

A map of Russia and surrounding regions, including parts of Europe, the Middle East, and Asia. Major cities like Moscow, St. Petersburg, and Vladivostok are labeled. The map is overlaid with text.

COMMERCIAL LAWS OF THE RUSSIAN FEDERATION

August 2006

AN ASSESSMENT BY THE EBRD

This Assessment was last updated during the preparation of the 2006 EBRD Strategy for Russia and reflects the situation at that time. It does not constitute legal advice. It was prepared by the Office of the General Counsel of the EBRD. For further information please contact ltt@ebrd.com

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Basis of Assessment: The assessment contained in this document is grounded on the experience of the Office of the General Counsel in working on EBRD legal reform and investment activities in Russia. The assessment also draws on legal assessment work conducted by the Bank (see www.ebrd.com/law). This publication does not constitute legal advice.

1. Overall Assessment

The steady progress of legislative reforms seen in 2005 has continued in 2006. Rapid changes and improvements in most sectors of the Russian economy require a business oriented, modern and more flexible legal framework.

Amendments to the Law ‘On Joint Stock Companies’ in December 2005 have brought about significant improvements in the area of corporate law. The amendments target purchasers of large shareholdings, requiring them to put offers out to tender, and introduce “squeeze out rules”, (i.e. a dominant shareholder holding more than 95 % of an open joint stock company’s voting shares as a result of a public offer can force the minority shareholders to sell their shares). Recent regulations made some of the provisions of the Corporate Governance Code mandatory, which should raise investors’ confidence in the management of Russian companies. The supervision of capital markets has been delegated to a new market regulator, the Federal Service for Financial Markets, which should help amend the flaws noted in the supervision of the market. Generally, the securities market framework requires further changes to improve settlement and prudential requirements for market participants. The Federal Law “On Special Economic Zones”, adopted in August 2005, is designed to stimulate investment in Russia. It provides for a special regime (including tax and custom duties exemptions) for entrepreneurial activities carried out in such special economic zones.

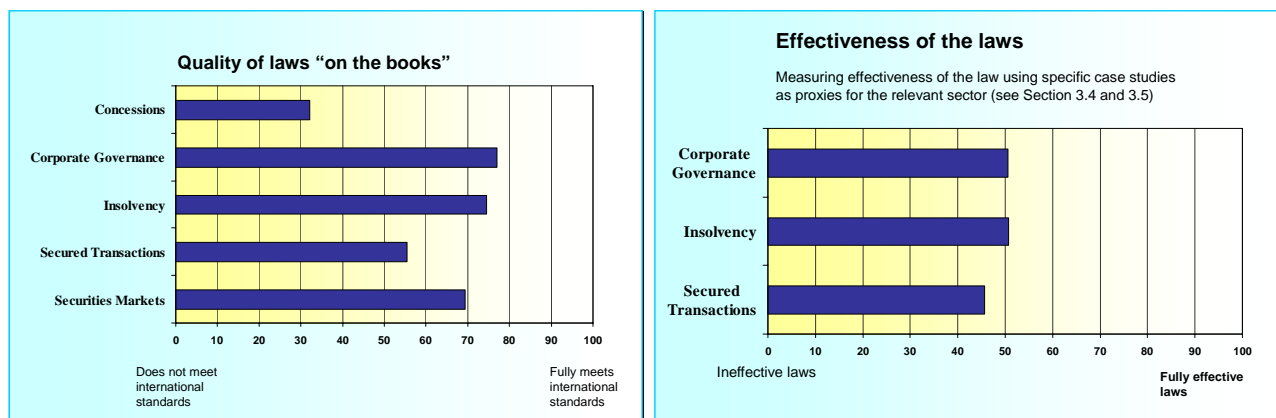
A new Law on Concessions was adopted in 2005, creating a legal framework that enables private participation in the provision of public services and creates a viable model for public-private partnership in Russia. However, a number of issues in the new law seem to be either over-regulated or vague. A consistent approach to applying the new law by the Federal, regional and municipal authorities, as well as by the courts is necessary to ensure its successful implementation.

The State Duma recently adopted amendments to the Insolvency Law that remove some discrepancies with the Civil Code regarding the priority ranking of creditors. Other adopted amendments are designed to contribute to the efficiency of insolvency procedures, and take into consideration both the managers of the insolvent companies and the bankruptcy administrators.

The framework for secured transactions continues to fall short of providing certainty and predictability regarding registration and enforcement proceedings. Current efforts to complete the privatisation of market participants, liberalise the market and enable secondary legislation have brought about significant changes in the telecommunications sector

The implementation of legal reforms has however been impaired by inconsistent application of the laws by federal, regional and municipal authorities, as well as by the judiciary. Chart 1 below shows the gap between the quality of the laws “on the books” and the practical application (effectiveness) of such laws in certain sectors. Further efforts are needed to achieve a positive change in the public perception of the stability of the business climate in Russia.

Chart 1 – Snapshot of country’s commercial laws



Source: EBRD legal assessments 2002-2005

2. The Legal System

2.1. Constitution and courts

The Constitution of the Russian Federation was adopted by National Referendum in 1993. According to the Constitution, Russia is a democratic, federal republic consisting of 89 subjects of the federation (regions, ethnically based autonomous republics, territories and the federal cities of Moscow and St Petersburg). State power in Russia is exercised on the basis of its division into the exclusive powers of the federal government, powers jointly exercisable by the federal and local authorities, and powers allocated exclusively to the local authorities.

The President of the Russian Federation is the Head of State elected for a four-year term by popular vote. He has wide authority in the sphere of judicial appointments, dissolution of the parliament, and formation of the government. The next presidential elections are scheduled to take place in 2008. The President, Vladimir Putin, is expected to respect the constitutional ban on a third presidential term in office and not to run for re-election. Even though constitutionally a democracy, Russia is largely perceived as an authoritarian regime - a distinctive feature of Putin’s administration. However, according to the opinion polls, most Russians are not troubled by this trend and Putin continues to be relatively popular with the public.

The legislative branch of the government is represented by the bicameral parliament (Federal Assembly) which consists of the 450-seat State Duma (lower house, elected every four years by popular vote) and the 178-seat Council of the Federation (upper house comprised of representatives of the regions - 2 per region). The State Duma considers and passes federal laws which are then approved by the Council of the Federation. The President can dissolve the State Duma if the latter expresses a vote of no-confidence in the Government twice in a three month period and if it rejects three consecutive candidates for Prime-Minister.

The Executive branch of the government is represented by the Government of the Russian Federation. The Head of the Government is appointed by the President with the consent of the State Duma. Federal ministers are appointed by the President at the suggestion of the Head of the Government.

In 2004, a major reform of the executive branch was carried out aimed at establishing more efficient structures and reducing bureaucracy inside the government. As a result, the government is now

comprised of the Head of the Government, the federal ministries, the federal agencies and the federal services.

According to the Constitution, the judicial system of the Russian Federation comprises three major components. Constitutional jurisdiction is overseen by the Constitutional Court, which rules on the conformity of federal and local legal acts/documents with the Federal Constitution and hears competency disputes between government bodies. Courts of general jurisdiction, with the Supreme Court as the highest judicial authority, rule on civil, administrative and criminal matters. Commercial (arbitration) courts, with the Supreme Arbitration Court as the highest judicial authority, decide economic disputes. Judges of the Constitutional Court, Supreme Court and Supreme Arbitration Court of the Russian Federation are appointed by the Council of the Federation after the approval of the President. Judges in other federal courts are appointed by the President.

The court system is comprised of federal courts (the Constitutional Court, the Supreme Court, supreme courts of the republics, regional courts, courts of the cities of federal status, courts of autonomous regions, district courts, military and specialised courts, High Arbitration Court of the Russian Federation, federal arbitrage cassation courts, arbitral appellate courts, arbitrate courts of the subjects of the federation, and courts of the subjects of federation, constitutional (statutory) courts and magistrates).

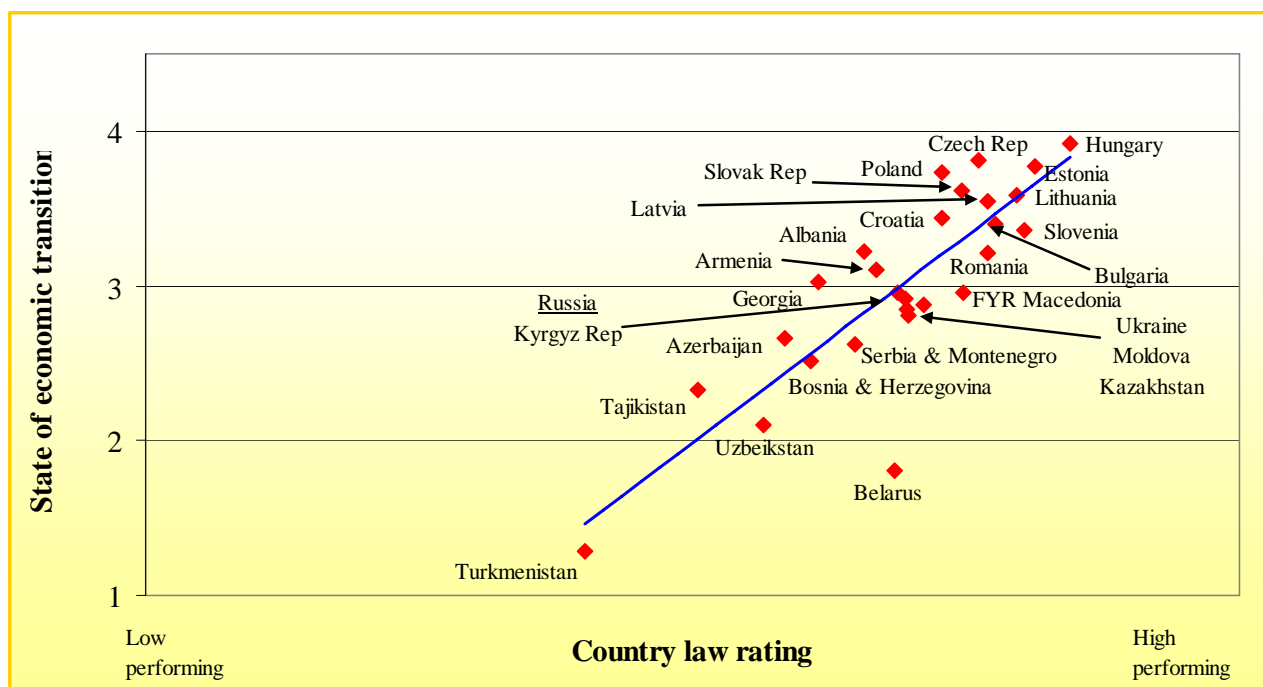
Judicial reform has been among the top priorities of the current administration and there have been significant attempts to increase judicial independence (including an increase in judges' salaries).

2.2. Relationship between legal transition and economic progress.

Russia has made significant progress in establishing the rule of law and democratic institutions. Experience in the EBRD countries of operations appears to suggest that legal transition and the pace of economic transition progress or regress hand in hand. Given the positive correlation throughout the Bank's countries of operations between these two dimensions, i.e., legal transition, and overall economic progress, it is reasonable to expect that the future success of the transition process in Russia will be dependent in part on improving the quality of the enforcement process.

Russia's progress in both areas is improving (see Chart 2). Steady success in implementation of the new features of the legal framework should further advance the overall development of the country.

Chart 2 – Rule of law and progress in transition in the EBRD countries of operations



Source: EBRD

Note: The **horizontal axis** measures the performance of commercial and financial laws. The **vertical axis** displays the EBRD transition index as an average of transition indicators between 1997 and 2003, with 1 referring to very early transition stages, and 4 referring to an advanced transition level.

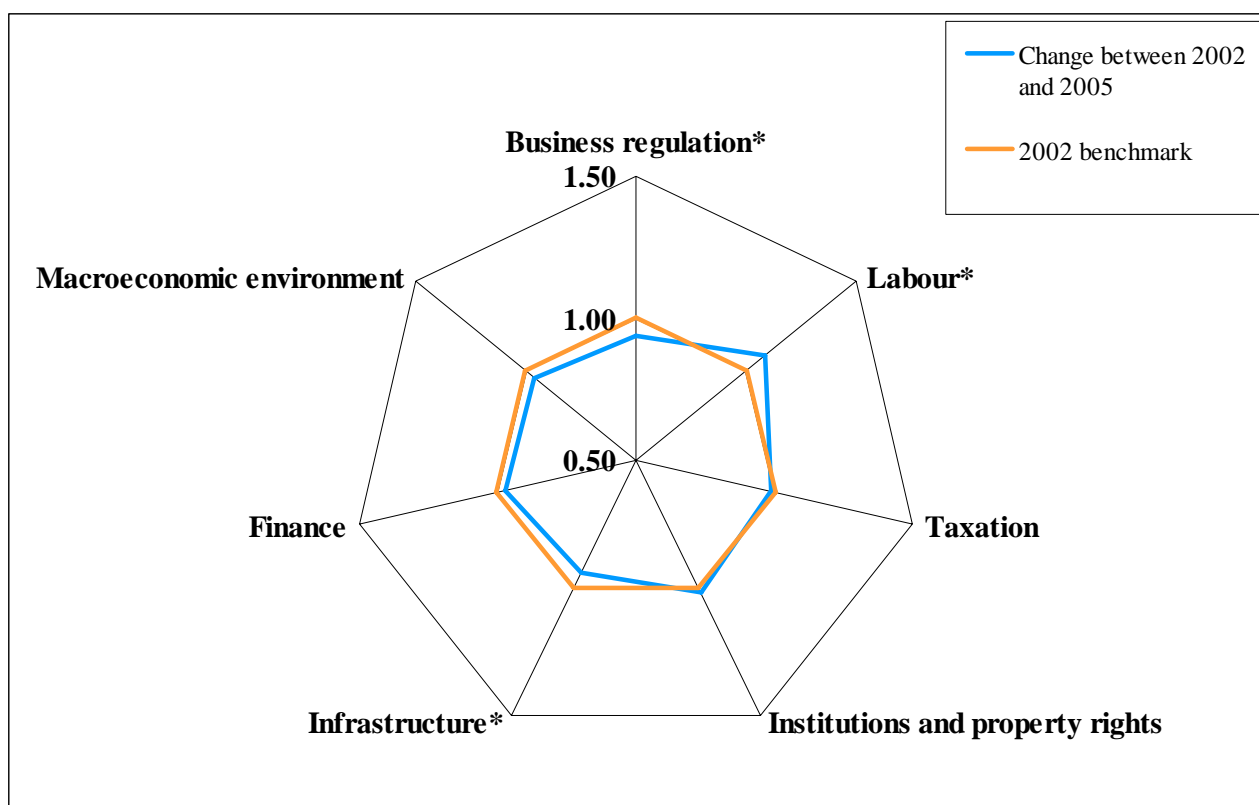
2.3. Implications for the investment climate

The Russian government continues to state its commitment to further developing and strengthening an attractive investment environment in the country.

Russia is currently undergoing a significant investment boom. In 2005, capital inflow exceeded capital outflow for the first time. The rate of foreign direct investment in the first half of 2006 equalled that of the whole previous year. Moreover, the structure of investments is becoming more diversified - investments are no longer concentrated in just the oil and gas sectors but are spreading to other sectors as well. The State Duma has, in the past couple of years, passed a number of laws that are expected to contribute to the improvement of the investment climate in Russia. The government has also signalled its intention to reduce the scope of the state's regulatory function and to make legislation more transparent.

The process of creating an attractive investment environment continues to be impeded, however, by shortcomings in the legal and tax systems, continuing corruption, poor business ethics, and inconsistent interpretation of the law. Increased dedication on the part of government will therefore be required if the private sector's faith and confidence in the investment environment is to be increased. The slow pace of improvement in key sectors of the business environment is depicted in the graph below (see Chart 3). The labour sector (the weighted average of labour regulations, and the skills and education of available workers) even shows a significant deterioration over the period.

Chart 3 – Changes in the business environment in transition countries, 2002-05



Sources: BEEPS 2002 and 2005

Notes: The spider charts show changes in seven aspect of the business environment between 2002 and 2005. The 2002 data represent a benchmark of no change. Where the line falls inside the benchmark, this represents an improvement in that aspect of the business environment. Where the line falls outside of the benchmark, this represents a deterioration in the business environment. Wherever the changes are statistically significant, the relevant categories are marked with an asterisk. The business environment was assessed on a scale from 1 (no obstacle) to 4 (major obstacle).

EBRD operations in Russia intended to contribute to economic development will focus on investments in the following sectors: infrastructure (transport, municipal and the environment), power, corporate (with an increased emphasis on equity investments, industrial restructurings, small and medium enterprises ('SME') and micro investments via private equity funds, framework lending schemes and financial intermediaries).

3. Evaluation of selected commercial laws

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, concessions, corporate governance, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of laws (also referred to as "effectiveness").

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

3.1. Capital markets

The principal legislation governing the Russian securities market includes the Civil Code - enacted in December 1994 and amended in 2003; the Law on the Securities Market (“SML”) – enacted in April 1996 and amended several times, most recently in March 2005; and the Law on the Protection of Rights and Lawful Interests of Investors on the Securities Market (“LPR”) - enacted in March 1999 and last amended in December 2004.

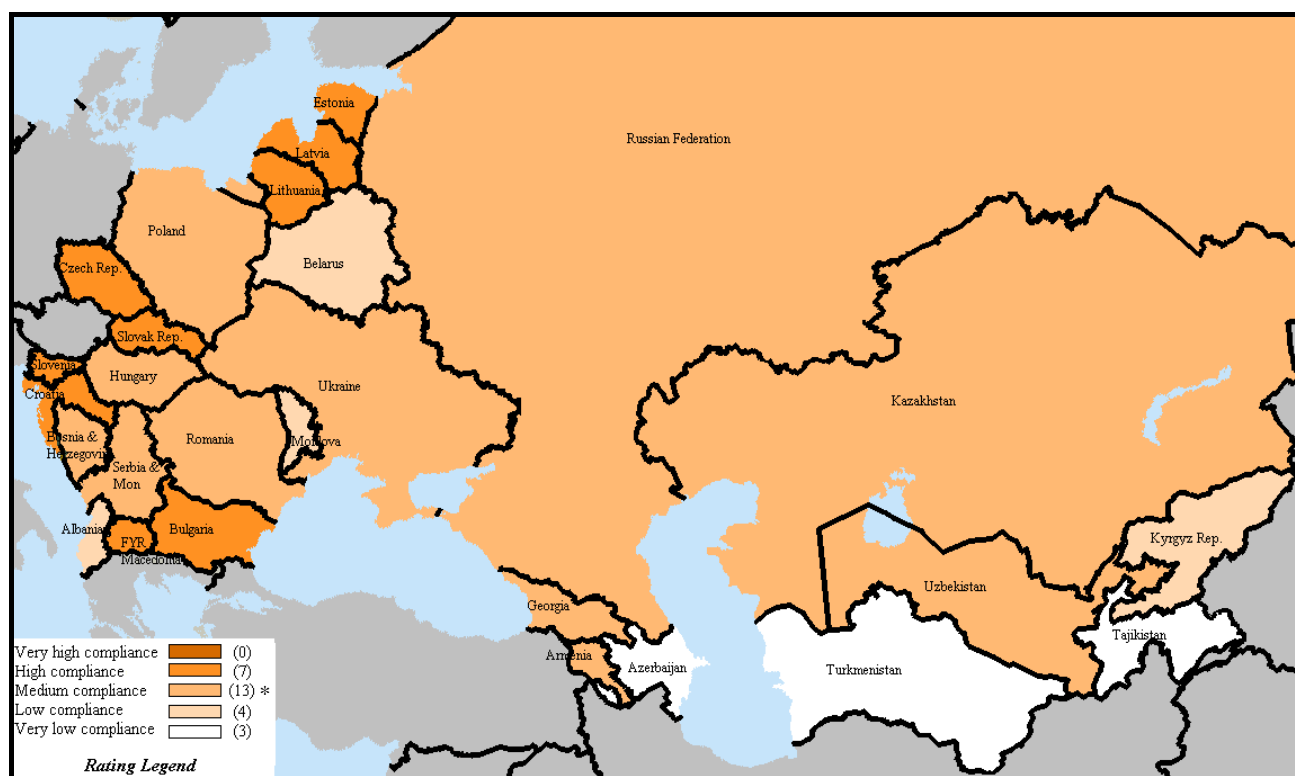
President Putin abolished by decree effective 12 March 2004, the Federal Commission for the Securities Market (“FCSM”), and transferred its control and surveillance powers to the Federal Service for Financial Markets (“FSFM”), operating directly under the jurisdiction of the federal government. The FSFM is the federal executive body that controls and supervises activity in the financial markets, including the activity of exchanges, and issues the relevant regulations. It also regulates the investments of pension funds.

The Moscow Interbank Currency Exchange (MICEX) is the largest financial exchange operating in the Russian Federation. Trading in non-government securities was launched in March 1997. Later that year, following the example of the MICEX, regional currency and stock exchanges in Samara, Rostov-on-Don, St. Petersburg, Nizhniy Novgorod and Yekaterinburg also launched trading in bonds and stocks. The financial crisis of 1998 had a disastrous effect on the Russian stock market and the MICEX Summary Stock Index (the MICEX SSI) dropped to its historically lowest level of 20.92 units. Since then the market has continued to grow and at the end of 2004, the MICEX Index¹ reached 552.22 points with 413 securities of 267 issuers traded in the MICEX.

According to the findings of the EBRD’s Securities Market Legislation Assessment in 2004, the Russian Federation is a country whose existing securities market legislation (i.e. “law on the books”, not how the relevant legislation is being implemented) when assessed against relevant international standards was rated among “medium compliance” countries. The assessment was updated in 2005 and the results confirmed the medium compliance rating. (See Chart 4) The few changes noted in the legislation mostly relates to the licensing of Market Intermediaries where the powers, including sanctioning of the FSFM have been strengthened.

¹ On 28 November 2002, the name "The MICEX Summary Stock Index" was changed for "The MICEX Index". The MICEX Index is an effective capitalization-weighted index of the market of most liquid stocks of Russian issuers admitted to circulation on the MICEX.

Chart 4 – Quality of securities market legislation in the EBRD Countries of operation

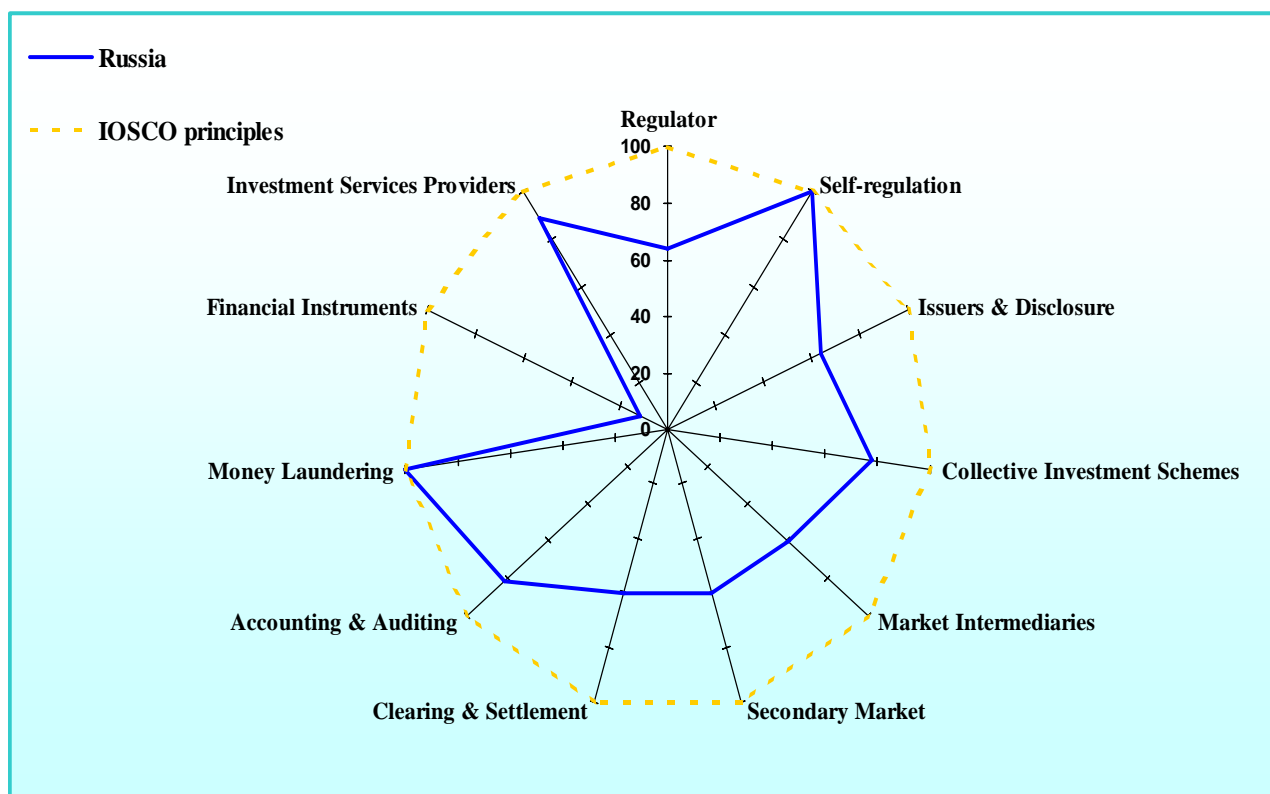


Source: Securities Markets Legislation Assessment 2005

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

The Assessment demonstrates room for improvement in the financial instruments, market supervision, clearance and settlement and prudential requirements for exchanges and intermediaries. (See Chart 5) For example, the regulator should be subject to a code of conduct and its activities made more publicly accessible, it should have investigatory and rule-making powers and should also cooperate with regulators from other jurisdictions. When considering the "financial instruments" section, the assessment revealed that financial instruments are not specifically defined in applicable securities legislation -although this term is used in normative acts of the FSFM - while the legislation regulating the marketing of more sophisticated financial products such as options and derivatives is limited. In other areas, Russia needs to implement listing particular requirements, further minority shareholder protection and impose real time trade confirmations and delivery versus payment clearance systems, as well as to centralise the securities depository system. Currently there are no “know your customer” rules and no regulatory powers to impose margin calls, reduce exposures to large share positions, or otherwise empower a market authority to take action against systemic risks.

Chart 5 - Quality of securities market legislation – Russia 2005



Source: EBRD Securities Market Legislation Assessment 2005

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

3.2 Concessions

The new Law on Concession Agreements (the “Concession Law”) was enacted in August 2005. The Concession Law is relatively detailed and covers all the most important areas including definitions and its scope of application, identifying sectors subject to concessions, entities involved in the concession granting process, selection procedure and dispute resolution, concession agreement as well as certain aspects of financial security and government support issues. Thus, the Concession Law seems to contain no fundamental omissions.

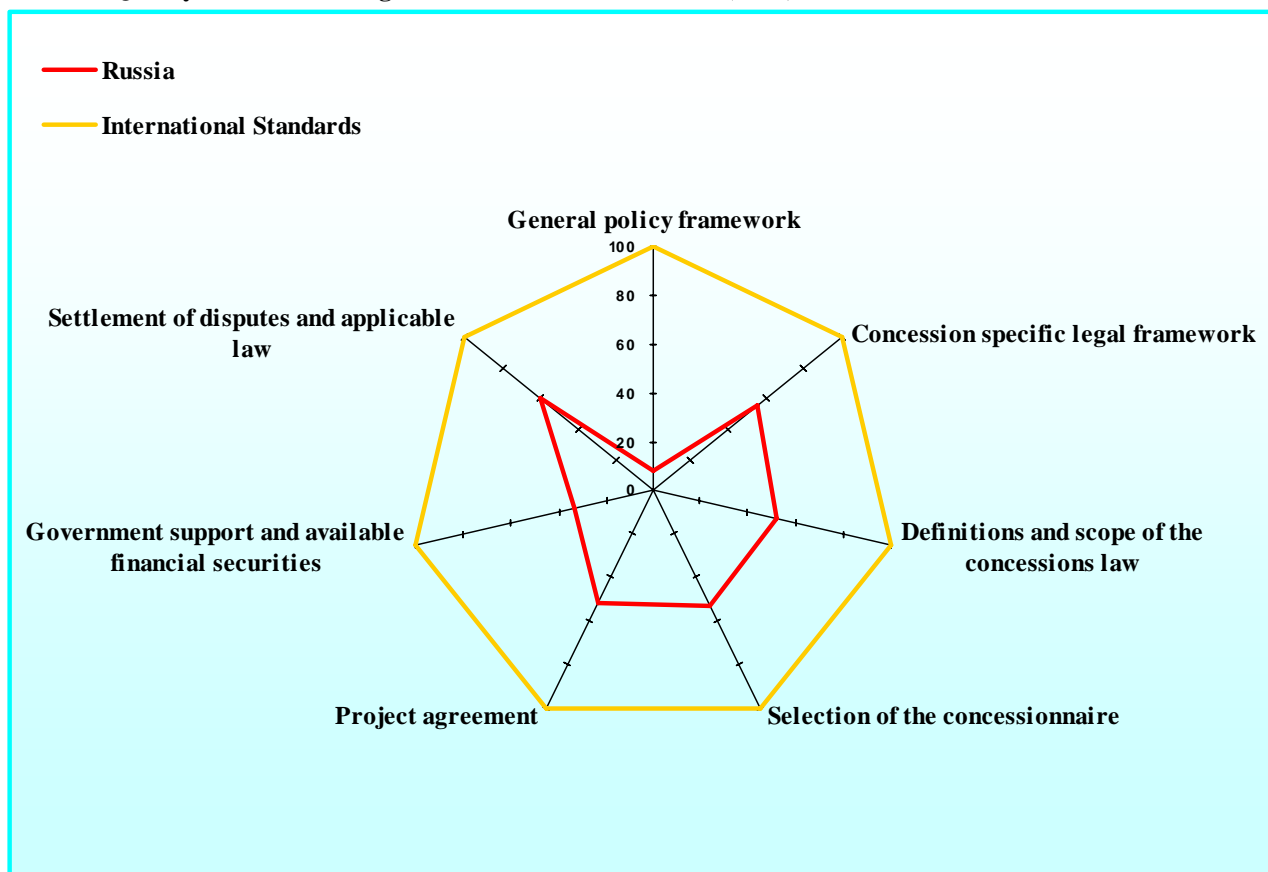
However, the Concession Law appears too detailed and over prescriptive on a number of issues which can make the implementation of concession projects difficult, if not impossible in practice. In particular, The Concession Law is very restrictive regarding the creation of security instruments and assignment of concession rights, and too prescriptive regarding the concessionaire's obligations and the selection procedure. Furthermore, it contains a number of ambiguous rules, the application of which can create a certain degree of insecurity in practice, e.g. it lacks a clear reference to international arbitration.

Among other critical issues affecting private sector participation that still remain unresolved are the lack of flexibility in the new regime (notably the limited negotiable terms) and a degree of uncertainty regarding property rights (e.g. restrictions to ownership over concession objects).

On the positive side, the Concession Law provides for detailed rules and greater stability in concession arrangements and offers mechanisms for concession application. It is well drafted and constitutes a solid basis for the development of PSP in the country. The Law is very recent however, so its implementation is still to be verified in practice.

As revealed by the EBRD 2004-2005 Assessment of Concession Laws (see Chart 6), one of the most significant obstacles to wide application of PPPs remains the lack of a clear national policy.

Chart 6 - Quality of concession legislation –Russian Federation (2005)



Source: EBRD Concessions Sector Assessment 2005

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.

Overall, since the enactment of the Concession Law, the idea of using concession-type schemes for financing transport infrastructure projects has been widely discussed and promoted by the

government, with the first PPP related projects using public monetary means from the Investment Fund to be announced in June 2006. The application of the law in the municipal utility sector is somewhat less certain and many advisors still seem inclined to apply general contract law schemes. It remains to be seen how the Concession Law will work once tested in practice.

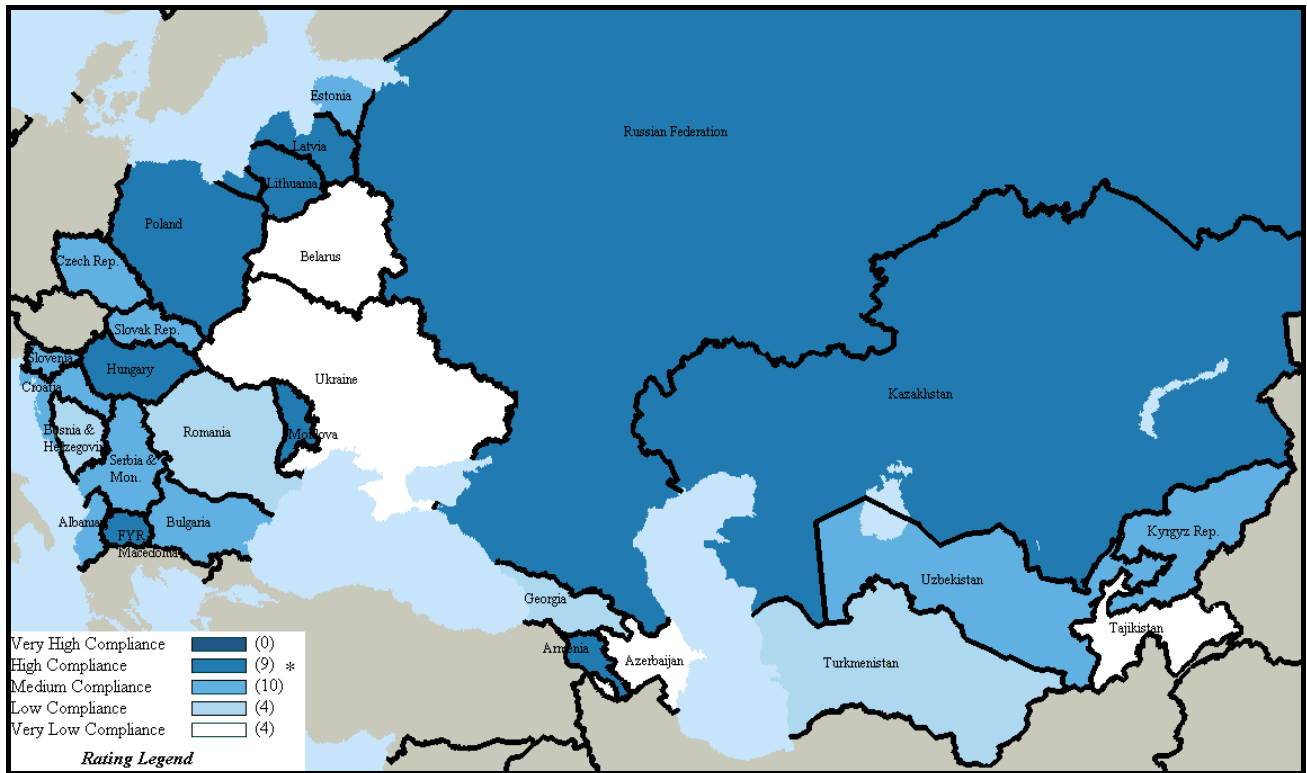
3.3. Corporate Governance

The main legislation concerning corporate governance in Russia is the Law on Joint Stock Companies (the “JSC Law”), which came into force in January 1996 with amendments in subsequent years, the most recent being in February 2006. The latest amendment, due to enter into force on 1 July 2006, will substantially change the requirements for the acquisition of major shareholdings in open joint stock companies. In summary, each acquisition of more than 30, 50 or 75 % of the voting shares in an open joint stock company will trigger an obligation to launch a public offer to buy the remaining shares. The same amendment introduces minority shareholders squeeze out provisions, according to which a dominant shareholder holding more than 95 % of an open joint stock company’s voting shares as a result of a public offer can force the minority shareholders to sell their shares.

In 2002 the FCSM, Russia’s former securities market regulator, issued a Corporate Governance Code, developed with the technical assistance of the EBRD and the financial support of the government of Japan. The Code, although being voluntary by nature, provides important guidelines on board composition (for example, there should be at least three independent directors and the audit committee should be composed of such directors) and transparency. The Code is voluntary and JSCs are only required to report compliance with the Code’s principles and explain deviations from these principles. In December 2004 a new regulation issued by the FSFM made some of the principles included in the Code enforceable starting from 1 July 2005 – then extended until 1 January 2006 - with respect to those companies that have listed equity and/or debt. In addition, the regulation introduced a requirement to publish audited IFRS or US GAAP annual.

According to the 2004 results of the EBRD's Corporate Governance Sector Assessment, under which corporate governance related “laws on the books” were assessed, the Russian Federation was rated as having achieved “high compliance”, when compared to the OECD Principles of Corporate Governance. (See Chart 7)

Chart 7– Quality of Corporate Governance legislation in the EBRD Countries of operation

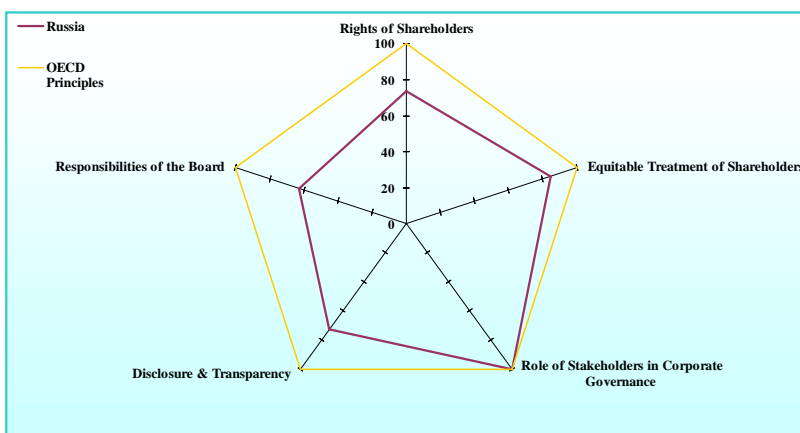


Source: EBRD Corporate Governance Sector Assessment 2004

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

Based on the results of the assessment some minor shortcomings were noted in the area relating to the "Responsibilities of the board" (see Chart 9), where according to the law, the responsibilities of the board do not include functions such as reviewing key executive and board remuneration, ensuring a formal and transparent nomination process for board members, ensuring the integrity of the corporation’s accounting and financial reporting systems and overseeing the process of disclosure and communications.

Chart 9 - Quality of corporate governance legislation – Russian Federation (2004)

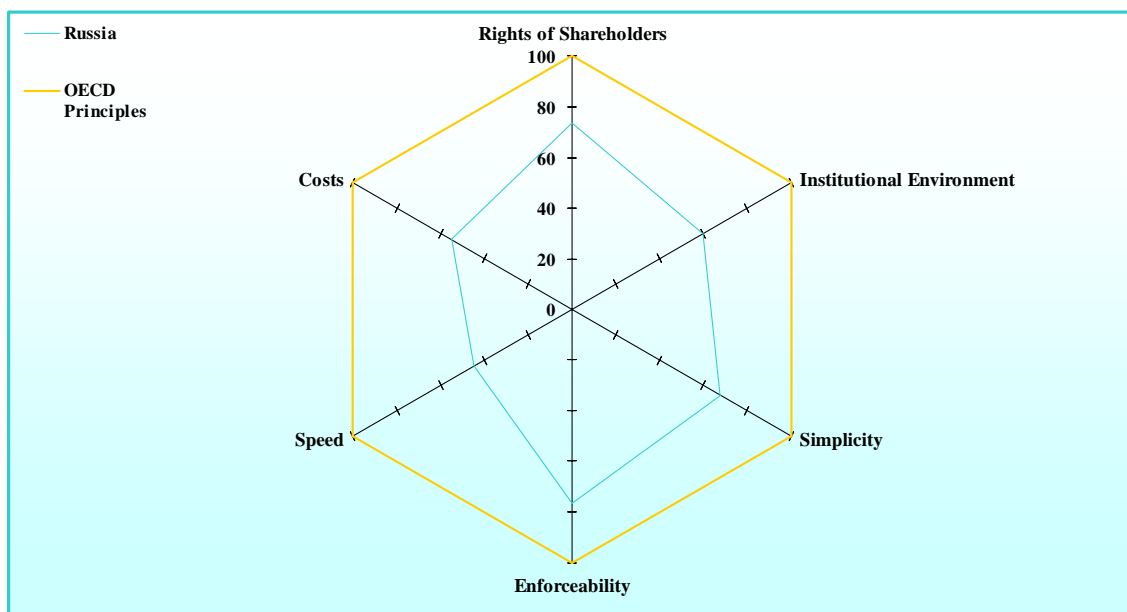


Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the ‘web’, the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2004 assessment

A general reform priority for Russia is to improve effective implementation and enforcement of existing legislation. The effectiveness (how the law works in practice) of corporate governance legislation was assessed by the EBRD in 2005. A case study dealing with related-party transactions was designed. The case study investigated the position of a minority shareholder seeking to access corporate information in order to understand if a related-party transaction was indeed entered into by the company and on how it was possible to obtain compensation in case damage was suffered. Effectiveness of legislation was then measured according to four principal variables: complexity, speed, enforceability and institutional environment.

Chart 10 - Different aspects of corporate governance law - Russian Federation



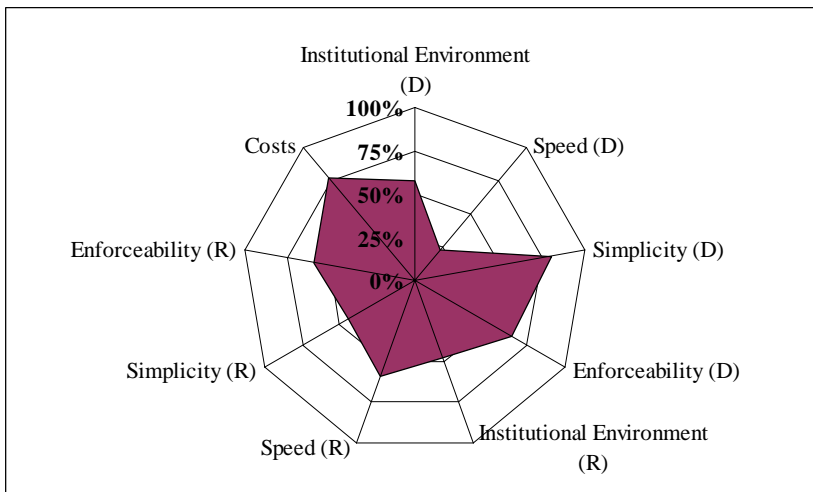
Source: EBRD Corporate Governance Legal Assessment, 2003; EBRD Legal Indicator Survey 2005

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

The survey revealed a variety of actions available to minority shareholders to obtain disclosure and redress but procedures are generally considered quite complex while it is reported to be easy for the defendant to further delay the proceedings. When considering enforceability, because of deficiencies in the Russian court system, such as case overload and the scarcity of judges, the procedure to enforce actions can be difficult and take more than several months.

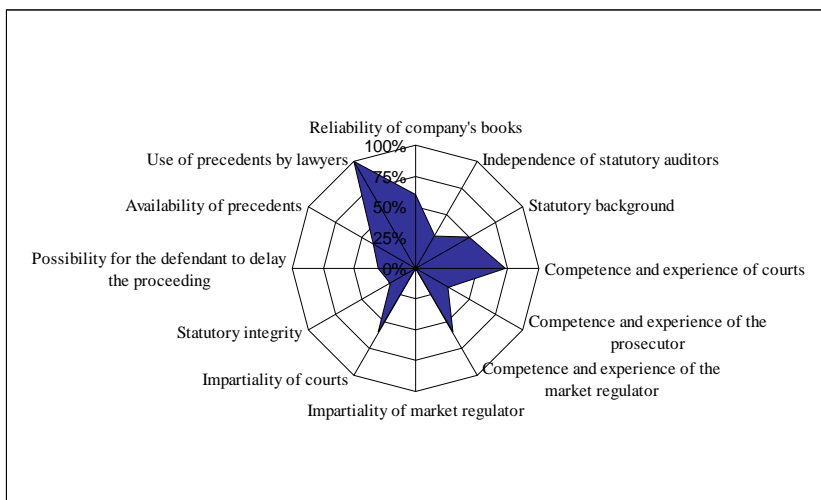
Finally, when considering the institutional environment, the survey evidenced the difficulty to find reliable corporate information and independent statutory auditors. Courts and the market regulator are deemed generally competent and experienced in corporate law cases, but courts can be biased - especially in favour of powerful defendants - while the market regulator's position was deemed unpredictable.

Chart 11 - Effectiveness of corporate governance in Russia (2005)



Note: The graphs show disclosure, redress and the institutional environment in the transition countries. The average results from the case study scenarios are shown. Disclosure refers to a minority shareholder's ability to obtain information about their company. Redress refers to the remedies available to a minority shareholder whose rights have been breached. Institutional environment refers to the capacity of a country's legal framework to effectively implement and enforce corporate governance legislation. Costs refer to the expenses a minority shareholder must pay to take legal action. The extremity of each axis represents an ideal score: the fuller the 'web', the better the corporate governance framework.

Chart 12 - Institutional Environment in Russia (2005)

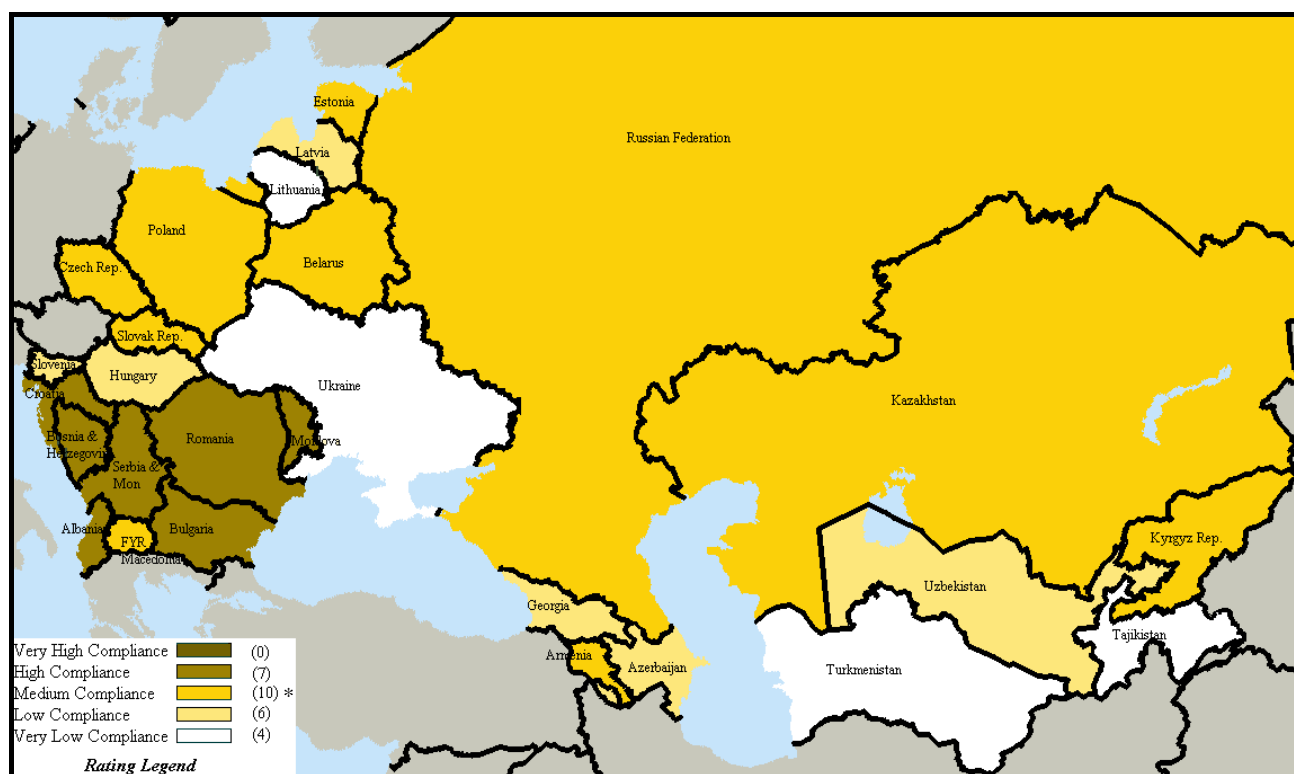


Note: Institutional environment refers to the capacity of a country's legal framework to effectively implement and enforce corporate governance legislation. Statutory background relates to how comprehensive, clear and well structured a country's definition of related-party, self-interested, self-dealing, or conflict of interest transactions is. In particular, whether this definition covers transactions in which the director or the dominant shareholder has an indirect interest (for example, the party to the transaction is a dominant shareholder's subsidiary). Statutory integrity refers to the level of corruption within a transition country, as determined by Transparency International's Corruption Perception Index 2005. This index is measured on a scale from 1 to 10, with 1 being the most and 10 the least corrupt environment. The extremity of each axis on the graph represents an ideal score: the fuller the 'web', the better the institutional environment.

3.4. Insolvency

The Law on Insolvency (Bankruptcy) (the “Insolvency Law”), which governs bankruptcy and insolvency in Russia, came into force in 2002 and has been amended on a number of occasions. As noted in the previous country strategy for the Russian Federation dated 18 November 2004, this represented a significant improvement over the previous regime. In the 2003 EBRD Insolvency Law Sector Assessment, the law achieved a score of ‘medium compliance’ when benchmarked against international standards. (See Chart 13)

Chart 13 – Quality of Insolvency legislation in the EBRD Countries of operation

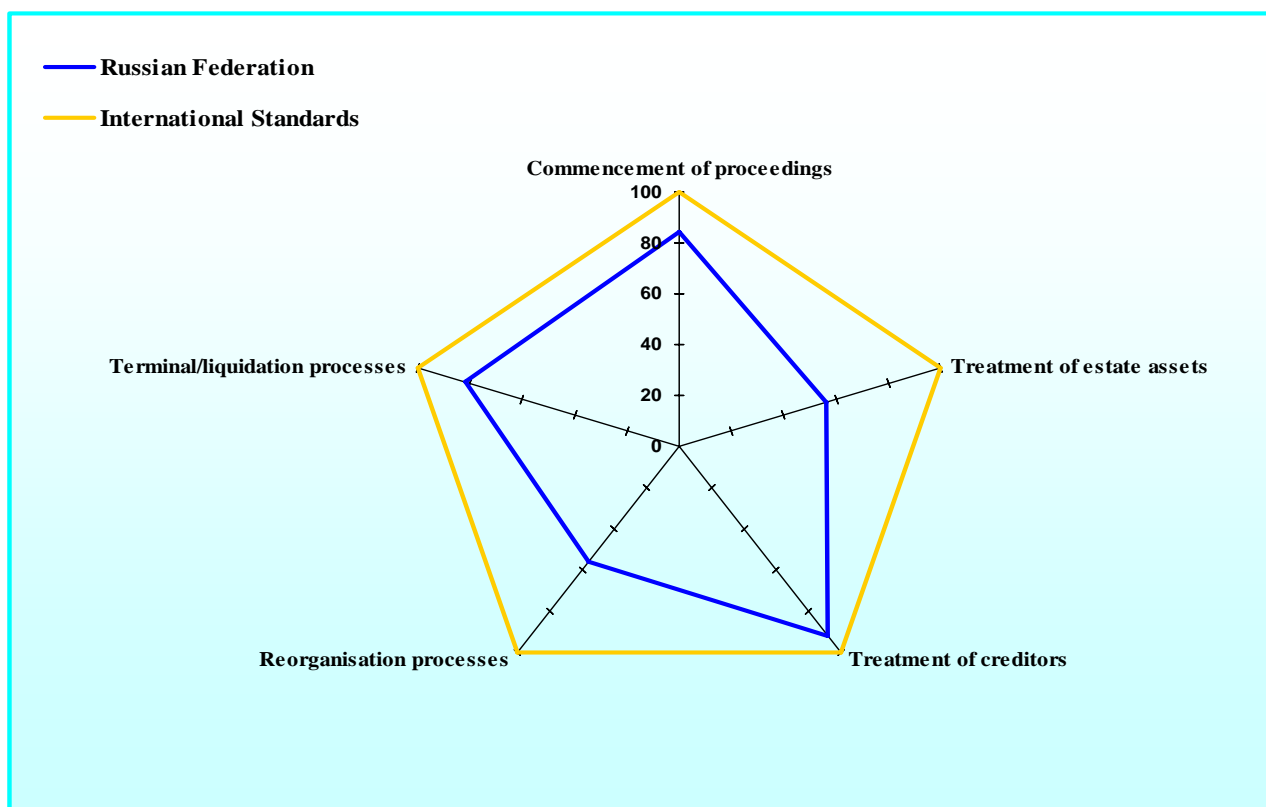


Source: EBRD Insolvency Sector Assessment 2004

Note: The various categories indicate the level of compliance of each country’s legislation (the “laws on the books”) with international standards, such as the World Bank’s Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on Legislative Guidelines for Insolvency Law, and others. The asterisk indicates in which category Russia ranks.

According to the Assessment, the Insolvency Law was notable for its treatment of the qualification, appointment and removal of insolvency administrators and its allowance for priority reorganisation financing. It rated relatively high in terms of the treatment of creditors, the commencement of proceedings and the liquidation process. (See Chart 11) It had a significant number of weaknesses, however. The Insolvency Law did not provide a balance sheet test for insolvency, nor did it provide sufficient safeguards in respect of reorganisations including a failure to prohibit critical suppliers from threatening to cut off supply unless past debts are paid in full. The cross-border insolvency provisions were insufficient, relying on international treaties and reciprocity rather than the UNCITRAL Model Law or similar EU regulations. The power of insolvency administrators to review pre-bankruptcy transactions was weak and ineffective, preventing insolvency administrators from maximising the estate value and preventing improper behaviour by debtors. Most critical, however, the system was slow, inefficient and presented significant barriers to creditor participation.

Chart 14 – Quality of Insolvency legislation – Russia, 2004



Source: EBRD Insolvency Sector Assessment 2004

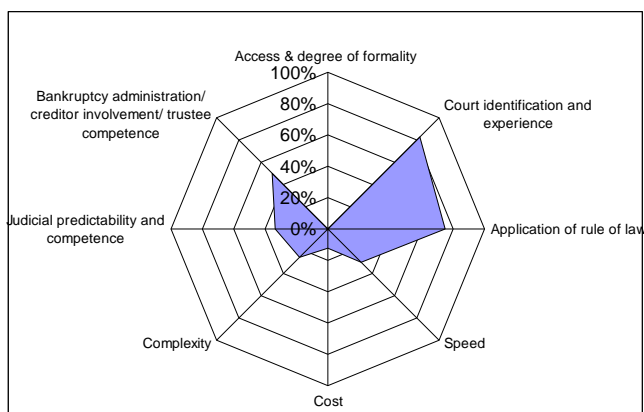
Note: The extremity of each axis represents an ideal score in line with international standards, such as the World Bank’s Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on Legislative Guidelines for Insolvency Law, and others. The fuller the ‘web,’ the more closely the country’s insolvency laws approximate these standards.

Recent amendments include the enactment of stiff new penalties. Top managers who disclose a firm’s insolvency after it is too late face severe fines; deliberate bankruptcies can result in prison terms of up to 6 years; and opposition to arbitrary managers, withholding or falsifying information can result in prison terms of up to 3 years.

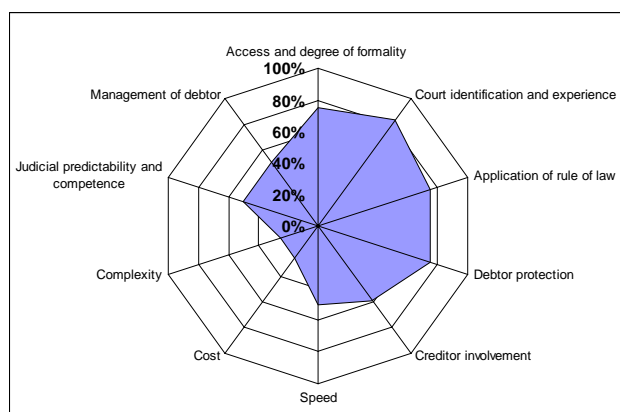
These recent amendments should help to improve the system, but to make the system significantly more effective, administrative improvement is required. Insolvency administrators are at the heart of any insolvency system; without improvements in their training, licensing and regulation, only minimal improvements to the system will be achieved. Moreover, the insolvency system would benefit from a dedicated judiciary that has proper training and experience in the conduct of insolvency files. To this end, the EBRD and the Russian Ministry of Economy and Trade, with funding from the Swiss State Secretariat for Economic Affairs (SECO), are set to undertake a project designed to build the capacity of insolvency regulators in Russia. It is expected that this project will help with the development of a more effective insolvency system in Russia. (See Chart 15 for graphical presentation of the effectiveness of insolvency regime in Russia)

Chart 15 – Effectiveness of Russia insolvency regime

Creditor-Initiated Insolvency



Debtor-Initiated Insolvency



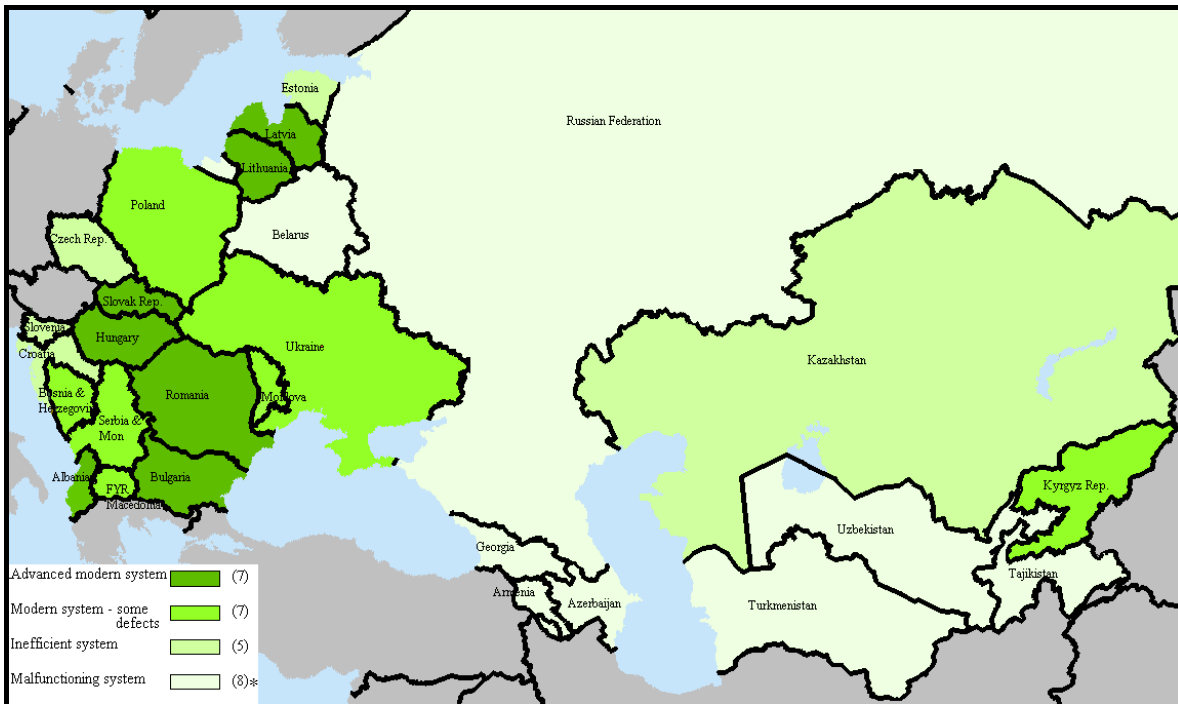
Source: EBRD 2004 Legal Indicator Survey on Insolvency

Note: The results have been derived from stakeholder responses to questions about the practical functioning of the insolvency regime. The fuller the “web,” the more effective the country’s insolvency regime is.

3.5. Secured Transactions

Taking security over property in the Russian Federation remains highly challenging and complex. The main provisions can be found at Articles 334 - 358 of the Civil Code, in the Federal Law on Pledge of 29 May 1992, as well as in the Law on Mortgage of 22 July 1998. Despite the recent reform substantially reducing notarial fees applicable to mortgages, Russia still falls short of providing investors and business players the legal framework with the necessary certainty and predictability in many respects. According to the results of the EBRD Regional Survey of Secured Transactions Legislation 2004, quality of legal framework for secured transactions was ranked in the “malfunctioning system” category. (See Chart 13, 14)

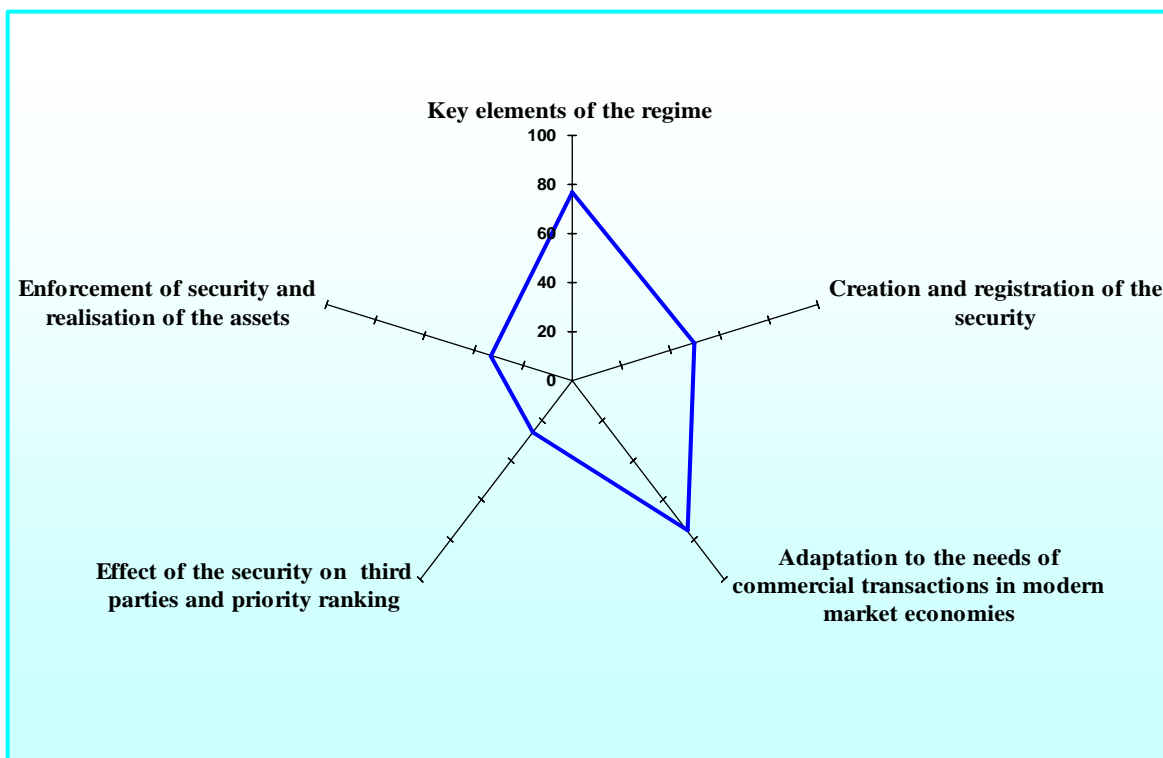
Chart 16 – Quality of secured transactions legislation in the EBRD Countries of operation



Source: EBRD Regional Survey of Secured Transactions Legislation 2004

Note: The level of reform referred to in the legend above is assessed in relation to the EBRD’s Model Law on Secured Transactions and the ‘ten core principles of secured transactions law. The asterisk indicates in which category Russia ranks.’

Chart 17 – Quality of secured transactions legislation – Russia, 2004



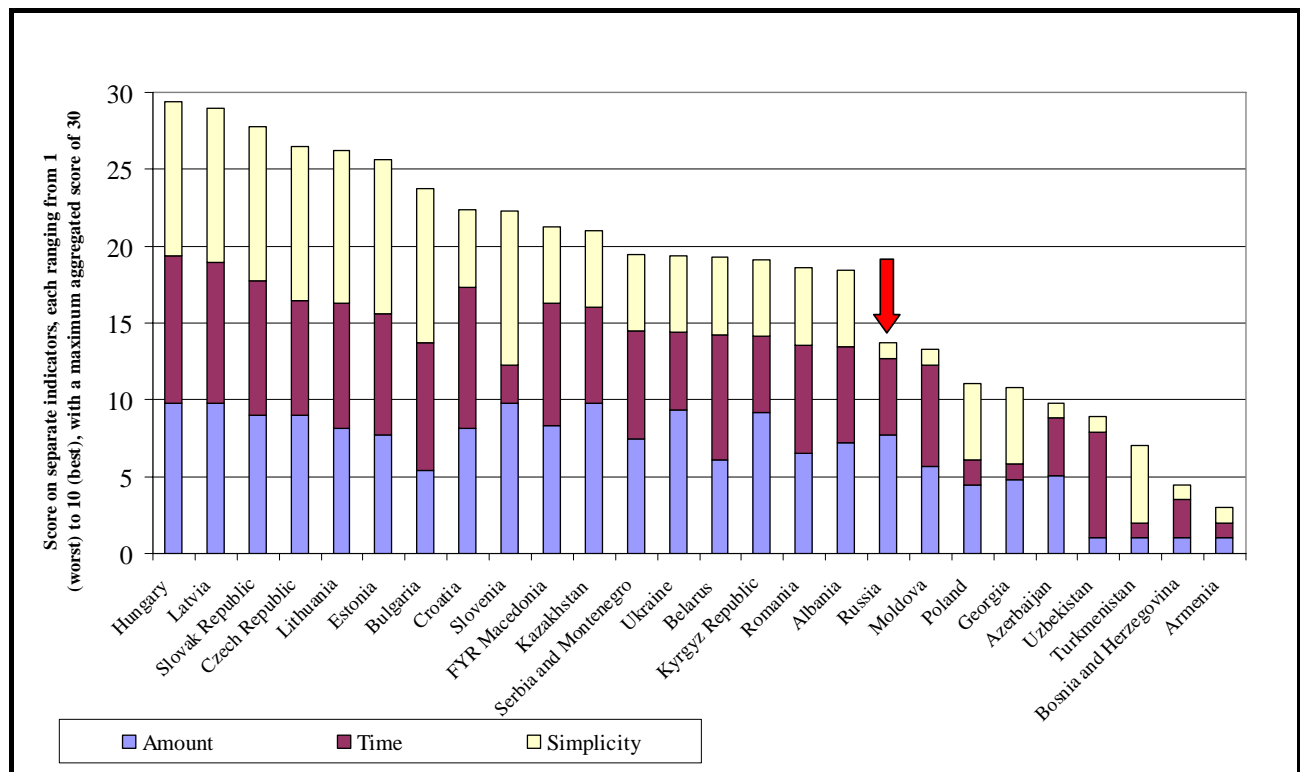
Source: EBRD Regional Survey of Secured Transactions Legislation 2004

Note: Scoring is done on a scale of 1 to 100, with 100 representing the most advanced legal regime. The fuller the ‘web,’ the more advanced the country’s secured transactions legal system is.

Main areas for concern are the following:

- the taking of security over intangible property, such as account receivables or bank account, which remains untested: despite efforts by the Bank and others, no appropriate legal provisions have been adopted. The Bank’s projects routinely include this type of security with the understanding that it may not be enforceable.
- the taking of security over generally described and fluctuating pools of assets, which is too restricted to be used in transactions;
- the priority ranking that creditors enjoy, since there is not centralised place where security rights would be recorded for all interested to see: as recently as 2004-05, the World Bank sponsored a project whose objective was to review the possibility of creating a centralised, notice-filing system. However it is unsure whether the project led to specific reform measures being adopted;
- Enforcement of the security and foreclosure, which is a long and uncertain process. This holds true whether a mortgage or a pledge is to be enforced. (See Charts 15, 16 for graphical presentation of key aspects of effectiveness of the regime)

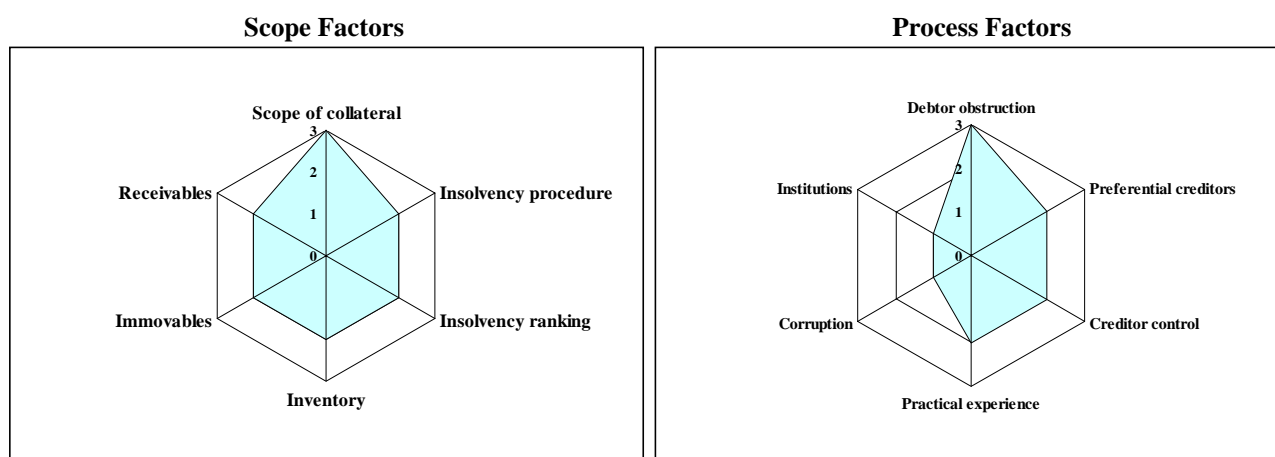
Chart 18 – Effectiveness of the Charge Enforcement Process – Russia (2003)



Source: EBRD New Legal Indicator Survey 2003

Note: The chart shows how much a secured creditor can expect to recover (amount), how quickly (time), and how simply (simplicity). The higher the bar, the more efficient and creditor-friendly the system is.

Chart 19 - Obstacles to Charge Enforcement Process – Russia (2003)



Source: EBRD Legal Indicator Survey 2003

Note: “Process” factors measure the impact that specific obstacles would have on the enforcement proceedings. “Scope” factors give an indication of how effective enforcement would be when conducted on various types of collateral and in the context of debtor insolvency. The fuller the coloured area, the more serious the problems are.

Despite a constant dialogue with the Russian authorities and repeated offers of technical assistance, the EBRD has not found political will or commitment to undertake the necessary reforms, not even with respect to a reform of more limited scope, such as the taking of security over aircrafts.

Given the increasing sophistication of the deals taking place in Russia (recent securitisation of consumer loans being just one example), it is regrettable that the legal framework, instead of supporting these deals, is in fact a hurdle to their implementation.

3.6. Telecommunications

The telecoms sector in the Russian Federation is currently regulated by the Ministry of Communications and Informatization (the ‘MCI’) and its Federal Communications Agency unit, and largely governed by the Federal Communications Law, 2003 (the ‘2003 Law’). The MCI was created in 2000 to administer government responsibilities within the sector. In addition to sector specific regulatory oversight, certain elements of the sector, such as local tariff setting are also subject to regulation by the Federal Anti-Monopoly Service and local administrations. Prior to 2003, laws governing the sector were somewhat confused and seen as outdated, failing to cover many important recent developments in the sector. However, the legislative base of the sector resulting has been clarified by 2003 Law, which took effect in January 2004.

The Russian Telecom Sector is currently undergoing significant change with the key drivers of this change being liberalisation and privatisation. The liberalisation agenda is being partly driven by Russia's desire to accede to the World Trade Organization (expected in 2006/7) and a framework to support this liberalisation is currently being implemented by the Ministry, based upon the 2003 Law. That Law provides for the implementation of a number of modern legal and regulatory standards for the sector.

Most elements of the Russian market have been liberalised for a number of years and, after some delay, full formal liberalisation came into effect at the beginning of 2006 with the lifting of the monopoly of long distance fixed-line state controlled incumbent Rostelecom. While Rostelecom still dominates its market, vigorous competition is expected from new competitors. Local fixed-line operations are dominated by the regional subsidiaries of Svyazinvest, the state controlled local

incumbent. While the fixed penetration level for the entire country is below 30%, there are major disparities in coverage between urban and rural areas. The mobile sector has recorded healthy growth in most of the recent years, with three leading operators competing: MTS, VimpelCom and MegaFon. The official mobile penetration rate is quoted as being in excess of 80%, though the actual figure for live and continually active subscribers is likely to be somewhat lower.

While the reforms of the telecom sector that the Russian authorities are undertaking are significant and notable, implementation of the practical machinery that underpins these reforms (e.g. secondary legislation, regulatory mechanisms and institutional reform) has been painfully slow, with many of the enabling secondary legislation and mechanisms only now being (or yet to be) put in place. Critical enabling reforms such as rebalanced tariffs, a functioning non-discriminatory interconnection framework and transparent licensing procedures have yet to be fully implemented. In addition to the slow pace of reform implementation, failure to harmonise the current sector's institutional structure with international best practice continues to negatively impact investor perception and therewith sector development. Most notable in this respect is the failure of the authorities to provide for a meaningful independent regulatory authority for the sector to implement policy and law and facilitate competition. Similarly, the Ministry's current role as policymaker, regulator and holder of state telecom assets is a notable deficiency. Such an institution is the cornerstone of a modern, vibrant and competitive telecom sector and essential if the government's liberalisation measures and forthcoming privatisation initiatives are to succeed.

Going forward, in order to maximise the benefits to consumers, investors and the economy as a whole which flow from a properly functioning competitive telecoms market, the authorities should ensure:

- the immediate separation of policymaking, regulation and operation (service/network provision) functions currently undertaken by the authorities;
- the immediate establishment of a fully independent regulatory authority, with all powers and resources necessary to implement, administer and enforce sector policy and the regulatory framework envisaged in the 2003 Law;
- the full and immediate implementation of all necessary second legislation arising from the 2003 Law; and
- that work begins immediately on a review of sector legislation to ensure it is fully harmonised with international best practice and appropriately reflects market developments since the previous legislative base was developed.