European Bank
for Reconstruction and Development

Commercial laws of Montenegro

An assessment by the EBRD

January 2014

COMMERCIAL LAWS OF MONTENEGRO
AN ASSESSMENT BY THE EBRD

January 2014

Legal system

Constitutional and political system

The current Constitution of Republic of Montenegro was adopted on 19 October 2007. In July 2013, a set of constitutional amendments were adopted, aimed at enhancing independence of the judiciary. In adopting the constitution, the Montenegrin parliament has taken one of the essential steps for joining the European Union (EU). It was stipulated as a condition for a prospective member state in the Stabilisation and Association Agreement (SAA). Pursuant to the new Constitution the Parliament has the ability to elect and dismiss the Prime Minister and members of the Government. The Parliament consists of 81 Members and has a mandate of 4 years.

The Constitutional Court is composed of five justices nominated by the President and appointed by the Parliament for a nine-year term. Either at its own initiative, or at the initiative of a government agency or an interested third party, the Constitutional Court examines the constitutionality and legality of legislative acts, examines alleged violations of the Constitution by the President, hears complaints involving the violation of constitutionally protected rights and freedoms, and rules on conflicts of jurisdiction between various levels or different branches of government

The Republic of Montenegro has a unicameral Assembly composed of 71 deputies directly elected for a four-year term. The Assembly can impeach the President if the Constitutional Court rules that the President has acted unconstitutionally. The President proposes to the Assembly the candidates for the position of Prime Minister as well as the president and justices of the Constitutional Court.

The Prime Minister is nominated by the President and appointed by the Assembly. The candidate for the position of Prime Minister proposes his programme and the list of Ministers to the Assembly. If the Assembly fails to adopt the programme, the President nominates another candidate for the position of Prime Minister within ten days. The Assembly may dismiss the Government by a vote of no confidence. The Prime Minister may request the Assembly to recall any member of the Government.

Judicial system

Montenegro's judicial system consists of courts of general jurisdiction covering both civil and criminal matters, and specialised commercial and administrative courts. The general courts are made up of 15 first instance "basic" courts, with appeals lying to one of two second instance "higher" courts.

There are two first instance commercial courts, appeals from which lie to the Appellate Court. The commercial courts can hear any disputes between legal entities (non-natural persons), and certain categories of dispute, such as those relating to intellectual property, competition, and insolvency. Administrative matters are heard by the first instance Administrative Court, with appeals lying also to the Appellate Court. The Supreme Court is the final appellate instance in all matters, with commercial matters being heard by the specialised Panel for Commercial Disputes.

The Judicial Council is responsible for appointing judges and for ensuring the overall autonomy and independence of the court system. It is composed of ten members, half of whom are judges. The Judicial Training Centre (JTC), functioning as a department within the Supreme Court, is responsible for judicial training and runs separate programmes for sitting and candidate judges.

The *EBRD Judicial Decisions Assessment 2012* found court judgments in commercial law matters to be moderately predictable and of reasonable but variable quality. The pace of justice was considered relatively slow. There remains a significant case backlog, which is being reduced slowly: in 2011 there was a 4% reduction in the backlog compared to 2010. Judges continue to have a large workload, despite Montenegro having one of the highest ratios of judge to population amongst the Council of Europe member countries. The lack of a formal system to monitor the length of trials has been noted as a deficiency in the current system and is an area of suggested reform. Access to court judgments has improved recently, with decisions of appeal courts now generally available, contributing to greater certainty in legal proceedings. However, more work remains to be done in this area; full public access to decisions at all instances would facilitate the country's efforts to strengthen the transparency and accountability of judiciary.

One of the main on-going concerns relating to the judiciary is the perception that it remains significantly politicised. This is referred to in recent reports of the European Commission as one of the main challenges confronting Montenegro on its path to accession. Among recent measures taken to address these issues are the establishment of a Judicial Disciplinary Commission, as well as a Commission for conducting new written tests for candidate judges. A new code of ethics for judges and prosecutors was recently adopted, and a commission created to oversee compliance with it. In additional, the institutional effectiveness of the Judicial Council has been enhanced by the adoption of detailed rules of procedure; however greater transparency in the appointment of members to the Judicial Council would be welcome, and is currently being considered by the government.

Weaknesses in the enforcement of commercial law judgments are another concern. Recent measures to improve the situation include the establishment of a bailiff service. This has entailed the transfer of enforcement powers from specialised departments established within the first instance "basic" courts to new public bailiffs, following the adoption of the *Law on Enforcement and Security of Claims* in July 2011 and the *Law on Public Bailiffs* in December 2011. Under the new system, the bailiffs rather than courts will be responsible for the issuance and implementation of enforcement orders in all matters other than those concerning family and labour relations, and requiring a debtor's personal performance. The system is not yet functional. Priorities are now to recruit and training bailiffs and professionalise the new role.

Recent developments in the investment climate

The Republic of Montenegro has continued to improve its legal framework in recent years, with the view of harmonising it with the EU legislation.

In June 2012, the country began formal accession talks with the EU. Consequently, the Montenegrin Government has put forward a set of amendments to the Constitution aimed at limiting political influence over key judicial appointments, which is one of the EU's key recommendations for national judicial reform.

Also, as part of its EU harmonisation efforts, the Government of Montenegro has been working on strengthening and augmenting laws governing business activities. For example, a new Law on Protection of Competition came into force in October 2012. It regulates both market behaviour (restrictive agreements and abuse of dominance) and merger control. With respect to the latter, the most significant changes relate to notification thresholds and deadlines, as well as deadlines within which the newly established national competition authority must review mergers and issue appropriate decisions.

Montenegro became a full member of the World Trade Organization in April 2012. Among its commitments as a new member, Montenegro agreed to liberalise its trade and foreign investment rules and regulations, including annual reporting on the privatisation program, application of price control measures to the WTO standard, and elimination of most of its existing restrictions on imports (such as quotas, permits, etc.).

Important steps have been taken to develop Montenegro's energy potential. Tariff reforms have progressed in the power sector, and plans are advancing in the development of an underwater interconnection cable between Montenegro and Italy. Electricity tariffs are rising towards more cost-reflective levels. In December 2011 the energy regulatory agency of Montenegro approved an increase in electricity prices to compensate the electricity generation company, EPCG, for its rising production and import costs. The regulator approved an average increase in tariffs of 6.13 per cent. The highest increases of on average 6.7 per cent were applied to households. This represents a partial reversal of moves by the energy regulator last year to lower consumer tariffs.

Freedom of information

Unlike the other countries in the region Montenegro did not establish a general right of freedom of information (FOI) in its Constitution.[1] Article 19 gives everyone a right to "timely and complete information" about the environment. Article 31 gives individuals a right to access personal information and prevent the abuse of that information.

The first single act (the Law on Free Access to Information) was adopted in November 2005, to some extent to fall in line with the rest of the countries in the region.

Most recently Montenegro adopted a new law on FOI, the Law on Free Access to Information, at the end of 2012, this entered into force in February 2013.

The new law will provide for, amongst other things; an effective oversight of the implementation of regulations on free access to information by a single second-instance body, which will be composed of non-partisan professionals; regular quarterly reporting on the application of the Law by officers tasked with addressing the requests for free access to information to a single second-instance body; creation of a list of documents that must be proactively published by each institution (government ministry, agency and other bodies tasked with public duties) subject to the Law; and promotion of the idea that free access to information is obligatory, with some restrictions in place to provide for justifiable exceptions.

The law, when it was published in draft was subjected to substantial criticism as it was rated as being only a marginal improvement upon the law adopted in 2005. It remains to be seen if enforcement of the law will be robust enough to counteract these deficiencies.

Commercial legislation

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities. These relate to investment in infrastructure and energy (concessions and PPPs, energy regulation and energy efficiency, public procurement, and telecommunications) as well as to private-sector support (corporate governance, insolvency, judicial capacity and secured transactions).

Detailed results of these assessments are presented below starting with infrastructure and energy and going into private sector development topics.

The completed assessment tools can be found at www.ebrd.com/law.

Infrastructure and Energy

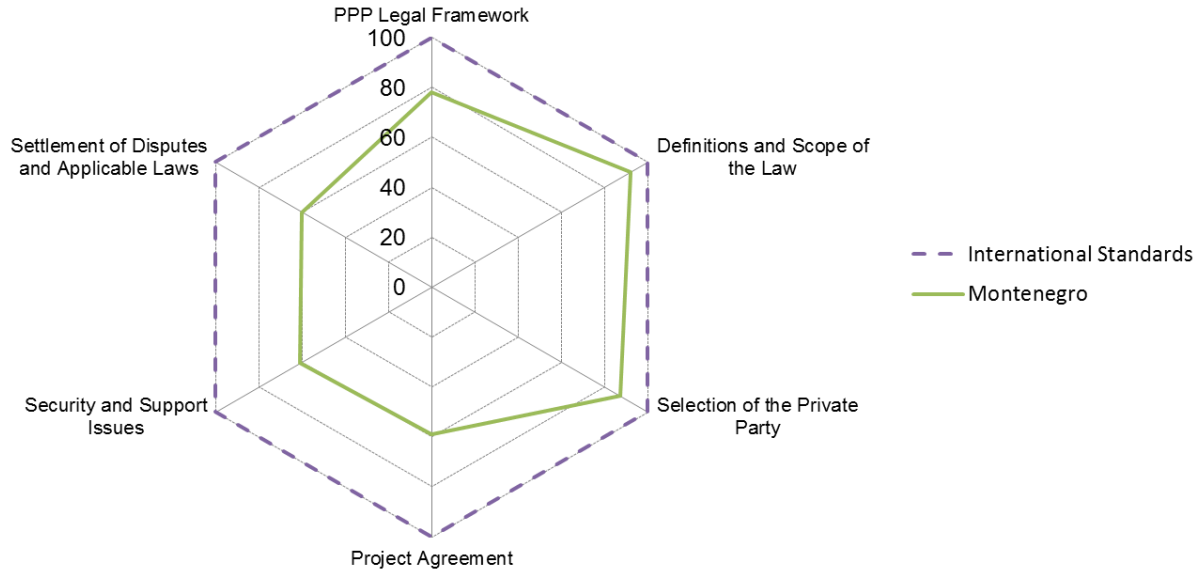
Concessions and PPPs

Montenegro has quite a modern and comprehensive concessions act, enacted in 2009 (the "Concession Law"). There is no special Law regulating all forms of private-public partnership, however, there have been reports about the existence of a PPP Working Group with one of the tasks being the drafting of such a law. In addition, the Law on Participation of Private Sector in Performance of Public Services, as amended in 2009, remains applicable for public services operated through leasing and management agreements.

Concession is defined fairly broadly thus conveniently making it possible to utilise the PFI-type of PPPs without the delegation of the public service itself and providing for a payment by the contracting authority.

The Concession Law provides for a non-exhaustive list of sectors where concession arrangements may be applicable. The granting of concessions is organised generally through a competitive procedure based on the well recognised principles of transparency, non-discrimination and competition clearly seen through the Concession Law. During the recent EBRD PPP/Concessions Laws Assessment throughout the EBRD countries the quality of laws of Montenegro were rated as "in high compliance" with international best standards" (see Chart 1). However the effectiveness of the laws in practice was ranked as in "low compliance" largely due to the absence of a clear PPP policy and the underdeveloped institutional infrastructure (see Chart 2).

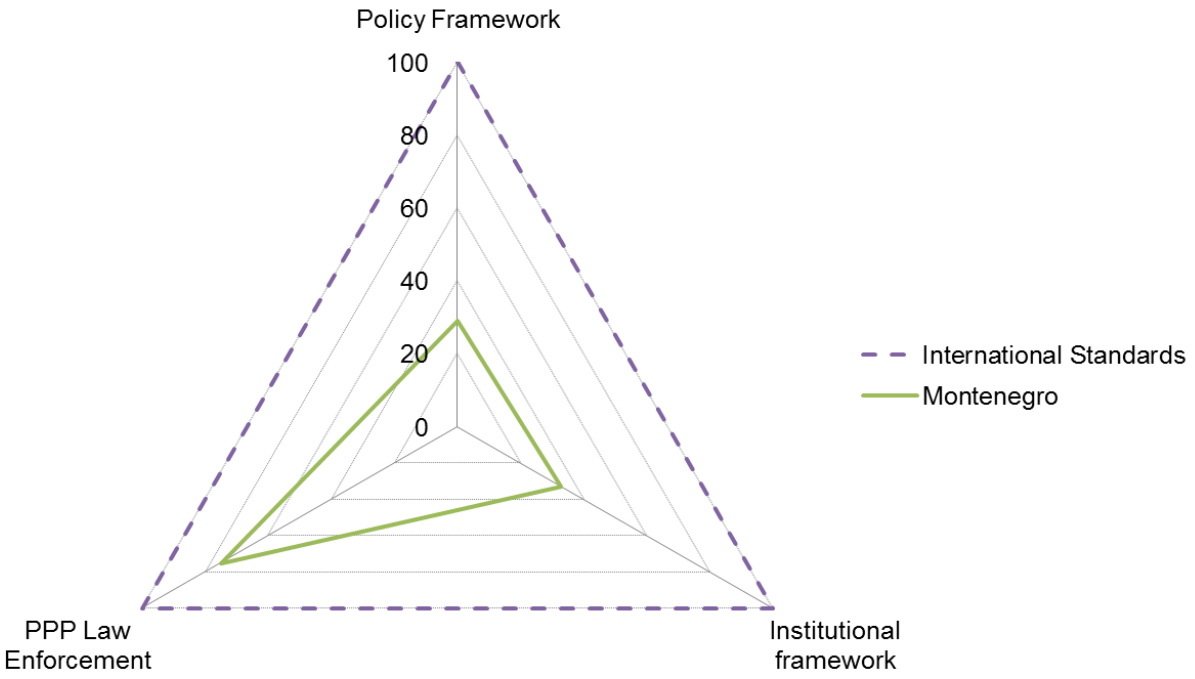
Chart 1 – Quality of the PPP legislative framework in Montenegro



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

Source: EBRD 2012 PPP Legislative Framework Assessment (LFA)

Chart2 – How the PPP law is implemented in practice in Montenegro



Note: The extremity of each axis represents an ideal score, that is, a fully effective legal framework for PPPs.
Source: EBRD 2012 PPP Legal Indicator Survey (LIS).

There is no special PPP Unit or an equivalent body. Furthermore, there are certain bodies involved in the process of awarding concessions, mostly per sector, such as the ports authority as far as relevant activities are concerned. In addition, some bodies are formed ad-hoc within the relevant ministry for the purposes of awarding specific concessions (maritime, railway, etc.). Based on the government's paper on summarising the award of concessions it looks like the main challenges relate to the monitoring of concessions implementation and the overlapping authority of the agencies participating in the process. In addition, Montenegro remains one of the very few countries in the region that has not yet ratified the Washington Convention (ICSID) which may be seen as a negative sign to investors.

Currently there are PPP projects in the health sector and in medical waste management, both structured under the Concession Law. A few projects in the transport sector are under development. In the energy sector, over a dozen concessions for the construction of small hydro plants have been awarded.

The setting up of a specialist PPP Unit could contribute to the solving of the identified problems, fix the weak institutional infrastructure and enhance PPP in the country

Energy

Electricity

The market is partially open, but impediments to development exist. In theory, the market is open because by law all customers have the right to purchase electricity from any supplier. In practice, the percentage of electricity purchased on the free market is around 15% and from imports. A Market Opening Plan is in place, and this Plan suggests a staggered opening consistent with market conditions. The recent EBRD energy law reform dimensions assessment project has shown that regulatory independence, transparency and tariff structure are the key strengths of the country's electricity framework, while public service obligations and market framework are its key weaknesses (see Chart 3).

Montenegro has partially unbundled its electricity sector; the transmission company is completely unbundled and is established as a separate legal entity, though a part of the EPCG holding company. Generation, distribution and supply businesses are

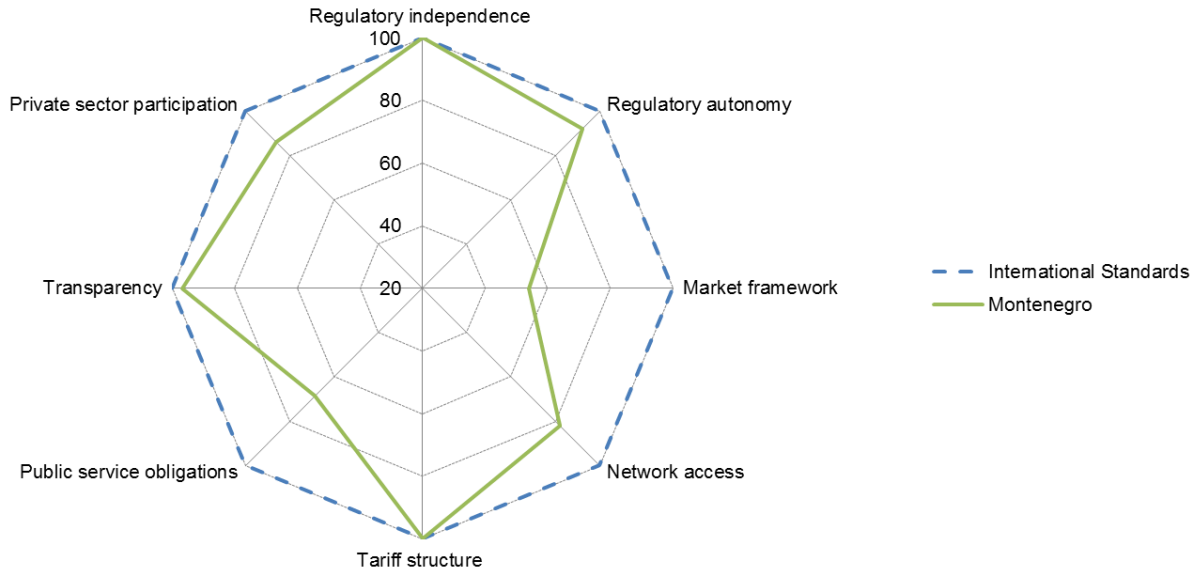
accounting and functionally unbundled within EPCG, and each is a separate licensed activity, though one auditing procedure is applied to the company as a whole.

Montenegro has a regulated market. The wholesale market is officially established, but is not yet functional.

Regulated tariffs are set ex ante and published on the Agency's websites. Under the Energy Law, the Agency regulates and licenses as separate activities; generation of electricity, transmission of electricity (including ancillary services), distribution and retail supply of electricity for tariff consumers. The regulated tariffs are approved by the Agency and published. The tariff methodology is published as well. In the first phase, the Agency approves the regulatory revenue, based on which the undertakings submit the tariffs for approval. The tariff approved by the Agency is an end-user tariff, which combines cost elements from generation, transmission, distribution and supply, taking care to avoid cross-subsidisation and to guard against corruption by clearly allocating the amounts to each within the tariff structure. Customer classes are divided based on voltage level, and for low voltage there are several groups, depending on the characteristics of the customer. The tariffs are designed to reflect actual costs, including operational costs, depreciation and return on assets. However, cross-subsidisation does exist between the households and commercial low voltage consumers.

Overall, Montenegro performs relatively well with respect to its electricity sector. As a small country with limited domestic energy resources, Montenegro must look to regional market development, and has taken an active position in the Energy Community. In 2009, Montenegro signed a Memorandum on common procedures for congestion management and coordinate auction with other South East European system operators. Montenegro's small size makes integration into regional markets key to its development.

Chart 3 – Quality of energy (electricity) legislation in Montenegro



Note: The spider diagram presents the sector results for Montenegro in accordance with the benchmarks and indicators identified in an assessment model. The extremity of each axis represents an optimum score of 100 that is full compliance with international best practices. The fuller the "web", the closer the overall regulatory and market framework approximates international best practices. The results for Montenegro are represented by the green area in the centre of the web.

Source: EBRD 2011 Energy Sector Assessment

Gas

The gas sector is non-existent, with legislation pending to meet the Energy Community requirements, and the adoption of a strategy to develop gas infrastructure, such as an LNG terminal, but the regulatory framework has not yet been enacted and no projects have been started to build infrastructure.

There is minimal natural gas resources and infrastructure Montenegro, with only small amounts of liquefied petroleum gas (LPG). Existing (LPG) oil and gas companies (with only one exception) in Montenegro are private companies; the only previously state-owned company Jugopetrol was privatised and sold to Hellenic Petroleum.

Montenegro's Energy Strategy (through to 2025) includes strategic goals for the gas sector, such as developing the gas infrastructure, namely a gas pipeline connected to South East European neighbours, and a liquefied natural gas (LNG) terminal, along with offshore exploration. A law on gas has been drafted and pending before parliament awaiting adoption for some time, and most recently provisions of the law were combined into a new draft Energy Law, currently under consideration.

Energy efficiency/renewable energy

Montenegro's policy and legal framework in the energy efficiency and renewable energy sector consists of: the Energy Law (April 2010), the Energy Efficiency Law (April 2010), the Energy Policy of Montenegro until 2030 (March 2011), the Energy Development Strategy of Montenegro by 2030 (December 2012), the Action Plan for Implementation of Energy Development Strategy for 2008-2012 (2007), the Energy Efficiency Strategy for Montenegro (2005), and the Energy Efficiency Action Plan for Period 2010-2012.

Montenegro's policy framework for renewable energy (RE) is set out in the Energy Policy of Montenegro until 2030 adopted in March 2011 (the "Policy") and the Energy Development Strategy of Montenegro by 2030 adopted in December 2012 (the "Strategy"). Both the Policy and the Strategy cover the broader energy and RE sector and were adopted with a view to harmonise the Montenegrin legal framework with the *acquis communautaire*. The Strategy replaced an earlier Energy Development Strategy adopted in 2007, revised due to the need of further integration of the country's policy framework with the EU Directives. Both the Policy and the Strategy place the development of RE on the government's priority list.

The regulatory framework in the RE sector has also been recently upgraded, with the adoption of the new Energy Law in April 2010 (the "Energy Law") that replaced the previous Energy Law of 2003. EU membership negotiations have been the main catalyst behind the recent legal and regulatory reforms. Harmonisation of national laws with the energy *acquis*, in particular, the EU Third Energy Package of 2009 is ongoing.

The Energy Law covers the broader energy sector, including the RE sector; several implementing regulations in the RE sector envisaged by the Energy Law have been adopted. The new RE regulatory framework provides for differentiated feed-in tariffs and system of guarantees of origin of electricity for the first time. It also allows RE producers to obtain the status of a "privileged producer" enabling them to use a price support scheme established by the government and priority in delivery of produced electricity within the transmission or distribution networks. The Energy Law does not regulate in detail the licencing and production of energy from renewable energy sources (RES). The incentives for the producers are to be provided for in special laws and regulations. The Energy Law sets forth certain protection for socially vulnerable consumers.

Montenegro ratified the Kyoto Protocol to the United Nations Framework Convention on Climate Change (the "Kyoto Protocol") in 2007; however, the government is yet to take steps to implement it.

Similar to the RE sector, Montenegro's current policy framework for the energy efficiency (EE) sector is set forth in the Policy and the Strategy, which envisage improvement of EE and growth of EE measures in various sectors.

With a view to harmonisation with the *acquis* on the way towards EU accession, the EE regulatory framework has been upgraded in April 2010 with adoption of the new Energy Law as well as the Energy Efficiency Law. A number of implementing regulations envisaged by the Energy Efficiency Law have been issued, with several yet remaining to be adopted. The new regulatory framework sets forth the basis for energy service companies (ESCOs) functioning, broader third party financing structures in the EE sector, as well as energy performance contracts execution. A requirement for undertaking energy audits has been further introduced for certain types of buildings as well as certain types of equipment such as boilers, along with the related requirement of issuing appropriate certificates. The introduction of EE labelling of household appliances is among other novelties of the Energy Efficiency Law. It further requires the adoption of a three-year energy efficiency action plan indicating a national target for energy savings, annual operational plans for EE improvements in public administration institutions and EE improvement programmes of municipalities. Overall the EE framework remains to be yet brought in line with the EU EE standards as part of the country's EU accession process.

With the basic framework for the sector being set up, several RES projects are being undertaken, including with respect to developing new hydro, wind and biomass energy capacity. The EBRD is supporting improvement in the district heating systems of Montenegro by financing a new biomass heating facility in Pljevlja, in the north-western part of the country. Other notable projects include pending construction of a hydro power plant on the Morača River, as well as a successful on-going project providing for 0% interest bank loans for solar water heating to households.

Further efforts in the RE sector need to be undertaken to fully align the country's RE regulations with the *acquis*, including adoption of a work programme for the development and use of RES over a ten-year period.

A number of EE financings have been made available by international donors, including the EBRD, the World Bank, UNDP, and GIZ, with a few more in the pipeline. Furthermore, a number of technical cooperation projects have been launched with a view to improving the EE framework, including a study by the EBRD on ESCO models and related gap analysis, and study on the implementation of Energy Performance of Buildings Directive. The government has unofficially expressed interest in developing the framework and effective implementation of the ESCO model and relevant institutional development, as well as setting up relevant incentives for attracting financing in the sector. [[Notably, EBRD has launched a regional project Western Balkans Sustainable Energy Direct Financing Facility: Institutional Capacity Building Component, with a focus on developing ESCOs, in order to facilitate development of EE projects in the public sector. The project is part of a broader Regional Energy Efficiency Programme for the Western Balkans, comprising: (i) a component of institutional capacity building as well as regulatory support and new product development for public sector energy efficiency, (ii) setting up credit lines for financing of smaller scale sub projects in public and private sector (including ESCOs), intermediated by local participating banks, and (iii) a component of direct financing for medium-sized renewable energy and energy efficiency measures, including for ESCOs.]]

On a regulatory level, EE regulations are being considered, with a view to their revision in line with the EU standards.

With some progress achieved in introducing a developed RE regulatory framework, the government should make further efforts on putting in place necessary implementation arrangements and providing for appropriate capacity building, as well as setting forth required incentives for the RE projects implementation, including providing training to both public authorities and local players. Further consideration should be given to setting up a specialised RE institutional capacity.

Efforts undertaken by the government of Montenegro in creating a developed and comprehensive framework for the EE sector has yielded little progress so far, and efforts should be intensified in adopting regulations aligned with the EU standards as well as putting in place implementation arrangements enabling both the government and the market players to contribute to effective market development. In particular, the ESCO model shall be given further consideration, with a view to making it an efficient instrument for EE financing. Setting up relevant incentives, including financial ones, such as establishing an ESCO fund, along with providing necessary capacity building for the state authorities and market players will further benefit the country. Awareness campaigns on ESCOs' functioning and benefits should also be considered.

Overall, the country has made some progress towards creating well-functioning RE and EE sectors as part of the negotiations towards its EU membership; however, efforts should be intensified in order to set up a modern and enabling regulatory and institutional framework for both the RES and EE sectors.

Public procurement

Public procurement in Montenegro is regulated by the Public Procurement Law (the PPL), adopted in 2012. Four pieces of secondary legislation supplement the PPL—the Regulation on expressing award criteria into corresponding number of points, the Regulation on standard templates and forms, the Regulation on public procurement records and the Regulation on violation of anti-corruption rules.

The PPL covers both national and local government procurement. It contains specific rules for procurement in the utilities sector; however, it does not extend to public law institutions. Separate legislation regulates PPPs and concessions, and the PPL clearly states that it does not apply to the granting of concessions or the privatisation of the economy. The Public Procurement Administration and the State Commission for Control of Public Procurement Procedures are established by law as a separate regulatory authority and a review body in charge of procurement related issues.

The PPL regulates pre-tendering, tendering and post-tendering procurement phases. As to the pre-tendering phase, it requires the mandatory planning of public procurement and appropriate budgetary authorisation prior to publicising the contract notice. The law also states that a contract profile or general terms and conditions must be prepared prior to launching the tender process and that all tender documents must contain a draft contract. As to tendering process, the law requires that the

procurement process must be conducted by dedicated procurement officers, whose duties are separated from the decision making process and supply management. However, the post-tendering phase is not as comprehensively regulated as the pre-tendering and tendering process. The PPL does not contain any requirements for contract revisions and amendments and contract management capability to be expected from the procurement staff.

The PPL states primary public procurement eligibility rules, which are distinguished from the qualification and technical requirements to be met by tenderers as defined by contracting entity in individual tenders. The PPL provides for public procurement procedures for goods, services and works, including negotiated procedures and framework agreements. The law establishes thresholds; however it fails to specify open or restricted tender as a default procedure. The law contains guidelines on how to draft tender documents for all types of procurement. Moreover, the PPL regulates that relevant information must be published at every stage of the procurement procedure and records must be kept of both procurement procedures and public contracts. The law also provides for the conditions under which a procurement procedure can be cancelled and a "standstill period" to allow tenderers time to submit an appeal to the State Commission for Control of Public Procurement Procedures.

The PPL contains some provisions aimed to control corruption and to prevent the conflict of interest. The PPL gives the tenderer the right to seek remedial action or monetary compensation by initiating an appeal procedure with the State Commission which is simple and inexpensive.

The public procurement legal framework in Montenegro scored high competence on average compared to the legislation in Western Balkans and Turkey. With regard to accountability, stability and competition principles, the legislation is in full compliance with international standards. However, the main regulatory shortcomings are in transparency, efficiency and enforceability indicators and they include:

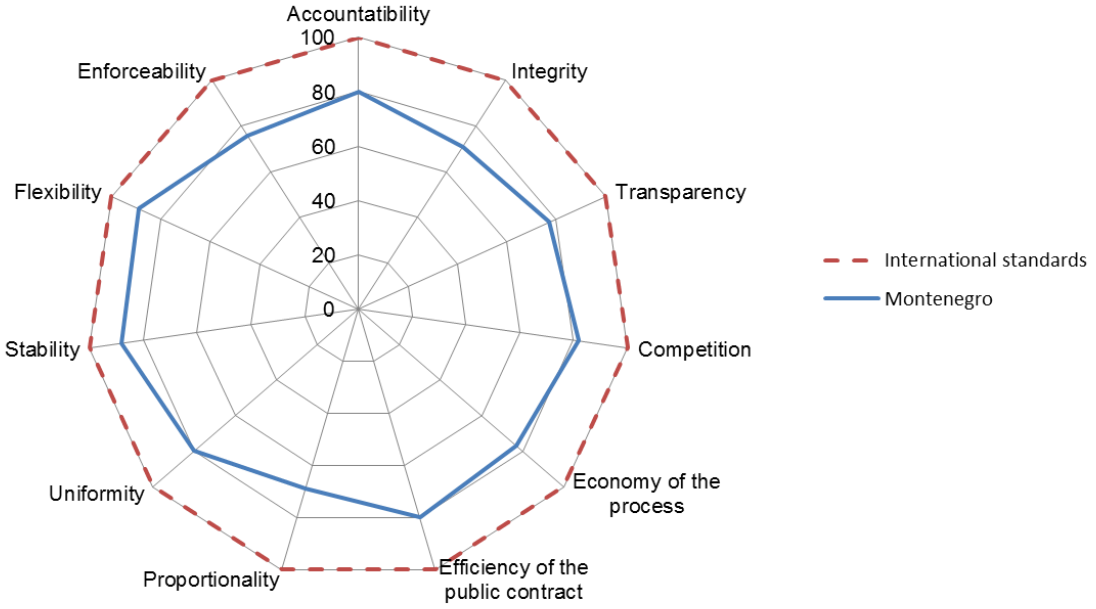
- absence of an efficient disclosure mechanism for secondary and tertiary legislation;
- lack of online publication mechanism as to tender documents;
- lack of the contract management options and also lack of computerised procurement monitoring and administration mechanisms;
- absence of any prohibition on granting domestic preference to local bids;
- lack of addressing the open procedure as the default method for conducting procurements;
- absence of the alternative dispute resolution methods such as arbitration and mediation which could be applied in case any dispute arise from the procurement contracts;
- lack of a regulation as to post tendering phase, specially contract management phase;
- lack of any regulation which prohibits negotiations on final tenders and proposals after they are submitted.

Legal gaps in Montenegro are around 10-20 % in every key regulatory area: regulatory gap in adopting transparency safeguards, regulatory gap in adopting efficiency instruments and regulatory gap in adopting appropriate institutional and enforcement framework measures. Under the Bank's operation, the EBRD Procurement Policies and Rules shall be imposed.

The EBRD assessments conducted in 2010 and 2012 shows that regulatory framework is being modernised in terms of stability and integrity measures. On contrary, results from assessment of the legislation in 2012 suggest that no action has been taken to improve the law since 2010, since all the indicators other than competition scored the same and competition scored lower than in 2010. (see charts 7&8 below).

The PPL in Montenegro needs to be updated to improve the regulatory framework in those areas such as transparency, uniformity, flexibility and efficiency. The reform should aim to improve transparency, efficiency and flexibility by further developing the Public Procurement Portal, Montenegro's e-Procurement platform and also by allowing for tenders and qualification documentation to be submitted in electronic form in all cases, not just when specified by the contracting entity. Additionally, the legislation should be amended in order to provide specific procurement rules for public law institutions

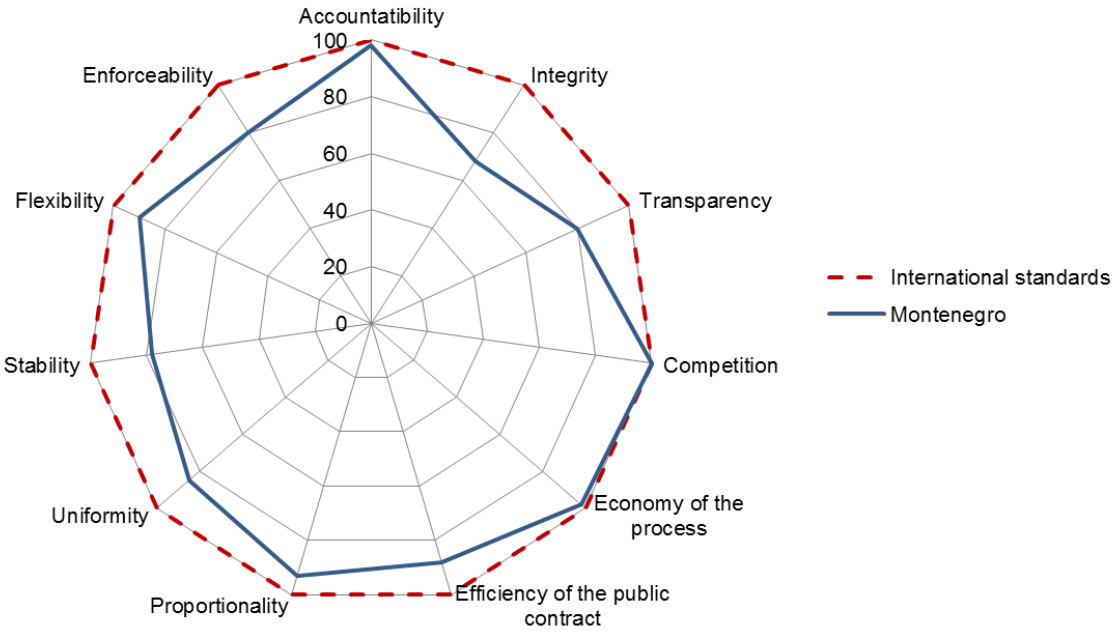
Chart 7 - Montenegro's quality of public procurement legislation



Note: The chart shows the score for the effectiveness of the national public procurement laws. The scores have been calculated on the basis of a questionnaire on legislation that is developed from the EBRD Core Principles for an Efficient Public Procurement Framework. Total scores are presented as a percentage, with 100 per cent representing the optimal score for each Core Principles benchmark indicator. The bigger the "web" the higher the quality of legislation.

Source: EBRD 2011 Public Procurement Assessment

Chart 8 - Quality of public procurement practice in Montenegro



Note: The chart shows the score for the extensiveness of the national public procurement laws. The scores have been calculated on the basis of a questionnaire on legislation that is developed from the EBRD Core Principles for an Efficient Public Procurement Framework. Total scores are presented as a percentage, with 100 per cent representing the optimal score for each Core Principles benchmark indicator. The bigger the "web" the higher the quality of legislation.

Source: EBRD 2011 Public Procurement Assessment

Telecommunications

The main legal basis for electronic communications regulation is the Law on Electronic Communications, 2008.

Montenegro formally liberalised its telecommunications markets at the beginning of 2004, but remaining high licensing fees created a barrier to entry up until 2007. A general authorisation framework for all electronic communications networks and services was introduced in 2008. Fixed telephony and broadband remains dominated by Crnogorski Telekom. The overall penetration of fixed-lines, while decreasing, remains above the regional average though significantly below EU levels. Fixed Broadband penetration matches the regional average though shows a very high growth rate. A competitive environment has emerged in mobile with three operators having similar market shares (Telenor, MTEL and Crnogorski Telekom). Mobile penetration is among the highest in the region and also significantly higher than the EU average. While the regulator (EKIP) has made progress in implementing competitive safeguards, including reference offers for interconnection and wholesale broadband access published by the incumbent, number portability in fixed and mobile markets and regulatory obligations enabling national roaming and access to mobile virtual network operators, their impact has yet to become apparent.

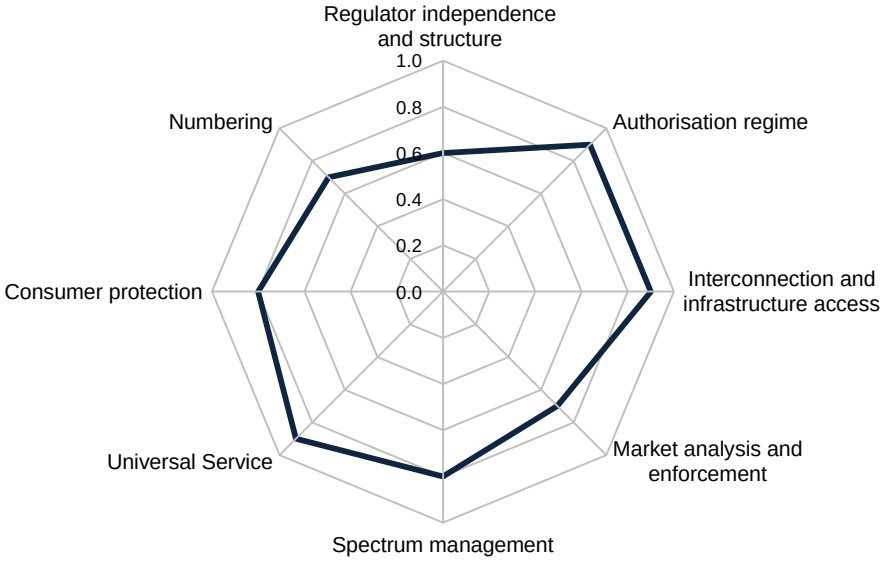
EBRD does not currently have direct investments in the sector in Montenegro; however (at a technical and business level) the presence of an EU-compliant legal and regulatory framework makes the overall environment for the sector attractive for investment, promotes broader competitiveness across the economy and aids social development.

The main reform efforts are understood to be centred on increasing harmonisation of the national regulatory framework with the most recent EU framework (2009), with a new law aimed at that objective understood to be currently under consideration.

Competition in fixed markets remains low, as most of the competitive safeguards introduced in 2011 do not yet appear to be effective. Worryingly, the maximum fine that can be imposed for non-

compliance does not appear to be a sufficient deterrent to anti-competitive behaviour. Competition in the mobile market could enter a new phase when the obligation imposed on the three existing operators to admit virtual network operators is implemented. The very high mobile penetration figures recorded in recent years do not appear to have been sufficiently adjusted downwards to exclude inactive numbers, and the figures are artificially high due to consumers typically holding three SIM cards in an effort to avoid paying the high off-net call charges of these operators, with these charges fuelled by the very high inter-operator wholesale rates. Better regulatory approaches, including the use of modern cost models should eventually reduce these interconnection rates. On the legislative side, while substantial aspects of the current law are broadly consistent with the EU 2003 framework several areas have yet to be fully aligned including independence of the regulator, more effective allocation of inspection and monitoring responsibilities, meaningful penalties for breaches of the law and comprehensive provisions for obtaining rights of way (see Charts 5 and 6).

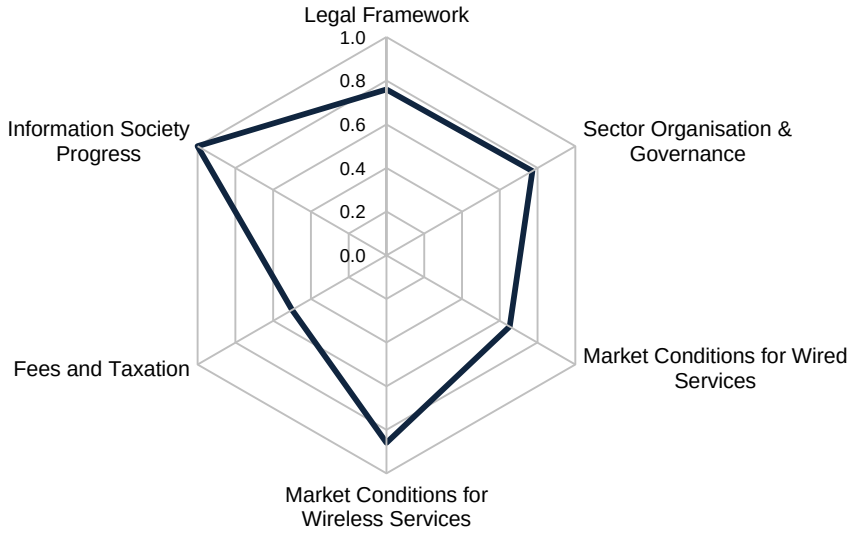
Chart 5 – Comparison of the legal framework for telecommunications in Montenegro with international practice



Key: Extremities of the chart = International best practice
Note: The diagram shows the quality of the legal framework as benchmarked against international standards (European Union). The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the "web", the closer the overall telecommunications legal framework of the country approximates these standards.

Source: EBRD 2012 Electronic Communications Comparative Assessment.

Chart 6: Comparison of the overall legal/regulatory risk for telecommunications in Montenegro with international practice



Key: Extremities of the chart = International best practice
Note: The diagram shows the quality of the legal framework as benchmarked against international standards (European Union). The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the "web", the closer the overall telecommunications legal framework of the country approximates these standards.

Source: EBRD 2012 Electronic Communications Comparative Assessment.

Private Sector Support

Access to finance

Montenegro's legislation regulating access to finance topics includes the Law on Property Rights, Official Gazette of the Republic of Montenegro, No 88/02, the Law on Secured Transactions, Official Gazette of the Republic of Montenegro, No 38/02, the Law on Enforcement and Securing, Official Gazette of the Republic of Montenegro, No 36 /11, the Law on Financial Leasing, Official Gazette of the Republic of Montenegro, No 81/05, and the Banking Act, Official Gazette of the Republic of Montenegro, No 17/08, 44/10, 40/11.

The Law on Property Rights provides a detailed, comprehensive and well developed framework for creating a mortgage over immovable property. A consensual mortgage is created by execution of a written agreement between the owner of an immovable property whose signature needs to be certified by the competent body and the mortgage creditor. A unilateral mortgage can be created on the basis of a pledge statement prepared by the owner by which he unilaterally obliges himself to bear, in the case the debt is not paid out when due, the satisfaction of the creditor's secured claim from the value of mortgaged immovable property, in the manner prescribed by law. The pledge statement corresponds in form and content to the mortgage agreement. Perfection of mortgages is done by registration into the cadastre of real property. The law allows for the securing of conditional, future and revolving loans as long as the maximum amount of debt is registered. The mortgage secures the entire claim, interests and other ancillary claims and enforced collection costs.

While authorities issued a campaign for registration of the property in the cadastre, it appears that this is still work in progress and that title over all the property in the country cannot be established with certainty. The law regulating restitution prescribes that encumbrances (including mortgage) created before the law came into force cease when the restitution decision becomes final. Thus, there still may be subsequent claims for restitution that may affect mortgagor's right to property. Cadastral data is available on the website of the Montenegrin Real Property Administration.

According to the Law on Property Rights, enforcement of mortgage may be by out of court and court enforcement. In case of extrajudicial sale, the selling agent is a person authorised by an agreement between the parties. The sale is done via public auction (Article 342 Law on Property Rights). The mortgagee may appoint the bailiff, an attorney at law or real estate agency to administer enforcement (Article 201 of the Law on Enforcement and Securing). In case of a court-administered sale, this can be done by public auction or direct sale. In general, this shall be done by a public auction, held in the office of public enforcement officer. Parties however may agree on the sale by direct negotiation during the enforcement proceedings (Article 172 of the Law on Enforcement and Securing).

Provisions on taking pledge over movable assets and rights are regulated in the Law on Secured Transactions No. 01-2178/2 adopted on 19 July 2002 and applicable as of 1 January 2003. Any movable property that may legally be transferred pursuant to the applicable law may serve as collateral and general description sufficient to reasonably identify the collateral is sufficient. Future property can be collateralised as well, including uncut timber, future crop and future livestock as well as fluctuating pool of assets such as inventory. Art. 13 paragraph (2) of the Law on Secured Transactions provides that the assets are transferred free of pledge if sold in the ordinary course of pledgor's business and the Law defines what is considered an ordinary course of business. Unless provided in the security agreement or by a written waiver, a pledge secures the entire amount of a secured obligation, including unpaid principal, interest, penalties, costs of repossession, maintenance, sale, and any other obligations secured. Article 4 of the Law provides that a pledge may secure one or more obligations and that the secured obligations may be identified generally or specifically. Future obligations can be secured by pledge.

To perfect a pledge a Notification Statement must be registered into the records of the Registration Office of a Notification Statement (Secured Transactions Registry of the Commercial Court in Podgorica) can be done electronically by authorised persons authorized persons (lawyers and commercial banks) or in a written form or by telefax by everyone else. The effective time and date of the registration shall be the time and date of the Notification Statement as presented to the Registration Office. The registry is centralised and can be searched on-line against the name of the pledgor, the serial number of the pledged assets or registration number.

Extrajudicial sale of collateral is provided for by Property Rights Law. If a pledgor has the status of a business entity, the pledge contract may envisage that a pledgee has the right to sell the collateral through extra-judicial public sale, if his claim is not satisfied when due. Judicial enforcement is covered by the Law on enforcement and securing.

Financial leasing is regulated by the Financial Leasing Law. The law provides a legislative framework for undertaking financial leasing transactions. Leasing companies are not regulated by the Financial Leasing Law. The Banking Act prescribes that supervised banks and micro-credit institutions can provide financial leasing services but this does not effectively exclude non-FI companies

from providing financial leasing services. There are five active providers of leasing services (1 bank and 4 private companies) with 1650 contracts signed in 2011 with more than 95% being different type of vehicles.

There is no special legislation of factoring apart from general "assignment of claim by contract" provisions of the Obligations Law which provides a basis for assigning account receivables. As a result there is no definition of factoring services or types of factoring transactions which can help increase legal certainty of the factoring transactions and hence reduce involved costs and risks of re-characterisation of transactions. Traditional or reverse factoring is almost non-existent in Montenegro.

Montenegro has a very developed and well-functioning credit bureau (the Credit Bureau of Montenegro) which automatically collects data from banks, leasing organizations, savings banks, insurance companies, funds, public companies and public utilities companies, trade organizations, telecommunication companies, and others. The system's users can at the same time be those that are data resources, but also other interested institutions and individuals. There is a developed feedback system for reporting and dispute processing. Clients, who have objections, are as a result of this system, given the possibility to submit a dispute on data accuracy, at the office of any user of the CBME services. The system itself identifies the data source concerned by dispute, and forwards the dispute for further processing. The data sources themselves have a simple way of correcting the inaccurate data within 24 hours of the dispute being submitted. Clients are automatically informed by e-mail that the dispute is processed.

Improving access to finance, especially for SMEs, is an important part of the EBRD's mission. There are no currently reported reforms in the sector.

Supporting development of factoring services by introducing legislation on factoring and developing reverse factoring programs and platforms might help to improve overall access to finance of SMEs by giving credibility to the service through supervision, making factoring services more transparent and legally certain

Capital Markets

Under the current regulatory and legal framework governing the local debt capital markets of Montenegro, the primary regulatory institutions are the Ministry of Finance (the "MOF"), the Securities and Exchange Commission (the "SEC") and the Central Bank (the "CBM").

There are several important laws and regulations that regulate Montenegro's primary and secondary capital market activity. The basic legislation on the securities market is the Law on Securities enacted in 2000 (as amended). The Law on Securities regulates the types of securities, their issuance and trade, the rights and obligations of the subjects involved in the securities' markets and the scope and activities of the securities markets regulator in Montenegro. Other relevant legislation includes the Business Organization Law, the Law on Business Organization Insolvency, the Law on Investment Funds and the Law on Banks.

The Montenegro Stock Exchange (the "MSE") is the only operating stock exchange, however, until the end of 2010 Montenegro had two stock exchanges, MSE and NEX Montenegro Stock Exchange, which were merged in 2011.

The legal framework governing capital markets is rather basic and displays various drawbacks. Among the major flaws, it is worth noting the lack of comprehensive legislation on self-regulatory organisations, bonds and derivatives. The Montenegro capital market is rather nascent and, for example, IPOs are not common and information required to be included in the prospectus is not comprehensive and does not seem to be reliable as to identification of risks of the proposed investment. Private enforcement mechanisms are generally lengthy and burdensome.

In Montenegro, the Bank focuses on the private corporate sector, tourism and property sector where the Bank plays an important role by providing both funding and political comfort to foreign investors.

In terms of financial markets, there seem to be no on-going reform, except the USAID work on the integration of stock exchanges from Southern and Eastern Europe in order to increase their attractiveness to issuers and investors. Within this project, the USAID is planning to implement a special IT system that would allow for more efficient execution of cross-border trades. The involved exchanges, including the MSE, established various working groups, including a legal and regulatory group, which is tasked to identify whether any legal or regulatory changes would need to be introduced for the implementation of this project. USAID is discussing possible cooperation on this project with the EBRD.

It is advisable that the regulator considers improving the required content of the prospectus to the level that would allow potential investors to take an informed investment decision when purchasing securities. This would, for example, include higher disclosure standards required from prospective issuers. The legal framework governing enforceability of derivatives and close-out netting could be considered to be developed in the longer term.

Capital market activities in Montenegro are rather low, however, the government could consider addressing the drawbacks relating to (i) the content of the prospectus; and (ii) derivatives.

Corporate Governance

The corporate governance framework in Montenegro is primarily detailed in the *Business Organisation Law*, enacted in February 2002, as amended. According to this law, commercial activities can be organised as individual entrepreneurships, joint stock companies ("JSC"), limited liability companies, general partnerships, limited partnerships and foreign company branches. JSCs are organised under a one tier system.

Corporate governance of banks is detailed in the *Law on Banks*, enacted in February 2008. The Law regulates the organisation, operation, management and control of activities of banks and financial institutions.

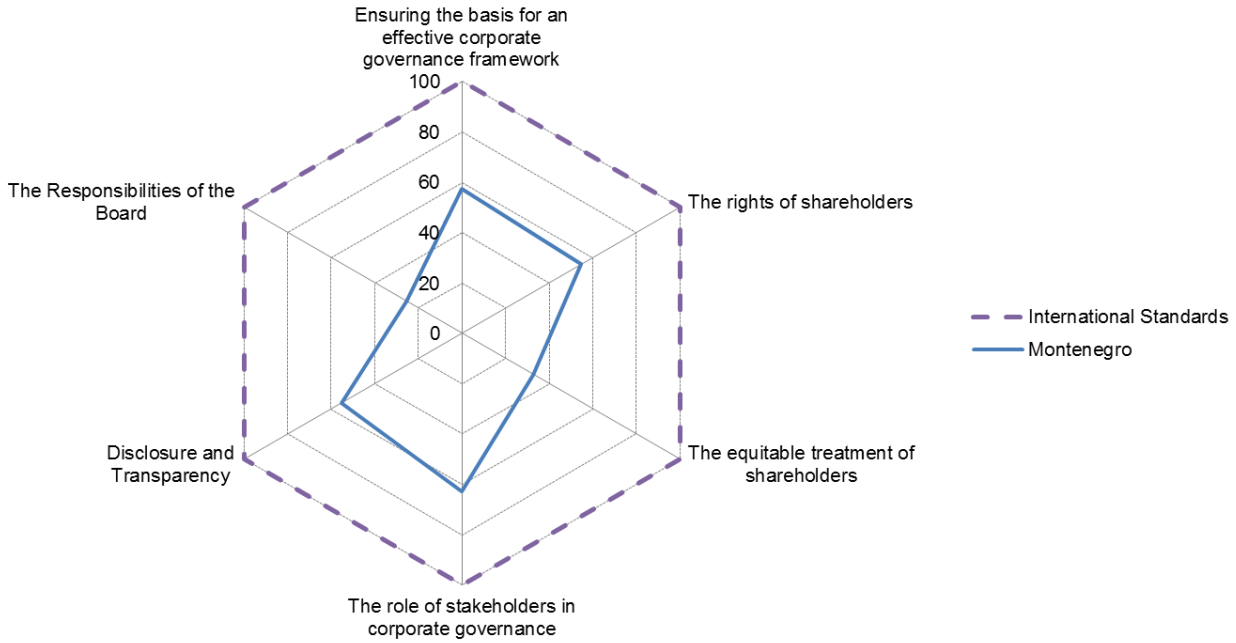
The *Law on Accounting and Auditing*, issued in 2002, as amended, requires companies to adopt International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) as promulgated by the International Accounting Standards Board (IASB).

In March 2011 the Parliament adopted the *Law on Takeovers of joint stock companies*, partly aligned with the Takeover Bids Directive.

In May 2009, the Montenegro Stock Exchange adopted a *Corporate Governance Code* recommending JSCs whose shares are listed on the stock exchange to comply with the recommendations included in the Code or explain any deviation (so-called "*comply or explain*" mechanism). The Code deals with shareholders' rights, general shareholders' meeting, board of directors, board committees, remuneration of directors, company's executive body, company's secretary, supervision and control activities, disclosure of company's information, and corporate conflicts. A Scorecard for reporting compliance with the code has been adopted by the Stock Exchange.

According to the results of the EBRD's 2007 Corporate Governance Sector Assessment legislation under which the quality of corporate governance in force in November 2007 was assessed, Montenegro resulted to be in "*very low compliance*" with the OECD Principles of Corporate Governance, showing a framework under an urgent need for reform in all sectors under consideration (see Charts 11 and 12). Since then, the corporate governance legal framework has been amended several times and considerably improved. Pursuant to the 2011 and 2012 Progress Reports issued by the EU, Montenegrin legislation on company law is largely consistent with the EU acquis, but some discrepancies remain to be addressed. In particular, an independent public oversight body for auditors and a quality control system need to be clearly planned and established.

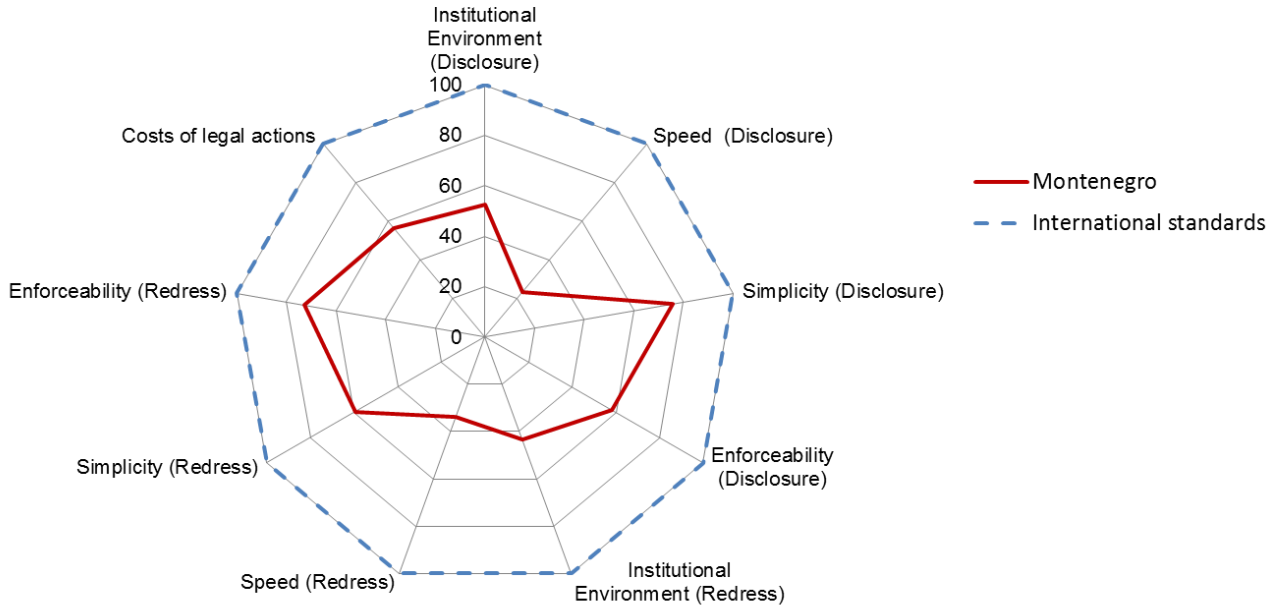
Chart 11 – Quality of the Corporate Governance Legislative Framework in Montenegro



Note: the extremity of each axis represents an ideal score, that is, legislation fully in line with the OECD Principles of Corporate Governance; the fuller the 'web', the better the quality of the legislative framework.

Source: EBRD Corporate Governance Assessment 2007

Chart 12 – How the corporate governance framework works in practice in Montenegro



Note: the extremity of each axis represents an ideal score: the fuller the 'web', the more effective the corporate governance framework.
Source: EBRD Corporate Governance Assessment 2007

The Corporate Governance Code undoubtedly provides some good guidance on how to shape corporate practices of listed companies, but it omits to detail some key aspects of corporate governance. For example, the Code recommends that companies should establish board committees (i.e., Appointments, Remuneration and Audit committees) but it fails to provide guidance on how the composition of these committees should be. The Code also recommends companies to consider having independent directors on their board but it only provides limited guidance on what "independent" means. Further, it is not clear what the role of the independent director should be within the board or committees. Further, the Code's implementation is quite limited: based on the information available on the Montenegro Stock Exchange, it seems that only five companies have adopted the Code.

When turning the attention to corporate governance of banks, the recent EBRD assessment highlighted that banks are required to create audit committees, made by a majority of persons "*not connected with the bank*". It seems that "*not connected*" persons are considered to be "*outsiders*" and not independent board members. The effectiveness of this structure should be assessed, as it might not be the most efficient in order to establish sound "lines of defence" within banks. Further, banks' compensation practices do not seem to be aligned with prudent risk management.

The issues outlined above are all relevant for the EBRD direct investments in Montenegro. However, no investee companies' corporate governance related suits have been reported.

The framework should clarify the role of independent directors on boards and board committees and provide a comprehensive definition of "independence" applicable to both listed companies and banks; and assess the effectiveness of the audit committee and consider whether to transform it into a proper board committee, made only of (independent) board members.

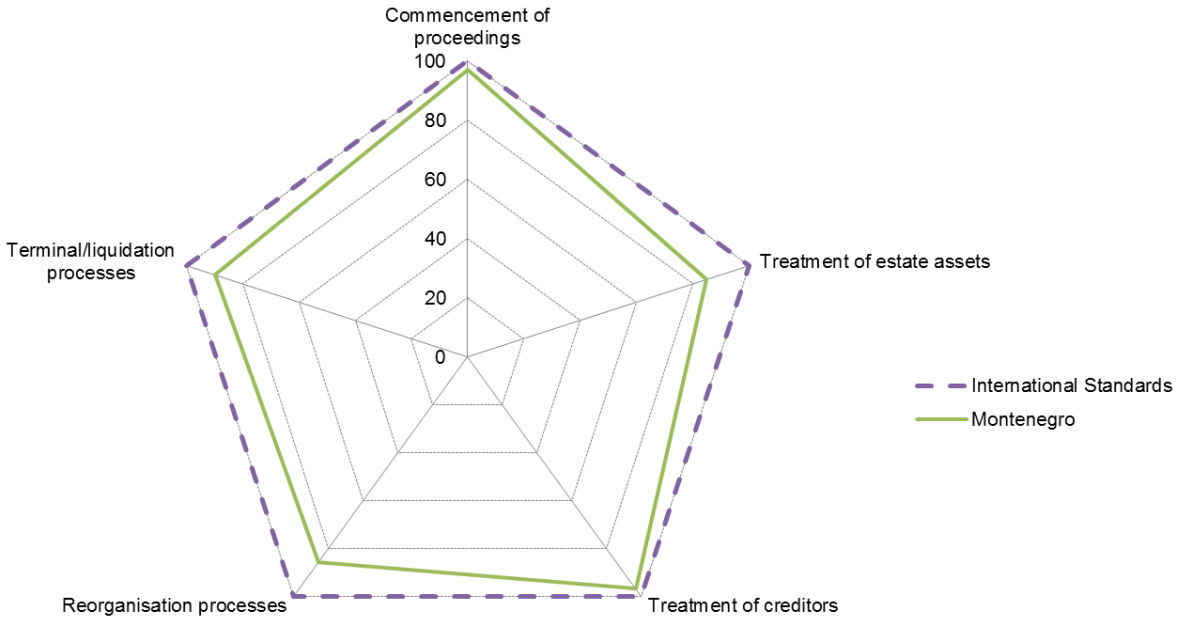
The Montenegro corporate governance framework has recently improved but room for further improvement remains, especially in ensuring that the legal provisions are well understood and implemented.

Insolvency

Montenegro's legal framework in the insolvency sector is based on the Law on Insolvency (Official Gazette of the Republic of Montenegro, no. 01/11) (the "Insolvency Law"). The Insolvency Law contains two main procedures for companies in financial difficulty: (i) bankruptcy resulting in liquidation; and (ii) reorganisation.

The Insolvency Sector Assessment (the "Assessment") completed in late 2009 concluded that Montenegrin insolvency law was of very high quality with no areas of significant weakness (see Chart 13). In particular the Assessment noted that the Insolvency Act was strong in the areas of commencement of proceedings, creditor rights and liquidation. Nevertheless the Assessment noted that provisions in the Law relating to insolvency administrators would benefit from review. Since the Assessment, a new Insolvency Law has been introduced into Montenegrin legislation (effective as of 20 January 2011) which has closely followed the provisions set out in the UNCITRAL Guide on Insolvency Law 2004.

Chart 13 – Quality of insolvency legislation in Montenegro



Note: the extremity of each axis represents an ideal score, that is, legislation fully in line with international standards such as the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group's "Legislative Guidelines for Insolvency Law"; and others. The fuller the 'web', the better the quality of the legislative framework.

Source: EBRD Insolvency Sector Assessment 2009

The reforms introduced by the new Insolvency Law are wide-ranging and include: (i) redefining insolvency criteria as a *permanent inability to pay debts* (evidenced by non-settlement of debts within 45 days of the due date or suspension of all payments for 30 consecutive days or more and over indebtedness (where the company's debts are greater than the value of its assets) and enabling insolvency proceedings to be initiated where the debtor fails to adhere to the reorganisation plan or if such plan is adopted fraudulently; (ii) changes to the procedural provisions that relate to the insolvency estate, the ranking of creditors and the settlement of insolvency creditors (secured creditors are entitled to full settlement of their claims from secured assets before any other preferential creditors); (iii) redefining of the consequences of the insolvency procedure, including provisions related to important matters such as the right to set-off and conditional claims (clear provisions have been introduced to restrict set-off of rights acquired after the initiating of insolvency proceedings or 6 months before the insolvency petition where the creditor knew or ought to have known of the grounds for insolvency); (iv) changes to the regime for the challenging of the transactions of the insolvency debtor (widening provisions to include regular and irregular settlement, direct and wilful harm to creditors, transactions at undervalue or without consideration as well as transactions with related parties); (v)

further provisions regulating reorganisation, as well as the detailed regulation of the reorganisation plan; and (vi) new provisions regulating cross-border insolvency and international cooperation.

Under the Insolvency Law, a reorganisation plan may be filed from the outset with the insolvency petition, effectively as a 'pre-prepared reorganisation plan' with relevant support from creditors, or 90 days (extendable by 30 days) following the opening of insolvency proceedings. As a rule secured creditors cannot enforce their security against the debtor in insolvency proceedings, although there are some important exceptions, notably if it can be demonstrated that the collateral is not adequately safeguarded or is depreciating in value or whether the collateral is worth less than the secured claim and it is not essential for a reorganisation. It is worth noting that security created 60 days prior to the initiation of insolvency proceedings will be automatically invalid. In addition to preventing the initiation or continuation of proceedings against the debtor, the Insolvency Law contains an important safeguard for reorganisation in that it provides the bankruptcy administrator with a right to resume performance of a contract and ensure that the counterparty performs its obligations akin to under the US Chapter 11 reorganisation proceeding.

The Insolvency law is cross-sector and affects all sectors where the EBRD has either an equity or a debt stake. Moreover, it impacts on the willingness of creditors generally to invest in the country and therefore also to enter into joint ventures with the EBRD.

We are not aware of any current or proposed reforms to the Insolvency Act.

Montenegro has recently introduced further improvements to its insolvency legislation, which have raised the overall standard of the legislation still further. Subject to consideration of how the Insolvency Law operates in practice, we have no significant policy recommendations at this stage.

Montenegro has advanced insolvency legislation that promotes the reorganisation of businesses in financial difficulty, as well as the liquidation of non-viable companies and contains detailed provisions regarding the more complex areas of insolvency law such as on avoidance of transactions and insolvency set-off.

[1] www.venice.coe.int/docs/2005/CDL(2005)096-e.pdf