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Basis of Assessment: This document draws on legal assessment work conducted by the Bank (see www.ebrd.com/law) and was last updated during the preparation of the 2012 EBRD Strategy for Russia, reflecting the situation at that time. The assessment is also grounded on the experience of the Office of the General Counsel in working on legal reform and EBRD investment activities in Russia and does not constitute legal advice. For further information please contact ltt@ebrd.com.
1. **Overall Assessment**

Recent years have been marked by Russia’s intensified efforts to upgrade its legislative framework in line with international standards and best practices. Despite the progress achieved, certain gaps and uncertainties still exist, causing concerns amongst both domestic and foreign investors.

In Russia the current regulatory and legal framework governing the local debt capital markets is by a mega regulator (following a merger of the Bank of Russia with the Federal Service for Financial Markets in 2013). Extensive laws and regulations have been enacted to provide this framework, including laws and regulations governing specific entities and areas. In addition the law introducing bondholders meetings was adopted and shall enter into force in 2015, which will strengthen investors’ confidence by providing for their ability to meet and introduce voting rights.

The Russian corporate governance framework has recently improved but further progress is necessary, especially in ensuring that legal provisions are well understood and implemented. In the most recent assessment by the EBRD of the Russian corporate governance legislation, certain shortcomings have been identified, in particular, in the regulation on the responsibilities of the board, as well as the rights of shareholders and disclosure and transparency.

Russia has an extensive commercial law insolvency framework, which may enable the reorganisation or liquidation of a debtor’s business. However, some scope for improvement exists, and Russia is in the process of considering significant changes to its Bankruptcy Law to facilitate reorganisation and cross-border cooperation, amongst other matters.

An improvement in judicial efficiency has long been on the government’s reform agenda. The EBRD 2010-2011 assessment of court judgments in commercial matters revealed that decisions of the Russian Arbitrazh courts were of generally good quality and were overall highly predictable. At the same time, efficient implementation of the court decisions and judicial independence are still areas of significant concern.

The secured transactions regulation contains a number of modern features but is inadequate for the demands of the market. The inefficiency of pledge as a tool for risk management and the incompatibility of the Russian law on pledge (security) with market realities and the needs of market players remain a serious barrier to further development of the market, growth in consumer lending and implementation of modern risk management tools. It is a factor resulting in higher banking risk and a dramatic reduction of the Russian financial market’s global competitiveness. The Bank has been cooperating with the Russian authorities to improve secured transactions regulation in a number of areas.

According to the recent EBRD assessment of PPP/concessions laws, Russian laws have been ranked in “high compliance” for their extensiveness and “medium compliance” for their effectiveness. The dimension of the definitions and scope of the law has been identified as the main strength of the country’s concessions legislation, with the PPP legal framework and the project agreement dimensions, measuring how extensive, specific and integrated the PPP legal framework is and to what extent the laws regulate the contents of the agreement entered into the PPP project parties, being on the weaker side. Furthermore, the policy and institutional frameworks have been considered as weaker aspects of the implementation framework.

In the energy (electricity and gas) sector, Russia’s efforts in the last decade to reform its electricity market offer a useful model for its neighbours. The wholesale market can be regarded as competitive and the reform is now smoothly moving towards a full liberalisation of the non-
household market. The situation is sharply different in the gas market, in which the state-controlled Gazprom has a legal monopoly on gas exports. Huge investment is needed in the exploration and production sector to allow Gazprom to meet expected domestic demand and export contractual obligations and to compensate the declining production of ageing fields.

In the renewable energy and energy efficiency sectors, a much greater resolve and focus, as well as a quicker timeline for implementation, will be required in order for any significant improvements in efficiency or use of renewable energy sources to be realised. There is potential for improvement in both sectors, but it is unlikely that significant improvement will take place in the renewable energy sector in the near future. This is due largely to the lack of a unified and focused government policy regarding the promotion of RES and no legal or regulatory system in place to provide government support for RES.

In the EBRD 2010 Public Procurement assessment the Russian legal and regulatory framework achieved medium compliance with international standards. However, in practice it does not ensure transparency of public procurement decisions or value for money objectives. A general conclusion is that the development of local public procurement capacity is progressing; however substantial gaps in the national legislation and institutional framework were identified. Thus, public procurement policies in the Russian Federation need revision and contracting entities could benefit from the development and implementation of eProcurement procedures available to all contracting entities and suitable for all public contracts.

In the telecommunications sector, at a technical and business level, it is understood that the presence of a legal, regulatory and institutional framework for telecoms which is reflective of proven best practice will do much to make the overall environment for the sector attractive for investment, promote broader competitiveness across the economy and aid social development. Russia has some way to go to harmonise with such practices. Reforms are understood to be ongoing at a technical level, generally improving the environment for operations. However, plans to adopt more far reaching and strategic restructuring of the sector, particularly on the institutional side, which would be necessary to adopt best practice, have yet to become apparent.

2. The Legal System and Investment Climate

2.1 Constitution and courts

The Constitution of the Russian Federation was adopted by the National Referendum in 1993. According to the Constitution, Russia is a democratic, federal republic consisting of 83 subjects of the federation (ethnically based republics, regions, territories, autonomous regions and districts, 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 six-year term by popular vote, following the 2008 amendments to the Constitution replacing the previous four-year term. He has wide authority in the sphere of judicial appointments, dissolution of the parliament, and formation of the government.

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 five years by popular vote, following the 2008 amendments to the Constitution replacing the previous four-year term) and the 166-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
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. Each of the subjects of the federation may establish its own constitutional (charter) court with powers to rule on the conformity of the local acts with the constitution (charter) of the subject of the federation and its interpretation. Courts of general jurisdiction rule on civil, administrative and criminal matters and comprise the Supreme Court as the highest judicial authority as well as supreme courts of the subjects of the federation, district court and magistrates. Commercial (“Arbitrazh”) courts decide economic disputes and comprise the Supreme Arbitrazh Court as the highest judicial authority as well as federal arbitration cassation courts, arbitration appellate courts and arbitration courts of the subjects of the federation. There are also specialised military and since 2013, intellectual property rights court. 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.

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). As for more recent steps, in 2013, the government introduced an initiative to merge the Supreme Arbitration Court into the Supreme Court. The reform will require amendments to the Constitution, among other legislative acts, and is viewed as somewhat controversial, with concerns being expressed about the ability of the united court system to preserve technical capacity accumulated by the Arbitrazh courts in the preceding years.

2.2 Relationship between legal transition and economic progress

Experience in transition countries suggests that advances in law reform and economic development progress or regress hand in hand. Over recent years, Russia has progressed considerably with respect to developing a stable and functioning market economy. However, there are still some areas for improvement. As a result, Russia performs reasonably well on combined legal and economic indicators performance as demonstrated in the following comparative chart (see Chart 1).
2.3 Recent developments in the investment climate

The Russian economy is still suffering from the aftermath of the eurozone crisis, most vividly reflected in the slowdown of both domestic and external economic growth. This feels particularly acute in the context of somewhat low investor and consumer confidence. Inflation has started rising again after reaching the historical low record of 3.6 per cent in early 2012, with the authorities confirming their commitment to targeting inflation and a floating rouble. The Central Bank of Russia has started to put more emphasis on price stability and has already significantly increased exchange rate flexibility.

Outlook of the Russian economic growth demonstrates continued high dependence on commodity prices, particularly oil and gas, proving the appropriateness of diversification of the economy as one of the government’s priorities. Outdated infrastructure calls for significant investments into the sector. Improvements in productivity and the investment climate are understood to be one of the most immediate needs in the sector and economy in general. The Russian authorities have been continuing work on development of local capital markets, including the establishment of the Central Depository and a number of measures to liberalise the domestic sovereign rouble bond market, as well as on the competition law, in particular with respect to clarifying enforcement rules.

Accession to the World Trade Organisation in August 2012 has marked the success of the 18-year negotiation period. Implementation of commitments made by Russia as part of the accession, including a gradual decrease in the import duties in agriculture and manufacturing, simplifying foreign entry to the service sectors such as insurance and telecommunications, decrease in future agricultural subsidies, as well as introducing non-discriminatory tariffs for trans-shipment of goods
through the country, are expected to shape the government’s reform agenda. Russia is also in the process of discussing its accession to the Organisation for Economic Co-operation and Development (OECD).

Economic integration between Belarus, Kazakhstan and Russia, launched in 2010 with the establishment of the Customs Union, has embarked on a new step with the creation of a common economic space within the Eurasian Economic Community, whose ultimate goal is stated as the free movement of goods, capital and people, as well as harmonisation of macroeconomic and structural policies.

2.4 Freedom of Information

The legal framework governing freedom of information (“FOI”) in the Russian Federation was initially established by its Constitution, enacted in 1993.

The next and most significant step occurred when Russia passed Federal Law No. 8-FZ “On Providing Access to Information on the Activities of State Bodies and Bodies of Local Self-Government” dated 28 January 2009.

It was allegedly the longest-debated bill in the Duma. It entered into force a year later, in January 2010. The law regulates the public’s access to government information, including request and response procedures, fee arrangements, exemptions, appeal mechanisms, enforcement bodies, and liabilities. The potential impact of this law should not be underestimated as “it positively guarantees the rights of Russian citizens to request and receive information, outlines a procedure for such requests, and determines government responsibility for providing such information.”

The Institute for Information Freedom Development, based in St Petersburg, published a report in 2008 regarding how accessible information was from various Russia state organisations. The 1993 Russian Constitution, Article 23 guarantees the right “to freely seek and obtain information about the activities of state organs and organs of local administration.” However, the Institution found this right was very inconsistently applied, and concluded that “Actual access to the information concerning the governmental bodies operation requires lots of time and efforts, lots of nerves and money. People believe that their right to have access to the information has to be “proved” or that the information needed can be received only through personal relations or with a lot of money, in other words, only through alternative – not necessarily legal – means of influence on the officials.”

More recently (2013) Russia has decided to withdraw from the much heralded Open Government Partnership (a new multilateral initiative that aims to secure concrete commitments from governments to promote transparency, empower citizens, fight corruption, and harness new technologies to strengthen governance), a negative move which has seen it become the subject of much criticism. Conversely, however the Russian Government has advocated its own Open Government initiative, resulting in the appointment of a Special Minister for Open Government in 2012. It remains to be seen how these developments will impact upon the FOI framework in Russia, observers are still keen to reform the current law and improve enforcement.
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: concessions, corporate governance, energy, insolvency, judicial capacity, public procurement, secured transactions, securities markets 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 such laws (also referred to as “effectiveness”). This section presents a summary of the results accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

All available results of these assessments can be found at [www.ebrd.com/law](http://www.ebrd.com/law).

3.1 Capital markets, including derivatives

Throughout the last two decades, the Russian financial sector has undergone a remarkable development, but policy-makers have also recognised that more has to be done if Russia, and specifically Moscow, wants to establish itself as a truly international financial centre, serving the needs of the entire Central Asian Region and beyond. EBRD is supporting the development of the Russian financial sector by: policy dialogue (including a technical cooperation), issuing the local currency bonds in Russia and equity investments, including one in the Moscow Exchange.

According to the current regulatory and legal framework governing the local debt capital markets of Russia, the Bank of Russia (the “CBR”) is a mega regulator (following a merger with the Federal Service for Financial Markets in September 2013) responsible for the regulation and supervision of the local debt capital markets. Extensive laws and regulations have been enacted to provide this framework, including laws and regulations governing specific entities and areas.

While reforms to the existing framework have moved forward, areas in need of improvement remain. Firstly, there would be benefits in introducing a greater variety of debt instruments. The availability of different debt instruments is important to the deepening of capital markets as this allows for better tailoring of an offer against investors’ interests and risk appetite. The charts below (no’s 2-4) show areas of particular deficiency relating to enforcement of investor rights, governing law requirements and issues relating to corporate governance, all key areas that need improvement.
Chart 2 – Debt securities investors (banks and non-banks)

Source - Local Capital Markets Development, Legal assessment 2012

Chart 3 – Debt securities issuers

Source - Local Capital Markets Development, Legal assessment 2012
It seems that the Russian market still only offers a small range of instruments, and this is primarily because only securities that are expressly contemplated under Russian law can be issued and traded. Currently, legislative recognition and the issuance procedure are expressly provided only for a relatively limited range of securities: shares, issuer's options (similar to warrants), bonds (including unsecured bonds, collateralized bonds, exchange-traded bonds, and state and municipal debentures), notes issued by the CBR, Russian depositary receipts, bonds convertible into shares (see below), mortgage-backed securities and investment units of investment funds. For the local capital markets in Russia to truly develop, a somewhat wider range of instruments would be very beneficial.

There seems to be a marked gap in structured products - specifically asset-backed securities other than mortgage-backed securities, such as, securities backed by auto-loans, consumer loans, credit cards receivables and lease payments. We understand that the draft law on asset-backed securities and all necessary amendments to existing legislation were submitted to the Russian parliament in October 2013.

Secondly, the current rules applicable to convertible debt instruments are too rigid to fit with the needs of investors and issuers. At present, it is legally possible for Russian issuers to issue convertible bonds but this rarely happens. Although there is no publicly available statistics on the issuance of convertible debt in Russia, the Moscow Exchange website reveals that, as of 11 May 2012, there were no outstanding convertible bonds traded on the exchange. However, recently a new law & regulation (law 282FZ) were adopted to address technical issues hampering development of convertible bonds market in Russia, including technical issues in relation to conversion (i.e. shares needed to be placed within 12 months of issuance while maturity of such convertible bonds is usually 3-5 years).
Moreover, in 2013 the law introducing bondholders meeting was adopted and shall enter into force in 2015, which strengthen investors’ confidence by the providing for their ability to meet and introduce voting rights. Investors’ confidence in their rights as noteholders is one of the most important factors in developing local capital markets. In developed markets, holders of debt instruments are provided with clear mechanisms by which they can voice their views, in particular via (i) debt securities holders’ meetings and (ii) debt securities holders’ voting. The new law will introduce such mechanisms in Russia.

In terms of derivatives, the new legislation provides for the enforceability of netting and close-out netting; however, subject to reporting of such transactions to the Russian trade repositories. Since November 5, a new reporting rule has been in effect in Russia for two types of derivatives (FX swaps and repurchasing agreements or repos). This allows “close-out netting” - a way of measuring transactions between two parties that helps protect one party’s investment if the other goes bankrupt. The reform will be extended in July 2014 to other types of derivatives transactions.

Further, the outright transfer of collateral under the Credit Support Annex to the ISDA Master Agreement is not enforceable in Russian Federation.

Finally, judicial training courses on financial instruments, with a focus on derivatives, should be considered. As in many countries, legal reforms have created their own challenges for the judiciary, which has had to absorb a vast array of new provisions, often anchored in economic transactions which judges may not have previously encountered. This is also of relevance to legal reforms in financial sector, which often are very complex and narrowly tailored. The EBRD has been providing such courses throughout 2012 and 2013.

3.2 Concessions

The main source of federal legislation relevant to the sector is Federal Law No. 115-FZ “On Concession Agreements” adopted in 2005 (the “Concessions Law”). It was further completed with sector specific Model Concession Agreement regulations and with the Amendments and Additions of 8 November and 4 December 2007, 30 June 2008, 17 July 2009, 2 July 2010, and 19 July 2011. It is not supported formally by a general policy framework for PPP but a number of senior government representatives have announced on many occasions that concessions and PPP in general, are acknowledged and welcome in Russia.

The Concessions Law operates under the general Russian statutory framework, meaning that it is intended to cover concession-specific aspects of a project only, and does not create a special (more favorable or straightforward) legal regime for concessions. The Concessions Law expressly refers to the land, subsoil, budgetary, tax, environmental and other legislation. It applies to all federal, regional and municipal concession projects. Regional and municipal authorities are not entitled to pass concession-related laws and regulations. They may, however, enact laws and regulations on other non-concession forms of PPP. As of September 2011, regional (sub-sovereign) PPP laws, regulating BOT and other non-concession PPP forms exist in more than half of all the regions of the Russian Federation. Their quality and importance are increasing.
The Concession Law is a relatively lengthy piece of legislation (38 articles) covering in detail the numerous key aspects normally covered by a general concession law including the definition, sectors/scope, the concession granting process and parties involved in the selection procedure, concession agreement, as well as certain financial security and government support issues.

There are no fundamental omissions in the Concessions Law, but it is not a self-standing piece of legislation which sufficiently allows any investor assessing the entire regime applicable to a concession project in a single document. In addition, the Concessions Law (i) is too detailed and over prescriptive regarding a number of issues which can make the implementation of concession projects based on the Law difficult/impossible in practice, and (ii) contains numerous ambiguous articles which create legal uncertainty. In particular, the Concession Law is very restrictive in respect of security instruments, too prescriptive regarding the concessionaire's obligations and selection procedure does not allow international arbitration and provides for a case-by-case institutional scheme. A history of annual amendments illustrates both the limited adequacy of the legislation and the awareness of the authorities in the need to improve the regime, although at their own pace. Numerous amendments made since its inception in 2005 and since the latest EBRD Assessment have added to the complexity and brought little clarification except with respect to compensation in the event of early termination of the concession agreement and the possibility expressly given to the granting authority to contribute to the expenses for the creation / renovation/ operation of the concession facility. The Concessions Law, however, contains a number of positive elements (guarantee of non-discrimination, open tender procedure, etc.) some further positive features being introduced lately (e.g. the step-in right and direct agreement concepts, the availability payment model in the transport sector, making model concession agreements in respect of some types of infrastructure not mandatory; allowing assignment of rights and transfer of debt by the concessionaire at any time (subject to the grantor’s consent) and not only upon completion of the construction stage, as currently provided by the Concession Law).

Generally speaking, the Concession Law and regional PPP laws may constitute a solid basis for the development of PPP in the country, but need some significant improvement compared to international standards as well as increased predictability and reliability to become more attractive to lenders and sponsors. The use of PPP forms and models in many sectors is still not possible (e.g. non-cash-generating social infrastructure concessions) and are limited in practice to transport and municipal infrastructure with only few exceptions still at the preparation stage.

According to the 2012 EBRD PPP/Concessions Laws Assessment Russian laws have been ranked in “high compliance” for their extensiveness (see Chart 2). The dimension of the definitions and scope of the law has been identified as the main strength of the country’s concessions legislation, with the PPP legal framework and the project agreement being on the weaker side (see Chart 3). According to the Assessment, implementation of the PPP / concessions laws has been scored “medium effectiveness” as compared to international standards, with the PPP law enforcement being a stronger pillar and the policy and institutional frameworks being identified as the weaker aspects (see Chart 4).
In comparison with the situation at the time of previous EBRD Concessions Laws Assessment the institutional base of PPP in Russia has also been improved. A number of PPP departments have been established in the federal and regional governments and its sub-divisions. PPPs are also noted in some of the regional strategy policy documents. Capacity building and various training initiatives have been launched by a number of institutions.

There is, however, a risk that without a serious policy and regulatory support the Russian PPP market, having just recovered from a significant set-back during the recent economic downturn with many concession/PPP projects abandoned altogether, may plunge into another prolonged period of standstill due to the global markets turmoil which arguably may again hit rather hard the Russian raw materials-based economy.

Chart 2 – Quality of concessions legislation in the EBRD countries of operations

Source: EBRD PPP Legislative Framework Assessment (LFA) 2011/12

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 UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects. The asterisk indicates in which category Russia ranks.
Chart 3 – Quality of the PPP/concessions legislative framework in Russia (2012)

Source: EBRD PPP Legislative Framework Assessment (LFA) 2011/12

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.
3.3 Corporate governance

The main corporate governance legislation in Russia is found in the Civil Code dated 1 January 1995, as amended; the Federal Law “On Joint Stock Companies” (the “JSC Law”), dated 26 December 1995, as amended; and the Federal Law “On the Securities Market” dated 22 April 1996, as amended. The Federal Law No. 395-FZ “On Banks and Banking Activity” dated 2 December 1990, as amended, governs banks and their activities. In 2002, the Federal Commission for the Securities Market issued a Corporate Governance Code developed with the technical assistance of the EBRD. The Code is voluntary but listed companies are required to report compliance with the Code’s recommendations, according to the “comply or explain” mechanism.

In early 2008, the EBRD benchmarked the Russian corporate governance legislation against the relevant international standards (i.e., the OECD Principles of Corporate Governance). The results indicated that Russia achieved a “high” level of compliance (see Chart 5), with certain shortcomings in the regulation on the responsibilities of the board and the role of stakeholders in corporate governance being the strongest point of the Russian corporate governance legislation (see Chart 6).
Joint stock companies with 50 or more shareholders are required to have a supervisory board and a management board appointed by the general shareholders meeting, unless otherwise provided by the company’s by-laws. This gives an unclear signal as to the role of the supervisory boards: in the event the general meeting of shareholders decides to keep the default rule and retain the authority to appoint the management board, the supervisory board has no real leverage for meaningful oversight of the senior management. The structure is a middle way between the unitary and two-tier board structures, but unlike the typical unitary board system, the board is not given a broad mandate to manage the company coupled with the power to delegate responsibility as it sees fit. Nor are boards just a supervisory body with all executive powers assigned to a management body.

Transparency of ownership structure still has room for improvement and related party transactions do not seem to occur under transparent conditions. Non-financial disclosure should also be improved. The “comply or explain” reporting pursuant to the corporate governance code is poor and very little explanations are offered in case of non-compliance with the code’s recommendations. Further, the identity and the qualification of independent directors and of board committees’ members are very often not disclosed.

When turning the analysis to corporate governance of banks, banking regulation barely addresses many key issues, such as the strategic and governance role of the board, risk governance and the organisation of risk management, executive compensation and transparency to the market and regulators. Internal control within banks seems to be the only area where there is detailed regulation. From our recent analysis of the Russian corporate governance framework for banks, it seems that the Central Bank of Russia (the “CBR”) only focuses on corporate governance when a bank is experiencing financial difficulties. But the importance of good governance is precisely to avoid financial difficulty by ensuring better strategy and control over time. The effectiveness of the CBR action is also undermined by the political environment in Russia and the strong presence of the state in the banking sector (the three largest banks are owned by the state). This creates significant conflicts: first, the authorities responsible for regulating and supervising the major banks are also responsible for their business decisions thus undermining the integrity and effectiveness of the supervisory process in these institutions. In addition, the divided loyalties of political board members, combined with the relatively weak presence of independent directors raises significant concerns as regards the safeguarding of these banks’ interests and of the interests of non-controlling shareholders. Finally, the blurring of boundaries also translates into an uneven playing field with private competitors.

The issues outlined above are relevant to the EBRD direct investment in Russian banks and JSCs, but there are no reported cases or pending law suits directly related to corporate governance.
The EBRD is currently assisting with the Federal Commission for the Securities Market with technical assistance dedicated to the revision and implementation of the Russian corporate governance code. The code was developed in 2002 and has not been updated since then. As a result, some of its recommendations are now outdated and not in line with the current legal framework. Further, the “comply or explain” mechanism should be revised in order to improve its effectiveness. Since March 2012, the OECD and MICEX-RTS are undertaking a benchmark study of best international practices to help establish a priority agenda for reform for the Russian regulator to undertake.

With reference to corporate governance of companies, the structure of joint stock companies should be assessed to ensure that the supervisory board is able to effectively perform its oversight over management and to clearly set the direction (in terms of strategy, budget, and risk) of the company. In a group of companies, the framework should make sure that the board of the parent is able to effectively provide oversight over all subsidiaries. Transparency and reporting pursuant to the Corporate Governance Code should be enhanced.

Banking regulation should require the establishment of audit committees in systemically important banks, responsible for supporting the board in ensuring the integrity of financial statements and the effectiveness of the internal control systems. The legal framework should strengthen external audit independence by requiring the rotation of external auditors and regulating the provision of non-audit services. Banking regulation should require systemically important banks to disclose the information necessary to enable the market and other stakeholders to understand their management, governance, financial performance and ownership structure, through annual reports or the corporate website. In addition, a report on risk along the lines required by Basel pillar III enabling a better assessment of their risk profile and their capital adequacy should be communicated to the CBR on an annual basis.

On the supervisory side, the CBR should enhance its supervision of corporate governance, risk oversight and control environment in banks. The CBR should have the power to reject the appointment of board members considered unfit for the position. Notification to the CBR should be done prior to the appointment of a board member. The CBR should encourage more transparency in the nomination process for board directors, including in the large state-owned bank as recommended by the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The effectiveness and independence of the risk management function should be reviewed as part of the supervisory process. The CBR should also require more transparency with regards to executive remuneration in line with the recommendations of the G20.
Overall, the Russian corporate governance framework has recently improved but space for further improvement remains, especially in ensuring that legal provisions are well understood and implemented.

**Chart 5 – Quality of corporate governance legislation in the EBRD countries of operations**

*Source: EBRD Corporate Governance Sector Assessment 2007*

**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.
3.4 Electricity and Gas Regulation

Russia performs reasonably well overall for both electricity and gas sectors. The institutional structure and the regulatory framework are considered quite modern, and the regulatory body, FTS, appears to be close to international standards in terms of authority. The recent EBRD energy law reform dimensions assessment has shown that the electricity sector performs quite well with respect to regulatory independence, transparency and private sector participation, while public service obligations is the weakest dimension (see Charts 7). In the gas sector, regulatory independence along with tariff structure have been considered strongest pillars, with significant deficiencies being found in the market framework and network access (see Chart 8).

Russia’s efforts in the last decade to reform its electricity market offer a useful model for its neighbours. The former monopoly RAO UES has been unbundled, and 20 of the resulting companies were privatised in 2008 — several with foreign investor participation. The (60%) state-owned RusHydro JSC manages the vast majority of the Russian hydro power plants.
The operation of the country’s transmission grid Unified National System (“UNS”), remains under state control through the Federal Grid Company, which is the transmission system operator (TSO). In 2006 a wholesale market (power exchange) was established. The share of electricity that is sold at non-regulated prices is increasing gradually, from 5% of the forecast balance prepared by the FTS for 1 January 2007 to full liberalisation of the wholesale electricity (capacity) market in 2011. By that date, all market participants, excluding the household sector, will be eligible and 100% volumes of electricity will be traded at free prices. As of 1 January 2010, 60% of the non-household market has been liberalised. The wholesale market can be regarded as competitive and the reform is now moving smoothly towards full liberalisation of the non-household market.

Russian legislation stipulates non-discriminatory access to grid infrastructures. The Federal Antimonopoly Service (the “FAS”) is responsible for settling disputes that may arise from access denial, whereas FTS and Regional Energy Commissions (“RECs”) are responsible, respectively, for those related to tariffs on transmission lines (UNS) and regional distribution networks (less than 220 kV). The Federal Tariff Service (the “FTS”) is responsible for setting tariffs, in compliance with the detailed federal relevant legislation. The RECs are responsible for setting tariffs at the regional level according to the guidelines issued by the FTS.

Regulated electricity prices for retail end-users, which are differentiated by categories, are typically the sum of the following components: weighted average generation cost, capacity cost in the wholesale market, cost of ancillary and system services, and retail supply cost (including distribution). The free market prices of the wholesale market (the day-ahead-market, ‘DAM’) are transferred to end-user prices for participants of retail markets in accordance to liberalised market share. Thus retail market participants (except for households) in fact partially pay for consumed electricity at regulated tariffs and partially (in accordance to liberalised market share) at free market prices.

The Ministry of Energy (the “ME”) is responsible for monitoring the expected future demand, foreseeing the need for additional production capacity and ensuring the security of supply. The legislation and market structure include a last resort supplier (“LRS”), which operates within the territory of the subjects of the Federation (Service Area of the LRS). Within each subject of the Federation several LRS can operate. LRS are defined for a certain period at special tenders. Each LRS is obliged to conclude contracts for electricity supply with any customer within their service area.

Currently, the legislation does not include any provision on vulnerable customer categories. In the competitive areas of the electricity market - that is generation and supply - there are no limitations on foreign capital investment. Transmission assets and facilities are controlled by the state.

The situation is sharply different in the gas market, in which the state-controlled Gazprom dominates the gas sector, accounting for over 60% of Russian reserves (almost 30 tcm according to IEA 2008) and almost 85% of Russian production, (amounting in 2007 to about 548.6 billion cubic meters). This means that Gazprom is by far the largest gas producing company in the world.
Oil companies and independent gas producers each account for another 20% of the Russian gas reserves and produce the balance of the total production. Since the beginning of 2000s, international concern about Gazprom’s capacity to keep current production levels has increased. Huge investment is needed in the exploration and production sector to allow Gazprom to meet expected domestic demand and export contractual obligations and to compensate the declining production of aging fields.

Gazprom has a legal monopoly on gas exports and owns the Russian gas transit and transmission system. Gazprom’s deliveries to Europe depend mostly on transit through CIS countries. Currently, more than 90% of its gas exports transit Ukraine, Belarus and Moldova (Ukraine alone accounting for about 75%). Gazprom is also the largely dominant end-user supplier, controlling the vast majority of the regional distribution companies.

The law stipulates that gas transmission and distribution network owners are obliged to provide non-discriminatory third-party access to free capacity, according to procedures determined by the government. The procedure to access Gazprom’s system is currently stipulated in the Regulation “On the Provisions for Access of Independent Enterprises to the Gas Transportation System of JSC Gazprom” approved by the Resolution No. 858 of the RF Government, dated 14 July 1997.

FTS regulates and approves tariffs for the following areas: gas transmission and distribution; wholesale supply; gas supply to end users (as maximum prices); and liquefied gas used in the household sector.

Since 2006 Russia has had a new policy to address price increases and requires that by 2011 domestic prices will be at “parity” with export prices (less transportation and excise duty); this in order to bring domestic gas prices to more cost-reflective levels. The price reform is expected to have a very positive effect on energy efficiency.

In the gas sector the role of the ME is less prominent than in the electricity sector. Nevertheless, it assesses and coordinates draft investment plans of gas companies and prepares draft decisions for the government; for that purpose, it can require relevant documentation from the involved companies. The legislation does not formally include a last resort supplier in the gas sector. In practice, regional gas companies belonging to the Gazprom group perform this function.

As for security of supply (at the end-user level) and protection of vulnerable customers, the law “On Gas Supply in the Russian Federation” provides a number of qualified buyers with a priority right for the conclusion of gas supply contracts. These subjects are essentially state or municipal entities and utilities that supply gas to household consumers (and provide universal service). Foreign capital investment in the gas sector (exploration, production, transmission, wholesale supply and export) is subject to state control, and is included in the list of business activities “which have strategic value for the Defence of the State and National Security Support”, according to the Federal Law No. 57 of May 2008, “On the Procedure of Foreign Investments into Economic Organisations of Strategic Importance for the Defence of the State and National Security Support”.

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Chart 7 – Quality of energy (electricity) legislation in Russia (2009)

Source: EBRD Energy, law reform dimensions assessment project, 2009

Note: The extremity of each axis represents an ideal score i.e., corresponding to the benchmarks and indicators identified in the assessment model. The fuller the ‘web’, the more closely the energy laws of the country approximate these principles.
3.5 Energy Efficiency / Renewable Energy


Within the renewable energy sector, the energy policy of Russia is broadly outlined in the Energy Strategy for 2030, adopted in November 2009. The Strategy sets out key energy policy for the period up to 2030 and outlines three stages of sector development, although some of the planned reforms should be run concurrently. The first stage includes development and improvement of power capacities (2012-2015); the second stage is oriented towards improvement of energy efficiency (2015-2022); and the third stage is directed to development of the legal framework for and promotion of renewable energy (2022-2030).

Russia’s current use of renewable energy is very low, although it has huge wind, hydro, geothermal, biomass and solar energy resources. In particular, Russia’s territorial expanse of arable land provides ideal conditions for biomass production for both biofuels and heat generation. The strategy
sets a goal of 4.5% energy produced from renewable energy sources (RES) (excluding large hydro) in power generation by 2030, which was the goal for 2020. Currently, the share of RES in power generation is roughly 1% and showing practically no indication of growth. Furthermore, yearly investment in RES in Russia is €10 mil, amongst the lowest in the world. The IEA predicts only a 1.6% increase by 2035.

Russia’s primary legislation on electricity is the Law on Electric Power. In 2010 and 2011, amendments were passed to this law which direct the executive branch to develop a system for the support of qualified facilities generating electricity from RES. As of yet, however, there is no legal or regulatory system in place to provide government support for RES.

This is due largely to the lack of a unified and focused government policy regarding the promotion of RES. One reason is that one of the instruments of promotion of RES in electricity generation is through the establishment of a preferential price for the produced electricity, which usually results in higher consumer electricity prices in the short term. The government regulates prices for residential consumers, and is unwilling to allow any significant increase in price due to the certainty of widespread public disapproval to any price increase. Furthermore, there is a low level of environmental concern among the population, resulting in a lack of pressure on the government to push for significant increase in the use of RES.

The existing legal framework regarding RES does not act as a source of support but rather as an administrative barrier to entry. Russian legislation requires that RES plants be certified as qualified producers, in accordance with the Resolution on Qualification of RES Facilities. The current criteria for qualification functions as a “guarantee of origin”, requiring the plant to show that it is powered solely or partly by RES, that it is producing electricity, that it is connected to a grid, and that its electricity has entered into the energy mix in a way approved by the Ministry of Energy. Such requirements serve as an administrative burden to market entry. Furthermore, there is no similar requirement for plants powered by traditional sources. Another problem is the timetable for receiving the certification decision, which is issued only after the plant has been built, connected to the grid, and begins selling electricity. Reserving the procedure for this late in the process makes it very difficult to attract investment.

With respect to the energy efficiency sector, there are several legal obstacles to energy efficiency improvements in the Russian Federation. The main problem is within the residential sector, which is the largest consumer of energy, where the main impediment to improvement has to do with the price of energy. The government regulates prices for residential consumers, and keeps the prices well below market price. Furthermore, the government is unwilling at present to allow any significant increase in price. The price for energy within the industrial sector, on the other hand, is not regulated. As a result, there is much more incentive for energy efficiency improvements within this sector. However, the combination of regulated and unregulated customers creates a further problem of cross-subsidisation. The government keeps the regulated price so low that energy suppliers are for the most part operating at a loss when they sell to residential consumers. In order to make up for this loss, the unregulated, industrial consumers are charged a higher price for energy. A lack of public awareness and general apathy towards energy efficiency or ecological conservation further contribute to the problem of inadequate incentives.

The Law on Energy Efficiency, adopted in November 2009, provided for a gradual implementation of energy efficiency measures, some of which have recently gone into effect. As of 1 January 2011, installation of water, natural gas, thermal energy, electrical energy meters in commercial and industrial buildings and constructions is required. Installation of collective and individual meters for family houses and apartments is required as of 1 January 2012. While adequate incentives exist in
the industrial sector to install measuring devices in order to lower costs, implementation within the residential sector has been slow.

As of 1 January 2012, an energy audit (resulting in the issue of an “Energy Passport”) is compulsory every 5 years for the following organisations:

- state agencies and local governments entities;
- companies in which the state or municipality participates;
- companies conducting regulated activities;
- companies engaged in production and/or transport of energy;
- companies with yearly energy consumption greater than 10 million RUB;
- companies conducting the activities in the field of energy conservation and energy efficiency, financed in whole or in part by funds from the federal, regional, or local budgets.

A significant source of high energy intensity in Russia is the above-average network loss due to the ageing energy infrastructure. The current laws on investment in the energy sector make it difficult or unattractive for private, especially foreign, investors to invest in infrastructure improvements. Another problem is that a fully open, privatised, and efficient energy market does not yet exist in Russia, although significant improvements have been made throughout the past two decades.

Russia’s “Comprehensive programme for the modernisation of apartments and reformation of public utility management for 2012 – 2020” calls for, among other things, measures to improve energy efficiency in apartment buildings and public utilities, including incentivisation of improvements through targeted grants and subsidies. The programme calls for the development of programmes for long-term financing of improvements by the collective residents.

Russia’s Energy Strategy for 2030 sets the target of a 45% decrease in total energy consumption by 2030. Implementation of energy efficiency improvements is to take place in the second phase of the strategy, from 2015 to 2022.

As to the current or proposed reforms in the renewable energy sector, in February 2012, the Ministry of Energy circulated a package of documents to various government entities entitled “Complex of measures for the stimulation of the development of electricity generation facilities powered by renewable energy sources”. The Complex of Measures provides a schedule for the preparation of draft amendments to existing legislation in order to incentivise investment in RES plants and to remove administrative barriers to market entry. The Complex of Measures also assigns responsibility to government entities for the preparation of each draft amendment. The amendments are to be introduced between December 2012 and July 2013.

The Complex of Measures is composed of six measures, which are as follows:

1. Amend the Law on Electric Power to more concretely reflect the current energy policy of Russian Federation
2. Provide a market mechanism to incentivise development of RES. The Ministry of Energy has not made it clear what mechanism should be put in place to incentivise development in RES. However, it states that price premiums are disfavoured, as a result of the high cost they place on consumers. Instead, it states that a mechanism which incentivises investment by eliminating risk in some other fashion is to be favoured.
3. Require grid operators to give priority to RES plants when compensating electricity generators for network loss. The implementation of this policy measure has been objected by the Federal Anti-monopoly Service (FAS).
4. Amend the Resolution on the Wholesale Market to
   a. allow sale on the retail market of electricity produced from solar and wind
electricity generators with installed capacity between 25 and 50 MW; and
   b. define the key terms of supply contracts, including requirements for establishing
price, as well as periods during which buyer is obligated to continue to buy
electricity from the qualified RES plant for that price.

5. Amend the Law on Qualification in order to lessen the administrative burden on RES plants.
   It is intended that the process will be simplified and administrative burdens significantly
reduced, especially on small to medium enterprises (SMEs). A change in criteria is
suggested in order to relate qualification to the governments overall strategy on RES, rather
than to provide a guarantee of origin. Guarantee of origin is to be provided through another
method.

6. Amend secondary legislation and implementing regulation in order to bring it in line with
the changes to the Law on Electric Power suggested in Measure 1.

Another change discussed throughout the Complex of Measures is to change the target indicator
used for RES in the policies of the Russian Federation from a target based on percentage of total
production to a target based on total installed capacity.

The implementation of the Complex of Measures is still to be seen but taking into account the
political agenda of the government it is unlikely to provide a functional market mechanism to
stimulate investment in RES. Nonetheless, it may be successful in reducing barriers to entry
through the amendment of the Resolution on Qualification.

As to the current or proposed reforms in the renewable energy sector, the government has stated
that it plans to remove remaining cross-subsidies for regulated customers from 2014 onwards.
However, it is uncertain what progress is being made in this field. The government also states that it
plans to raise regulated prices such that domestic price matches export price. However, the final
decision regarding time frame for adjustment has not yet been taken because of the widespread
public opposition to price increases. Although initially planned for 2011, this has now been
postponed until at least 2015.

With respect to main policy recommendations in the renewable energy sector, the government
should focus on producing and publishing a clear, consistent, and comprehensive policy on RES.
Simplification of the Law on Qualification should take place as proposed by the Ministry of
Energy. A functional market mechanism to incentivise investment of RES is needed based on
established best practices from other countries.

In the energy efficiency sector, regulated prices must be adjusted to reflect actual costs, and cross-
subsidies must be eliminated. Continued reform is needed concerning the laws on the operation of
the market and on investment, in order to incentivise investment in energy infrastructure
improvement. “Smart” metering technology should be installed, both at the user’s and supplier’s
end.

Overall, a much greater resolve and focus, as well as a quicker timeline for implementation, will be
required in order for any significant improvements in efficiency or use of RES to be realised. There
is potential for improvement in both sectors, but regarding RES, it is unlikely that significant
improvement will take place in the near future.
3.6 Insolvency


The Bankruptcy Law contains five possible stages of Russian insolvency proceedings which might apply to a Russian company: (1) supervision, a compulsory initial stage, involving the appointment of an interim administrator by the insolvency court whose primary aim is to preserve the company’s assets while conducting a financial audit of the company to determine whether the company may be restored to solvency; (2) financial rehabilitation, instigated by the insolvency court following petition by creditors or shareholders and aimed primarily at restoring the company’s solvency and the satisfaction of creditors’ claims in accordance with a debt repayment schedule; (3) external administration, generally instigated by the insolvency court at the petition of creditors, involving the appointment of an external administrator to collect in debt, make an inventory of assets and prepare a plan for restoring solvency; (4) liquidation, where a solvent solution is not possible, involving the appointment by the insolvency court of a liquidator to realise the company’s assets and satisfy its debts in accordance with the statutory order of priorities; and (5) voluntary arrangement, whereby the debtor and its creditors agree to the repayment of creditors’ claims in accordance with a repayment schedule.

The Insolvency Sector Assessment completed in late 2009 concluded that Russian insolvency law was of a generally acceptable standard – i.e. it was in “medium” compliance with international standards (see Chart 9). The existing Russian insolvency framework is relatively comprehensive, in particular when it comes to the treatment of creditors; however there are a number of areas where improvements could be made, including reorganisation processes and treatment of estate assets (see Chart 10).

In Russia, the debtor is required to file for bankruptcy within one month of triggering certain criteria, including inability to pay its creditors or insufficiency of assets. This is a relatively short period. Rules on creditor initiation of bankruptcy proceedings are restrictive. In order to petition successfully for the initiation of bankruptcy proceedings, creditors generally require: (i) a monetary claim against the company confirmed by a court decision; (ii) equal to at least RUR 100,000; and (iii) for such claim to be overdue by at least three months. A requirement for a shorter period of approximately one month for a creditor’s claim to be overdue would be more in keeping with international best practice. The debtor may also of its own initiative petition for entry into bankruptcy proceedings if bankruptcy is anticipated because of circumstances clearly evidencing its inability to perform its payment obligations to its creditors in accordance with their terms. There is, however, no formal legal process under Russian law specifically designed to assist a debtor on the verge of bankruptcy.
Under Russian law, if a company becomes distressed, the founders of the company are required to take measures, upon agreement with the company, to restore the company’s solvency. The only measure specified by law is rehabilitation by way of provision of financial assistance in an amount sufficient to satisfy the payment obligations of the company to prevent its bankruptcy and restore its solvency. The regime of rehabilitation is not sufficiently developed and is not usually used in practice.

Certain restructuring tools are unavailable for a Russian company and its creditors. In a number of jurisdictions the “pre-pack” mechanism, involving the sale of a distressed business to a “newco” on a pre-agreed basis, free of residual liabilities which are left behind in the old structure, has been successful in encouraging the restructuring of companies. No such “pre-pack” concept exists under Russian bankruptcy law. Sale of a company’s assets prior to instigation of bankruptcy proceedings may instead be challenged as a “suspicious” or “preferential” transaction. Standstill agreements entered into outside of bankruptcy proceedings, which introduce a moratorium on enforcement of creditors’ claims and security against a Russian company in financial difficulty are unlikely to be enforceable, unless the terms of each agreement under which the relevant debt obligations have arisen have been formally amended. This may restrict the ability of debtors and creditors to achieve an out-of-court restructuring by making the process more lengthy and burdensome. Higher consent thresholds may also apply to amend a document as opposed to implement a standstill. Furthermore, debt to equity swaps, a feature of many restructuring plans in insolvency, are not available in the course of bankruptcy proceedings against a Russian company. Debt to equity swaps have, however, been recently permitted outside of insolvency following amendments to Russia’s company laws.

At present the provisions of the Bankruptcy Law on preferential transactions give rise to a risk of a challenge to the restructuring of the financing of a Russian debtor. Any payments to a creditor under an existing facility affected within the suspect period may potentially be subject to claw back, even if money was not in fact transferred and irrespective of whether the refinanced facility agreement was entered into before the suspect period. In the event of the debtor’s bankruptcy, new money provided under a new facility and money clawed back under a refinanced facility would be subject to repayment according to a statutory order of priority in insolvency. In Russia, there are limited provisions relating to the disclosure of information to insolvency office holders in the context of bankruptcy proceedings. This shortcoming has been emphasised by the EBRD for some time. In June 2012 EBRD was involved in commenting on new draft legislation prepared by the Russian Ministry for Economic Development which would intended to create wider investigatory powers for an insolvency practitioner, greater obligations and duties on those associated with insolvent companies to disclose relevant information concerning the debtor, and obligations on various state authorities and banking institutions to provide information concerning the debtor. Such legislation is at draft stage and has not yet been approved by the government.
As regards the interests of secured parties in insolvency, the Bankruptcy Law expressly recognises only a pledge or mortgage as giving the holder the status of a secured creditor. Claims secured by a pledge or mortgage over the company’s assets are settled out of the proceeds of sale of such assets in priority to all other claims. This is subject to a requirement for part (20-30%) of the proceeds of sale to be set aside to meet the claims of certain priority creditors (principally employment claims and court and bankruptcy costs, including the costs of bankruptcy administrators) and creditors with current claims that have arisen after the opening of bankruptcy proceedings.

According to the Bankruptcy Law, decisions of foreign courts on bankruptcy are recognised in Russia as provided by the international treaties of the Russian Federation. To date no such treaties have been put in place and this area of the law may soon be reformed (see below).

Russia has a somewhat unique system for regulating insolvency practitioners whereby such practitioners must become members of a self-regulating organisation (“SRO”). A Union of SROs exists, which may provide some uniformity amongst SROs by establishing common professional standards and ethics. However there is no requirement for SROs to be members of the Union and a number of SROs are not members. EBRD has been involved for some years with the Ministry of Economic Development and commenting on draft standards prepared by the Union. Such standards require the approval of both the Union and the Ministry of Economic Development to come into force. Further work is required to strengthen the profession as a whole.

Russia benefits from significant and widespread EBRD investment across the corporate, energy, financial institutions and infrastructure sectors. Insolvency laws may potentially affect all sectors where the EBRD has either equity or a debt stake. They provide an important framework for dealing with distressed investments. Insolvency laws complement other financial and commercial laws. Where reliable and efficient, they may contribute to the creation of a legal environment which is attractive for private investors.

A number of amendments have been proposed by the Russian government to the Bankruptcy Law. These include introducing rules on cross border insolvency aimed at determining the jurisdiction of the Russian courts to hear cross border insolvency proceedings, identifying the law to be applied in the event of cross border insolvency proceedings, establishing rules on recognition and enforcement of foreign court judgements on insolvency cases and addressing issues arising in the event of initiation of conflicting insolvency proceedings against the same debtor in different jurisdictions. Other amendments proposed would, if implemented, introduce new rules for financial rehabilitation with the purpose of expanding the role and use of such procedure for restoring a debtor’s solvency as well as establishing rules on out-of-court settlement of creditors’ claims by imposing the institution of standstill agreements. Another area of proposed reform on which the EBRD has commented is reform of the powers of insolvency office holders. At the moment these amendments have not been presented to the State Duma and are still in the process of discussion and further development.
The proposed amendments to the Bankruptcy Law outlined above would address some of the policy concerns with the existing legislation. Other areas for consideration would include reviewing the existing avoidance provisions to ensure that refinancing of businesses is not subject to claw back risk and considering the adoption of a “pre-pack” mechanism (in each case as outlined above).

Overall, Russia has an extensive commercial law insolvency framework, which may enable the reorganisation or liquidation of a debtor’s business. Nevertheless Russia is in the process of considering significant changes to its Bankruptcy Law to facilitate reorganisation and cross-border cooperation, amongst other matters.

Chart 9 – Quality of insolvency legislation in the EBRD countries of operations

Source: EBRD Insolvency Sector Assessment 2009

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.
3.7 Judicial capacity and contract enforcement

Judicial power in Russia is exercised by the Constitutional Court, courts of general jurisdiction, and specialised commercial (“Arbitrazh”) courts. Arbitrazh courts have a three-tiered structure, comprising first instance and appellate courts, as well as the Supreme Arbitrazh Court, which operates as the final level of appeal. They have exclusive jurisdiction over disputes arising out of the application of legislation governing corporations, and consequently hear disputes involving companies and shareholders on all matters except for employment issues. Arbitrazh courts also have exclusive jurisdiction over the recognition and enforcement of foreign court decisions and arbitral awards for disputes arising out of commercial activity. These courts also consider companies’ claims against the decisions of state authorities which are alleged to have infringed their rights and interests. This includes tax, land and other administrative disputes. Arbitrazh courts are regulated by the 1995 Federal Constitutional Law “On Arbitrazh Courts in the Russian Federation” and the 2002 Arbitrazh Procedure Code of the Russian Federation.

The jurisdiction of civil courts includes: (i) all criminal cases; (ii) appeals of administrative and other state actions that do not fall within the jurisdiction of other courts, including the Arbitrazh Courts; (iii) labour and employment disputes; (iv) consumer protection and civil cases when a party is an individual and the case does not involve a business dispute. Civil courts operate under the 1996 Federal Constitutional Law “On the Judicial System of the Russian Federation,” the 2002 Civil Procedure Code of the Russian Federation, the 1998 Federal Law “On Justices of the Peace” and the 1999 Federal Constitutional Law “On Military Courts.” The Supreme Court of the Russian
Federation is the supreme judicial body for civil, criminal, administrative and other cases under the jurisdiction of civil courts. For certain categories of cases it acts as a court of first instance (generally those which are considered to be of “special importance” or “special public interest”).

The EBRD’s Judicial Decisions Assessment conducted in 2010-2011 revealed that decisions of Russian Arbitrazh courts were of generally good quality and were overall highly predictable – the best in the CIS region (see Chart 11). The general level of sophistication of judicial decisions is typically higher in Russia than elsewhere in the CIS. Nevertheless, some decisions showed a lack of commerciality and a tendency towards formalism in interpreting and applying laws. It was considered that some judges would benefit from greater experience in complex business disputes and specialisation in key areas, such as insolvency.

The EBRD assessment found that the generally good quality of commercial law decisions in Russia was partly due to the activity of the Supreme Arbitrazh Court in providing guidance to lower courts through binding formal instruments on points of interpretation and practice. In addition, quality and predictability were aided by the fact that judicial decisions are widely available and searchable online. In the latter regard, Federal Law 262 of 2010 requires courts to publish their decisions and information about their activity online. All courts have created websites, albeit with different amounts of information. The data provided on the websites ranges from information on scheduling of cases and logistics of court hearings to more in-depth information on case decisions, analogous decisions and filing fees.

According to the EBRD assessment, one of the main areas of concern in the court system remains the inconsistent implementation of decisions (see Chart 11). This problem is further reflected in the large numbers of decisions against Russia in the European Court of Human Rights, finding breaches of the right to a fair trial because of the non-implementation of judgments, including in commercial cases. In addition, the assessment raised concerns about lack of partiality in the courts. Bribery is believed to be widespread (Russia is ranked Russia 143 out of the 183 countries in Transparency International’s Corruption Perception Index). Courts are also considered to favour the state in litigation, although outside of strategically important sectors of the economy, this is not considered to be a strong tendency.

Procedural and substantive legislation shapes the performance of the judiciary. On the negative side, civil procedure rules make it too easy for a party to reopen a determined case based on ‘newly discovered circumstances’, adversely affecting the finality and implementation of decisions. And stronger legislative provisions are required for preventing respondents to commercial cases diluting or hiding assets during litigation, such as freeze orders and security for costs. On the other hand, fast track procedures, including for the recovery of simply debts, have clearly assisted the courts to deal expeditiously with smaller value cases.

Recent reforms include a law on mediation enacted in 2011 in order to reduce heavy caseloads and facilitate speedy and amicable resolution of legal disputes. Under the new law, mediation can be used in commercial disputes without prejudice to the right to litigate at a late time, as limitation periods for filing claims are suspended during mediation. Further, the law ensures that mediation agreements are enforceable in the courts.
3.8 Public Procurement

Public procurement law in Russia is regulated by the Federal Law N 94-FZ “On Procurement of Goods, Works and Services for State and Municipal Needs”, adopted on 5 July 2005 (the “PPL”). This law was substantially amended in 2009 in order to introduce mandatory electronic reverse auctions. Currently, a major reform of public procurement system is in progress: the Russian parliament completed a first reading of the draft public procurement legislation based on the 2011 UNCITRAL standards, intended to replace current laws by the end of 2012.

In the EBRD 2010 assessment the Russian legal and regulatory framework achieved medium to high compliance with international standards (see Chart 12). The system, however, displayed no major strengths, since it did not score well in any of the assessment benchmark indicators (see Chart 13). Russian legislation provides for most of the basic features of the public procurement regulatory framework; however most of the efficiency instruments, recommended by international standards are not incorporated. Good compliance has been recorded in indicators for uniformity and enforceability of the legal framework (see Chart 14).

The institutional framework is well developed, but complicated and with overlapping duties. Still, an independent dedicated review and remedies function has not been provided for: a review process is conducted by Federal Antimonopoly Authority, with no tribunal standing or procedures ensuring procedural fairness to private sector enterprises complaining against public entities. In addition, Russian public procurement legislation is far from stable; frequent amendments and complex enforcement mechanisms result in the general perception that public procurement laws and their application in practice is unpredictable. Until the end of 2010 Russian laws allowed for preferences for domestic tenderers. Since 2009 all public procurement procedures in Russia are conducted as electronic reverse auction; tendering has been abandoned. Due to no procurement planning and aggregation mechanisms in place and interconnectivity problems, with different platforms...
providing auction services (suppliers have to register at each of the 18 active platforms, no data exchange takes place) very limited competition has been recorded. All these problems provided an incentive to overhaul the regulatory framework and a reform process was initiated in 2011.

Under the Bank’s operation, the EBRD Procurement Policies and Rules shall be imposed, as there is a high procurement risk in conducting procurement under local system.

At present there are reform initiatives undertaken by the government, in order to adopt a new modern legal and regulatory framework for public contracts. The EBRD UNCITRAL Initiative for Enhancing Public Procurement Regulation in the CIS countries and Mongolia has been designed to support governments in the CIS region in their reform efforts and potentially can contribute to the development of the new legal and regulatory framework in the Russian Federation.

The current public procurement legal and regulatory framework in the Russian Federation is of medium compliance with international standards, and in practice does not ensure transparency of public procurement decisions or value for money objectives. A general conclusion is that the development of local public procurement capacity is progressing; still substantial gaps in national legislation and institutional framework were identified. Thus, public procurement policies in the Russian Federation need revising and contracting entities could benefit from development and implementation of the eProcurement procedures available to all contracting entities and suitable for different types of public contracts.

**Chart 12 - Quality of Public Procurement legal framework in Russia as compared to other EBRD countries of operation**

![Chart showing the quality of public procurement legal framework in Russia compared to other EBRD countries](image)

**Source:** EBRD Public Procurement Assessment 2010

**Note:** The score represents the level of compliance of the country’s legal framework with international standards such as the revised UNCITRAL Model Law on Public Procurements. Russia is highlighted in comparison with other countries.
Chart 13 - Quality of Public Procurement legislation – Russia (2010)

Source: EBRD Public Procurement Assessment 2010

Note: The extremity of each axis represents an ideal score in line with international standards such as the revised UNCITRAL Model Law on Public Procurement. The fuller the ‘web’, the more closely the public procurement laws of the country approximate these standards.
3.9 Secured transactions

Within the warehouse receipts law reform, the EBRD, together with the UN FAO, has been supporting the Ministry of Agriculture on the development of a long overdue legal framework for grain warehouse receipts. The reform’s objective is to enable grain producers to safely store their crops in public warehouses that are properly managed and financially sound and, if they wish so, mobilise the grain as collateral to raise finance. The draft law is now nearing finalisation and it is anticipated that it will be approved by the Government and submitted to the Duma by the end of 2012. It is significant progress during a reform programme that has been unsuccessful in the last decade or so.

The remaining challenge will be to implement the new Law on Public Grain Warehouses, once adopted. This will rest in part with the newly created Self-Regulated Organisations of Public Warehouses ("SROs") which will be formed as per the new Law. These SROs will be responsible for developing internal rules and mechanisms to ensure that the warehouses which are members of the SRO meet all technical and financial requirements imposed by the SRO, operate as intended by the Law, and contribute to an indemnity fund also run by the SRO. The Ministry of Agriculture will also remain instrumental in ensuring the proper implementation of the law and encourage its use. The EBRD remains more than ever committed to the reform and will actively seek means by which it can support the adoption of the draft Law and also contribute to the good implementation of the Law by providing further technical assistance.
The EBRD is also discussing with the Ministry of Agriculture the launch of a new legal reform initiative within crops receipts, aiming at providing a legal framework for the issuing of a so-called ‘crops receipts’ by farmers – a note undertaking the delivery of agricultural products or a financial obligation vis-à-vis a creditor secured by a pledge over future crops. This instrument, inspired by the very successful Brazilian experience, would represent an important alternative mode of financing for crops producers in Russia. The Ministry of Agriculture has expressed an interest and it is hoped that work will start in the second half of 2012.

Within the pledge law reform, the law on security (pledge) remains as one of the most serious bottlenecks in the functioning of Russian financial markets, and an obstacle to their further development. Taking security is included in the majority of banking products: corporate loans secured by available assets, consumer lending, asset securitization, development of exchange-traded and OTC derivatives, collateral in the securities markets, collateralization of cash and bank accounts, legal treatment of pledged assets in bankruptcy proceedings, and creation of a system for the registration of moveable property.

The inefficiency of the pledge as a tool for risk management and the incompatibility of the Russian law on pledge (security) between market realities and the needs of market players remain a serious barrier to further development of the market, growth in consumer lending and implementation of modern risk management tools. It is a factor resulting in higher banking risk and dramatic reduction of the Russian financial market’s competitiveness globally.

The EBRD had been advocating the need to reform secured transactions (also referred to as pledge law) in Russia for many years and with various counterparts, in particular with the Central Bank, the Ministry of Finance, and more recently the Duma’s Committee on Credit Organisation and Financial Markets, with limited success. It is also, as a member of the Foreign Investors Advisory Council (“FIAC”), drawing the attention of Russian policy-makers to the importance of such reform.

At the end of 2009, the Bank was approached by the Ministry of Economic Development (“MED”), which requested EBRD technical assistance for such reform. The MED’s objectives were to undertake a complete review of the legal provisions related to security rights (pledges and mortgages) with the view of making them more coherent, comprehensive, legally efficient, and market-oriented. More specifically, the MED has been entrusted with the task of fundamentally revising the two applicable laws - namely the 1992 Pledge Law and the 1998 Mortgage Law. Due to the experience it has accumulated over many years and in many jurisdictions while leading projects of similar nature, the EBRD was well placed for providing technical assistance to the MED on this project. The EBRD counterpart is the MED Department for Corporate Governance.

In order to ensure that the reforms targets the right issues and suggests appropriate solutions, the EBRD advised the MED to undertake, with EBRD assistance, a process by which i) the problems to be addressed by the reform would be identified by approaching market players and ii) the reform’s broad conceptual approach and most salient changes were to be articulated in front of the main stakeholders (represented in a Working Group (“WG”) set up for the reform by the MED), via a Concept Paper which was drafted with EBRD assistance. The Concept for reform of the Russian security legislation dated October 2010 became the blueprint for the subsequent work.

From the outset, it was clear that the project was going to comprise an important consensus building component. The official remit of the MED is limited to the reform of specific laws devoted to secured transactions - namely the Mortgage Law and the Pledge Law. The MED would not be entrusted with the reform of the Civil Code provisions on secured transactions, which is undertaken by the Council for Civil Law Codification and Enhancement of the President of the Russian
Federation (the “Codification Committee”), especially the Sub-Group working on Chapter 23 on Pledge. At the end of 2010, the Codification Committee released the draft of General Provisions of Russian Law on Obligations, including paragraphs 3.1 (Pledge) and 3.2 (Specific pledges) of Chapter 23 (Security for performance of obligations) of Section III (General part of law on obligations) of the draft Civil Code, as well as Chapter 20.4 (Mortgage) of Subsection 4 (Limited property rights) of Section II (Property rights) of the draft Civil Code. Generally it was noted that, although changes to existing provisions were quite extensive, they did not fundamentally change the underpinning principles of security law that currently exist in the Civil Code, which market participants have repeatedly denounced. Furthermore, the draft provisions did, in some instances, provide totally opposite approach to Concept Paper.

Between December 2010 and April 2012, the EBRD thus supported the MED by providing detailed comments on the draft Civil Code provisions related to pledge (and mortgage), putting forward alternative provisions, and discussing with a number of key stakeholders, in particular the relevant working group of the influential Moscow as International Financial Centre, for amending the draft. The draft Civil Code is now before the Duma and has passed the first reading. A number of key concerns remain.

Firstly, the statutory contents of a pledge agreement should be further liberalised. This would allow; the expansion of the scope of assets that the creditors may use as security, and the scope of transactions that may be secured; to increase the creditors’ confidence in reliability of security provided to them (for example, the risk of declaring a pledge agreement as “unconcluded” based on the formal ground of an insufficiently precise description of the subject of pledge, that is now significantly high for creditors, will be considerably decreased); and to decrease transaction costs related to the granting of secured financing (for example, in case of changes in the subject of pledge the amendment of a pledge agreement should not be necessary when the initial general description has allowed for such change).

Secondly, the certainty of creditors as to their priority over the pledged assets should be ensured. The priority for the satisfaction of the pledgeholders’ claims should depend on the time of recording (registration) of pledge (where such recording (registration) is provided by law), except for certain type of security where recording would not be deemed appropriate.

Thirdly, the provisions governing pledges of specific objects (in particular, claims (rights) and bank accounts) should be strengthened. The provisions on pledge of rights must take into account the international recommendations in the area of assignment and pledge of rights. As to the pledge of rights under a bank account, it should be possible to use the rights with respect to any bank account as security. The pledgeholder should have certainty that he will be able to seize the account rights under which are pledged in accordance with the pledge agreement, and not only in case of non-performance of a secured obligation by the debtor, as provided by the draft Civil Code.

Fourthly, the procedure of levy of execution should be further simplified and liberalised to meet market expectations. The quality and effectiveness of rules on levying execution is one of the factors strongly affecting the value of pledge as a type of security. Therefore, the procedure for levying execution should be as much as possible clear, predictable, quick and cost effective. Russian law has made tremendous progress in this respect. However, those progressive changes may be impaired by certain provisions of the draft Civil Code, which it is strongly recommended to repeal.

In addition to the work advising the MED on the Civil Code provisions, the EBRD was also asked to advise on the development of the pledge register. The MED is preparing a Law on the Recording of Pledges and the EBRD has provided full technical assistance in its preparation. It is expected that the draft will be passed to the Duma very soon indeed. This aspect of the reform is specifically
support by the Legal Department of the Presidential Administration and the EBRD is working closely with them too.

3.10 Telecommunications / Electronic Communications


MTMC is responsible for policy and regulation in the sector. The main functions of regulation are divided among different state bodies funded from the state budget:

- The Federal Agency of Supervision in Telecommunications, Information Technologies and Mass Communications (RosComNadzor) is responsible for control and supervision in the area of mass information, including electronic and mass communications, information technologies, personal data protection and the organisation of radio service activities.

- The Federal Agency of Communications (RosSvyaz) is responsible for organizing measures for recovery of networks in states of emergency, certification, numbering administration and regulation of universal services including tariffs for these services.

The functions of these bodies are separated based upon the provisions of the Statutes for MTMC, RosComNadzor and RosSvyaz. RosComNadzor and RosSvyaz are under the authority of MTMC, which limits the independence of the regulatory function. RosComNadzor and RosSvyaz are financed from the federal budget. These bodies are entitled to establish consultative and expert bodies (such as boards, committees, groups), the activities of which are regulated by statutes approved by RosComNadzor and RosSvyaz. The heads of RosComNadzor and RosSvyaz are appointed by the Government, on presentation by the Minister of Telecommunications and Mass Communications. Deputies of these bodies are appointed by the Minister of Telecommunications and Mass Communications. This regulatory structure is further complicated by the functions of:

- the Federal Tariff Agency, which has strong powers in controlling “natural monopoly” tariffs. Regulation of tariffs on network interconnection and traffic transmission provided by dominant operators is carried out by RosSvyaz in coordination with the Federal Tariff Agency.

- the State Committee of Radio Frequencies (SCRF) which manages the spectrum

- the State Antimonopoly Agency, which is responsible for designating a dominant position in the market, initiating and considering cases on violation of the antimonopoly legislation.
Although the primary law does not define the separation of policy and regulatory functions, in practice, based on various decrees, the functions of regulation appear quite fragmented, with no overall consistency in approaching the increasingly convergent electronic communications sector.

While Russia has adopted some modern practices in the regulation of the sector, many of the competitive safeguards found in other jurisdictions are missing from the Russian sector framework. A summary of positive and negative aspects of the regime can be seen below. In the EBRD Telecommunications Regulatory Assessment 2008, the telecommunications regulatory framework of Russia has shown deficiencies in all six dimensions, with dispute resolution and appeal being the weakest pillar (see Chart 17). The Assessment has further shown the fixed network penetration level at approximately 33%, below the EU average (see Chart 18(a)). Mobile network penetration is slightly less than 140% of population (see Chart 18(b)), above the EU average. Broadband penetration is still well below the EU average; standing at approximately 7% (see Chart 18(c)).

While RosComNadzor is working to ease authorisation and licensing requirements for provision of service, there are still a large number of different categories of licence required for local, national, international, leased capacity, infrastructure and data communications services, contrary to best practice.

For rights of way over public and private property, state authorities and local self-governing bodies must assist operators who provide universal electronic communications services in building communications networks, facilities and/or premises designed for universal service provision. Operators must first seek agreement from the owner (or other tenants) of any buildings, power lines, railways, masts, bridges, tunnels (including subway tunnels), highways, and other engineering facilities.

There are no provisions regarding infrastructure sharing and access. The dominant operator has no obligation to share essential facilities including ducts, conduits, infrastructure or other facilities. Local loop unbundling is not available to alternative carriers, unless they are subsidiaries to the incumbent network provider. All independent alternative providers therefore have to build their own infrastructures.

Operators designated as dominant are required to publish their terms and conditions of network interconnection, but there is required content for such documents. Regulations apply to the dominant operator’s call termination, call transit and call origination services and it appears, also to the co-responding services of the counterparty to the interconnection. Number portability has not yet been implemented.

Decisions on assignment of frequencies for commercial use are taken by RosComNadzor within 35 working days from the receipt of application. Information these assignments should be published on their official website within 5 days from the date of decision. In 2011 RosComNadzor conducted 7 contests for the provision of spectrum authorisation. The frequencies assigned are not technologically neutral. Recent contests have specified LTE standard, fixed wireless access and GSM. In May 2012 RosComNadzor announced that it plans to hold a contest for the 800MHz “Digital Dividend” spectrum for LTE, thus paving the way for the extension of fixed and mobile broadband services. A commission on re-farming GSM900/1800 frequencies has been formed consisting of RosComNadzor and SCRF. In consultation with the major mobile operators: Beeline, Megafon, MTS, Tele2 Russia, Rostelecom and SMARTE, this commission is understood to have already agreed on the re-farming of frequencies in 6 of Russia’s regions. The re-farming aims to create wider bands in order to raise the efficiency of spectrum use. No spectrum trading is allowed without authorisation given by SCRF. The introduction of virtual mobile operators into the market has recently stimulated competition, and there were 17 new licences issued during 2011 alone. The
major mobile network operators, led by MTS are now getting involved with the new retail service providers.

The Russian government has been attempting to implement mobile number portability for many years, but it is yet to become effective.

Reference interconnection offers are published by the largest operators. RosComNadzor claims that there is no need for regulation, because mobile termination rates are comparatively low. Currently the average in Russia is at the level of EUR 0.022 per minute, which is low by average European Union comparison.

National roaming is required by regulation.

EBRD does not currently have direct investments in the telecom sector in Russia; however (at a technical and business level) the presence of a legal, regulatory and institutional framework for telecoms which is reflective of proven best practice will do much to make the overall environment for the sector attractive for investment, promote broader competitiveness across the economy and aid social development. Russia has some way to go to harmonise with such practices.

Reforms are understood to be on-going at a technical level, generally improving the environment for operations. However, plans to adopt more far reaching and strategic restructuring of the sector, particularly on the institutional side, which would be necessary to adopt best practice, have yet to become apparent.

The operators appear to be entering a new phase of co-operation, with significant infrastructure sharing deals, participation in joint investments and a very active market in virtual mobile service providers in conjunction with network operators. The regulatory agencies should continue to insist that such deals do not reduce the already limited competitive safeguards available to the newer, smaller players. By adopting best practice regulatory approaches, all parts of the market will ultimately benefit. The most significant event in 2012 will be the auction for large sections of valuable spectrum for broadband services. Its outcome will determine the competitive market landscape for many years in Russia. The outcome of the current moves in Russia – particularly the initiatives on infrastructure sharing and the auctioning of new broadband spectrum – will have repercussions outside Russia, especially in the former Soviet republics with a number of them tending to follow the situation in the much larger Russian market, with the bigger market players in Russia having operations in many of the former republics, including the Central Asian States, the South Caucasus countries, Belarus and Ukraine. In most of these countries, infrastructure sharing has not been mandated by regulators beyond the simple case of duct sharing. If those countries follow Russia’s lead, then considerable investment savings may be possible to complete the infrastructure, especially out to the rural areas where penetration of modern telecommunications networks have been historically low. The outcome of Russia’s 2012 LTE spectrum auction will also be watched closely, as many of Russia’s neighbouring states still need to plan their own “digital dividend” based on spectrum demand over the next 3 years, leading up to the required deadline for analogue broadcasting switchover in mid-2015.
Chart 17 – Quality of telecommunications regulatory framework in Russia (2008)

Source: EBRD Telecommunications Regulatory Assessment 2008

Note: The diagram shows the combined quality of institutional framework, market access and operational environment when benchmarked against international standards issued by the WTO and the 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 regulatory framework of the country approximates these standards.

Chart 18 – Key indicators for Russia (2008)

18(a) Fixed Network Penetration

<table>
<thead>
<tr>
<th>Country</th>
<th>Fixed network penetration (% of population)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>31</td>
</tr>
<tr>
<td>EU average</td>
<td>47</td>
</tr>
<tr>
<td>SEE average</td>
<td>29</td>
</tr>
<tr>
<td>CIS+M average</td>
<td>29</td>
</tr>
<tr>
<td>EU8 average</td>
<td>41</td>
</tr>
</tbody>
</table>
18(b) Mobile Network Penetration

![Mobile network penetration chart]

18(c) Broadband Network Penetration

![Broadband access chart]

*Source: EBRD Telecommunications Regulatory Assessment 2008*

*Note: Key indicators for Russia provide the fixed network penetration defined as active subscriber lines as a percentage of population, mobile network penetration defined as active pre- and post-paid subscribers as a percentage of population and the broadband network penetration defined as the number of access subscribers with speeds of 144k/bits or more as a percentage of population (broadband Network Penetration less than 1% is not shown on this chart).*