Dr. Leila Yunus, Director, Institute for Peace and Democracy

Ogtay Hamidov, Director, Anti-Corruption Center (ANCOR)

Grace Vance, Director of Marketing, The Nature Conservancy

Intigam Aliyev, Legal Education Society

Azer Tagiyev, President, Collegium of Advocates

Mameov Oktay Xanbala, Collegium of Advocates

Knute Kasperson, Assistant Director, Red Cross

Sabit A. Bagirov, President, Entrepreneurship Development Foundation

David Stubbs, Director, Azerbaijan Soros Foundation

Fuad Sulimanov, Director of Legal Programs, Azerbaijan Soros Foundation

Marcel Eschweiler, Economist, LFS Financial Systems

Accounting Firms and Business Advisory Organizations

Stephanie Inman, Managing Partner, Ernst and Young (CIS) Ltd.

Timothy Bray, Managing Director, KPMG

Farrukh Gassimov, Senior Attorney, KPMG

Shoukran Aliakberov, Assistant Manager, KPMG

Etibar Jabbarov, Chief of the Center for Small and Medium Enterprise Development,

Masalli Province

Multilateral and Bilateral Donor Organizations

Jonathan Dunn, Resident Representative, International Monetary Fund

Tevfik M.Yaprak, Resident Representative, The World Bank

Amit Mukherjee, Task Officer Public Sector Reform, The World Bank, Washington, DC

Rochelle Hilton, Operations Officer, Private and Financial Sector Development, Europe and Central Asia, The World Bank, Washington, DC

Carlo Segni, Consultant, The World Bank, Washington, D.C.

Murat Yildiran, Senior Banker, Head of the Office, European Bank for Reconstruction and Development

Atena Duicu, Chief Technical Advisor, UNDP Business Support Center

Aydin Suleymanov, Legal Consultant, GTZ

Boris Smolin, Adviser, EU-TACIS Coordinating Unit

Stein Iverson, Consul, Embassy of Norway