





# Competition Law and Policy in Russia



An OECD Peer Review



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# **COMPETITION LAW AND POLICY IN RUSSIA**

**-- AN OECD PEER REVIEW --**

This report was principally prepared by Sarah Reynolds, a consultant to the Directorate for Financial and Enterprise Affairs of the OECD. It has benefited from extensive comments provided by colleagues throughout the OECD Secretariat and by the Government of the Russian Federation.

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## *FOREWORD*

The Russian Federation is the first non-member economy that has volunteered to participate in the OECD Regulatory Reform Programme, which was launched in 1998. The Russia review is implemented under the aegis of the Centre for Cooperation with Non-Members (CCNM), which promotes a mutually beneficial dialogue between OECD members and non-member economies. This review aims to assist the Russian authorities' efforts to foster competition, innovation, and economic growth as well as to meet important social objectives. It follows a multidisciplinary approach, with competition policy as one of the several areas under review.

A report by the Secretariat was the basis of a three hour peer review discussion at the meeting of the Global Forum on Competition (GFC) in Paris on 13 February 2004. The GFC, one of the OECD's eight Global Forums held under the aegis of the CCNM, gathers national competition authorities from around the world, and officials from some economies that do not yet have competition authorities, to advance a range of objectives including the promotion of global competition enforcement cooperation. An increasingly common way to structure and focus the dialogue is through a peer review exercise in which probing questions are asked and the responses lead to in-depth exploration of shared experiences and evolving common standards. The Russian Federation is the second country, after the Republic of South Africa which was reviewed in 2003, to undergo a peer review in the GFC. Russia was represented at the Global Forum by the Minister for Antimonopoly Policy, who expressed support for many of the recommendations and Russia's desire to continue its long-standing cooperation with the OECD in this important area.

The following Secretariat report concludes that although a strong legal foundation for competition policy was put in place early in Russia's transition, competition has not been a priority in practice. The Ministry for Antimonopoly Policy and its predecessor agencies have made important contributions to the creation of a competitive market environment through both enforcement practices and creation of necessary laws and institutions;

however, the excessive breadth of MAP's responsibilities has substantially interfered with its ability to concentrate on serious competition issues. Structural and legal problems – including low merger control thresholds, the absence of comprehensive regulation of natural monopolies, a broad jurisdiction over state actions and decisions, and the lack of any discretion in enforcement – result in unmanageable caseloads containing many matters that are unlikely to have any effect on competition. Sanctions for even the most serious violations are insignificant, providing little or no deterrent effect, and the law provides MAP with very limited investigation powers. Substantial change will be required to produce a stronger and more focused competition authority that will be able to meet the challenges of reform and be a catalyst for economic growth. The report identifies the most serious obstacles and suggests alterations in the structure and powers of the competition authority and in the substance of the competition law and related legislation that should be considered. The report comes at an important juncture for Russian competition policy, as a general reform of state bodies and the completion of a new competition law have both been identified as high priorities of the Russian Government for 2004, offering an excellent opportunity for the issues identified in the report to be addressed in a comprehensive fashion.

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Center for Cooperation with Non-Members

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## ***NEW DEVELOPMENTS IN RUSSIAN COMPETITION POLICY***

This report on competition policy and the role of the competition authority in the Russian Federation was completed in late 2003 and formed the basis for an in depth discussion at the Global Forum on Competition on 13 February 2004 at OECD Headquarters in Paris, France. Only a few weeks after that event, the Russian government was substantially restructured, resulting in the elimination of the Ministry for Antimonopoly Policy and the creation of a new federal competition authority.

The new body – the Federal Antimonopoly Service – will have a special status directly subordinate to the Prime Minister. Unlike the Ministry for Antimonopoly Policy, the Federal Antimonopoly Service will not be responsible for regulating telephone tariffs and will not bear primary responsibility for the enforcement of consumer protection laws. As this report is being finalized in March 2004, it is not yet possible to assess all of the impacts of the change on the Russian competition authority. Legislation must still be completed to define the structure of the Federal Antimonopoly Service and delineate its powers and tasks, including the newly assigned task of supervision over the highly concentrated energy sector of the economy. Nonetheless, the changes made appear to be positive steps toward a more efficient, independent and focused competition authority. They are consistent with the report's concern for the ability of the competition authority to support pro-competition solutions in all areas of policymaking and follow its strong recommendation that the task of the competition authority be narrowed and matters not directly related to competition transferred to other bodies.

In order for the promise of the new structure to be fulfilled, however, other problems identified in the report must also be addressed. If the legislation defining the new body does not provide adequate investigative authority and the power to impose real sanctions, even a newly streamlined Federal Antimonopoly Service will have difficulty in detecting, proving and deterring violations. Changes in the competition law itself are equally important to allow the new enforcement body to focus its energies on serious competition problems that have a substantial impact on the economy. The OECD looks forward to working with the Federal Antimonopoly Service to meet these challenges.

## **EXECUTIVE SUMMARY**

### **Background Report on the Role of Competition Policy in Regulatory Reform**

Competition policy is central to regulatory reform, because its principles and analysis provide a benchmark for assessing the quality of economic and social regulations, as well as motivate the application of the laws that protect competition. As regulatory reform stimulates structural change, vigorous enforcement of competition policy is needed to prevent private market abuses from reversing the benefits of reform. A complement to competition enforcement is competition advocacy, the promotion of competitive, market principles in policy and in regulatory processes.

The Russian Federation created a competition authority early in its transition period and has embodied strong support for competition in law, but competition has not always been an immediate priority in practice. After a shift away from a gradualist model of transition, emphasis was placed on rapid privatisation, resolution of fundamental questions of state structure and then the management of a major fiscal crisis. Instead of concentrating narrowly on the creation and vigorous protection of competition, the competition authority has been expected to serve as a general regulator of behaviour in markets, assigned to remedy institutional and structural problems and enforce against a variety of undesirable practices. Relatively rapid changes in its structure and task assignments, regular amendment of the competition law and related legislation, and the sheer size of enforcement responsibilities have complicated the development of legal standards and drained resources away from core competition concerns.

Despite these difficult conditions, the competition authority has made significant contributions to the creation of a competitive market environment, both through enforcement practices and through creation of necessary institutions. Achievements include a significant reduction in barriers to the movement of goods and services and the creation of legislation needed to protect consumers and to regulate other aspects of market activity. The competition authority was also responsible for the creation of the initial legislation on natural monopolies, establishing a narrow field of regulation and the concept of independent regulators, and it continues to play a major role in the reform of monopolised areas, both in defining reform strategies and in supervising the operation of new systems to ensure the development of competition.

*EXECUTIVE SUMMARY (cont.)*

As Russia moves past crisis stabilisation concerns and into the next phase of economic expansion, new priorities include the broadening of economic growth into more domestic industries and geographic areas and the creation of new investment and new business opportunities. This will require the further restructuring of regulated sectors to promote investment and provide support for overall growth, as well as the removal of both state and private impediments to entry and to vigorous and fair competition in a transparent and open environment. A strong and effective competition policy will be essential in meeting these goals; experience shows that a competition policy that rewards efficiency has a positive effect on overall economic performance. But significant structural and legal problems currently interfere with MAP's ability to be effective in its enforcement of the competition law and to undertake focused competition advocacy. MAP's responsibilities are too broad and interfere with its ability to concentrate on competition issues. And while the subject-matter coverage of the competition law conforms to familiar models, sanctions for even the most serious violations are insignificant and MAP has limited investigation powers. Low merger control thresholds, the absence of comprehensive regulation of natural monopolies and a broad jurisdiction over state actions and decisions, combined with the lack of any discretion in enforcement, result in unmanageable caseloads containing many matters that are unlikely to have an effect on competition. A general reform of state administration and the beginning of drafting work on a new competition law offer an important opportunity for these structural and legal issues to be addressed, resulting in a stronger and more focused competition authority that will be able to meet the challenges of reform and be a catalyst for economic growth.

## **1. Foundations and History of Competition Policy**

The Russian Federation created a competition authority early in its transition period and has embodied strong support for competition in law, but competition has not always been an immediate priority in practice. In addition to core competition issues, the competition authority has been assigned a broad variety of tasks related to market activity, including the creation of legal institutions to regulate market behaviour, regulation of natural monopoly tariffs, and the development of market infrastructure and new enterprises. There have been rapid shifts in its priority areas of activity and in its authorities, as well as regular amendment of the competition law and related legislation. Current priorities include participation in the restructuring of natural monopoly areas and creation of the associated legislation and new enforcement patterns and a focus on the role of state bodies and officials in the economy. Authorities continue to be shifted into and out of the competition body and drafting work on a completely new competition law is beginning.

### ***1.1 Context and early history***

When the Soviet Union began to plan a path toward a market economy in the late 1980s, the initial transition policies of the central government focused on stimulation of the creation of small businesses and new enterprises. A gradual reduction of the amount of planned activity was to allow state enterprises to move at a measured pace into market behaviour patterns, while newer forms of business enterprise would speed increases in the provision of consumer goods and services and spur the formation of the market infrastructure needed to support broader market reform. Enterprises and activities that were considered strategic or key to basic economic stability were to be left in state hands and/or regulated until other parts of the economy had moved into more market-oriented structures. Significant concerns were expressed about the starting levels of monopolisation of both productive industry and distribution channels, and this concern led to expectations of a relatively strict regulation of dominant enterprises during a potentially long transition period, to be combined with very substantial “demonopolisation” or deconcentration of larger enterprises and associations before privatisation. Special provisions allowing state control of monopoly behaviour began appearing in legislative acts concerning reform.<sup>1</sup>

In 1990, the first Russian<sup>2</sup> competition authority was created – the State Committee for Antimonopoly Policy and the Support of New Economic Structures<sup>3</sup> – and the Law “On Competition and the Restriction of Monopolistic Activity on Goods Markets” (hereinafter the Law on

Competition) was passed in 1991.<sup>4</sup> The law contained relatively mild sanctions for most violations, preferring cease and desist orders and disgorgement of improperly received income to direct fines or the punishment of individuals. This was consistent with expectations that the worst potential problems would be controlled by regulation and also reflected fairness concerns about the complete unfamiliarity of competition law concepts and a desire to allow the new rules to become known before severe sanctions were applied. A long history of planning and coordination, as well as a lack of familiarity with methods used to govern and regulate markets, led to expectations that state bodies of various kinds would attempt to continue to control economic activity. To counter this, the Law on Competition included provisions prohibiting such behaviour. Likewise, the expectation of a need to divide large enterprises or associations was reflected in the inclusion of an article specifically authorising such division after repeated violation of the law.

Many enterprises had been deliberately created by planners to be dominant or even monopolists within specific geographic areas or in specialised products and activities and transportation and distribution functions were likewise deliberately concentrated under planning. This situation contributed to fears of a massive, inflationary price explosion and wide-spread abusive behaviour as liberalisation reduced legal controls on enterprise behaviour. One of the chief tasks of the new competition authority was expected to be prevention and control of this problem and accordingly one of its first acts was the creation of a register of enterprise-monopolists. It was expected that supervision would be exercised over the business decisions of those enterprises included in the register, especially over their pricing patterns.<sup>5</sup> A significant amount of energy was expended by the competition authority during the earliest part of its existence in the compilation of the register, creation of reporting forms for enterprises listed in it, verification of their activities and reports, and participation in disputes concerning the removal of enterprises from the register. At the same time, the competition authority worked to develop guidelines for the enforcement of the new law and materials for the education both of new staff and of a public almost completely unfamiliar with market mechanisms and competition concerns after several generations of state planning.<sup>6</sup>

As its name suggested, the State Committee's mandate was not limited to competition issues. The new State Committee was made generally responsible for the support of "new economic structures" -- i.e. markets. The tasks that would be involved were not specified and it was anticipated that the State Committee itself would take some responsibility for defining the necessary programs and legislation, as well as being assigned responsibilities by the Government. In practice, it included measures to

encourage the formation of new businesses and proposals concerning the development of necessary market infrastructure. It also included the control of not only anticompetitive actions, but of all kinds of undesirable or ‘uncivilised’ behaviour that might be engaged in by economic actors in a market setting. As a part of this broader mandate, the new body expended substantial effort during its first years on the production of a law on consumer protection appropriate to market conditions. It was also necessary to develop the legislation, regulations and other legal acts necessary for the organisation and functioning of the authority itself and for the creation of “territorial administrations” – branch offices of the new body in the territorial units that form the Russian Federation.

### ***1.2 Legislation to address shifting paradigms***

While the competition authority was engaged in these tasks, the broader transition process was moving quickly, with fundamental changes in the structure of the state. This process gave rise to a new Constitution, adopted at the end of 1993. Among other innovations, the new Constitution expressed Russia’s intent to adhere to market principles, explicitly including support for competition as a constitutional value in two separate articles.

#### **BOX 1. CONSTITUTION OF THE RUSSIAN FEDERATION**

##### **Article 8.**

1. In the Russian Federation, the unity of the economic space, the free movement of goods, services and financial assets, ***support for competition*** and the freedom of economic activity shall be guaranteed.

##### **Article 34.**

1. Each person shall have the right to the free use of his/her talents and property for entrepreneurial and other economic activity not prohibited by law.

2. ***Economic activity directed toward monopolisation and unfair competition shall not be permitted.***

(emphasis supplied)

The first part of the new Civil Code of the Russian Federation, passed in 1994 and intended to serve as the foundation upon which new economic

relationships would be constructed, also contains specific provisions designed to protect competition.

#### **BOX 2. CIVIL CODE OF THE RUSSIAN FEDERATION**

**Article 1(3).** Goods, services and financial assets shall circulate freely on the entire territory of the Russian Federation. Restrictions on the movement of goods and services may be imposed in accordance with federal law, if this is necessary in order to provide for safety, protect the life and health of persons, and to protect the environment and cultural values.

**Article 10 (1).** Actions of citizens and legal entities taken solely for the purpose of causing harm to the other party shall be not be permitted, nor abuse of rights in other forms.

The use of civil-law rights for the purposes of restriction of competition or for abuse of a dominant position on the market shall not be permitted.

During this same period (late 1992 through 1994), the Russian government's paradigm for economic transition was shifting fundamentally. Concerns about the maintenance of political support and fears of asset stripping during a prolonged transition led to rejection of the earlier focus on gradual change and movement instead toward a policy of rapid privatisation. This change in economic policy entailed a major shift in the role envisioned for competition policy and the competition authority. Instead of the expected effort to divide enterprises to promote competition prior to their privatisation, proponents of rapid privatisation insisted that no division or restructuring of enterprises should be attempted, either because no rational choices could be made concerning the desirable size and structure of enterprises or because political considerations required the fastest possible transfer of wealth to private hands in order to create a political constituency for further reform and restructuring for competition would take too long. Instead, the new strategy would rely on profit incentives to encourage efficiency and restructuring of enterprises, as well as competition from international firms after an abrupt opening of previously controlled foreign trade.

Practice had also begun to reveal difficulties with the Register system. Some enterprises in the Register appeared to be operating in markets where little initial investment was required and in which the possibilities for quick

entry and increased competition seemed intuitively high. Others appeared to be “dominant” in a particular area more as the result of habitual trading patterns, lack of transportation and distribution channels, and absence of market-supporting information systems than due to any durable qualities of their markets or products. The Register system applied price control based on costs reported by the enterprises, and thereby encouraged the regulated enterprises to overstate costs and provided few incentives for the listed enterprises to move toward more efficient and competitive behaviour.<sup>7</sup> From this perspective, the controls imposed by the Register system appeared likely to retard the restructuring of markets and to reduce incentives for entry, and thereby to lead to an unnecessarily long-term regulation of many enterprises. In 1994, the Register system was changed to eliminate direct controls over the business decisions of enterprises, and to provide instead for monitoring of enterprises with more than a defined market share.

Criticism of the perverse incentives produced by the Register, growing attention to the significance of market infrastructure and the fundamental change in transition theory all led to a shift in perception of the proper role for the competition authority. It was no longer expected that the competition authority would exercise supervision over the economic conduct of a large number of dominant enterprises over a long transition period, nor would restructuring for competition play any substantial role in the privatisation process. Instead, the competition authority would be responsible for the creation of the institutions and infrastructure that would allow competition to develop post-privatisation and would enforce against specific instances of anticompetitive behaviour.

During the next several years, the competition authority undertook a major legislative drafting effort to meet these goals. One primary objective, related in part to experience with the registers, was the separation of areas in which direct price control was required from others in which this would be counterproductive. The competition authority led an effort that resulted in the passage of the law “On Natural Monopolies<sup>8</sup>” in 1995. That legislation introduced the concept of natural monopoly and contained a narrow definition of natural monopoly areas in which price regulation was to be carried out by independent regulators (outside the branch ministries and enterprises themselves) created or designated by the Government. While this did not prevent price regulation from being imposed in other areas by legislation, it did in principle identify those areas as potentially competitive. After its passage, work began on the legislation and regulations required to establish separate regulatory bodies in the areas of energy, transport and communications, as these tasks were viewed as separate from and not entirely consistent with the competition authority’s focus on the creation of competition. Another priority objective was encouragement of the creation

of new businesses, and new substantive legislation articulating general principles in this area was developed, together with legislation establishing a state body to administer programs of support for small and medium enterprises.<sup>9</sup> Further items of specialised legislation were also created, supporting the participation of small enterprises in specific economic activities and reducing reporting requirements.

Additional legislative drafting was done to fill perceived gaps in legal regulation of market activities. One of the largest of these projects was the drafting of a broad federal law “On Advertising<sup>10</sup>” that was also passed in 1995. Although the Law on Competition already gave the competition authority some control over advertising practices as between competitors, including publication of false information about competitors or of incorrect comparisons of goods, the new legislation was intended to provide a complete framework for advertising regulation for the protection of consumers, public health and morals, and other values. The new legislation was based on systems and rules in place in European market economies and included restrictions on advertising of alcohol and tobacco and on advertising directed at or involving children, established maximum amounts and timing restrictions on advertising in some broadcast media, and addressed a variety of other concerns. The competition authority was assigned as the primary enforcement body for the new advertising legislation, and began to establish monitoring practices the wide variety of advertising media and enforcement procedures for advertising cases.

In the area of support for the creation of market infrastructure, the competition authority was assigned to elaborate broad “demonopolisation plans,” directed toward the elimination of structural barriers to competition, the creation of infrastructure, and the facilitation of entry in highly concentrated markets.<sup>11</sup> This task was defined in an expansive manner that in practice required the State Committee for Antimonopoly Policy to expend a great deal of effort in the creation of universal formulas and criteria to be used for evaluation of the level of competition in markets at all levels and a set of general solutions that could be applied to increase competition in any sector. These criteria and potential solutions were to be the basis for the creation by branch ministries and by other state and local bodies of demonopolisation plans for branches of industry and for specific regions and localities. The competition authority and its territorial offices supervised the creation of the plans and reviewed them, but no budget was allocated to fund the implementation costs of specific policies and programs to increase competition and no authority was established to directly impose demonopolisation plans or to force the completion of specific measures to reduce concentration and market power. The authority also completed a substantial set of amendments to the Law on Competition<sup>12</sup>, and continued

throughout the period to process a significant caseload concerning specific violations of the competition law.

While the competition authority was occupied with these tasks, a great deal of attention was being given to questions of state structure and the authority of local, regional and federal bodies, including in relation to control of economic activity through licensing, standards, safety restrictions and direct limitations on the movement of goods. Measures to ensure the application of federal laws, to eliminate local and regional legislation and regulations in conflict with superior legal rules, and to provide for the preservation of the single economic space guaranteed by the Constitution became an increasingly high priority of the Government as a whole. Within the competition authority, this was reflected in an increased priority on scrutiny of state action at the regional and local levels and a program of cooperation with the procuracy to address legislative acts outside the reach of the Law on Competition.

### ***1.3 Crisis and retrenchment***

Following the severe financial crisis in 1998, the Government of the Russian Federation was restructured to reduce size and expenditures. As a part of this restructuring, the process of transfer of regulatory authority over tariffs for natural monopolies out of the competition authority was reversed. The regulatory bodies for transport and communications – created in 1996 and 1997<sup>13</sup> – were moved into the competition authority, although regulation of natural monopolies in the energy sphere was left with the Federal Energy Commission. The separate state committee for the promotion of small business was eliminated and those functions were also returned to the competition authority – which was recreated as the Ministry for Antimonopoly Policy and the Support of Entrepreneurship. (The competition authority will be referred to hereinafter as the Ministry for Antimonopoly Policy, the Ministry or “MAP.”)

New responsibilities were also created. In 1999, in part as a response to financial manipulations and anticompetitive behaviour by banks and financial institutions that was revealed during the crisis, a law on competition in financial markets was passed.<sup>14</sup> The law had been drafted and entered into the legislative process several years prior to its passage, but had made little progress toward passage and prior to the financial crisis had seemed to have become lost or been abandoned in the passage process. The law has a similar structure to that of the Law on Competition. It contains provisions covering state actions, unfair competition and abuse of dominance and establishes preliminary controls over agreements involving financial organisations and state purchasing of financial services. The Ministry for Antimonopoly Policy is the primary enforcement body for the

law, although it is in some instances required to determine standards by agreement with other oversight bodies – the Central Bank, the Federal Commission on Securities Markets and others – whose responsibilities include the relevant financial services sectors.

#### ***1.4 New restructuring and the challenges of reform***

As the economy has stabilised, overall economic priorities have moved toward the promotion of investment and support for broadly-based economic growth. Administrative reform of state structures and of regulatory procedures is also a high priority, although this is primarily associated with the elimination of wasteful duplication of functions and reduction of the general regulatory burden on enterprises rather than specifically with the promotion of competition. Structural reform of MAP has reversed direction yet again. In 2001, by a Presidential edict, the task of regulation of natural monopolies in transportation was moved out of the jurisdiction of the competition authority and was assigned to the Federal Energy Commission.<sup>15</sup> MAP continues to serve as the regulator for natural monopolies in the sphere of communications, but it is generally expected that this function will also be transferred in the relatively near future either to the FEC, effectively creating a unified tariff setting body at the federal level, or to a separate body focusing on communications issues. Other structural changes that would mirror those made in the mid-1990s are also under active discussion as a part of administrative reform efforts, including removal of functions in the area of support of small enterprises, and possibly those relating to advertising, into other state bodies.

The removal of these tasks from MAP, however, does not necessarily indicate a trend toward a narrowing of its overall responsibilities. In 2002, another significant set of amendments was made to the Law on Competition – the eighth amendment of the law in its ten years of existence. Changes in this most recent round included the creation of a voluntary procedure for submission of agreements to MAP for review and clearance, and the addition of a new article requiring MAP to enforce legal standards ensuring the fairness of individual tender processes for purchases by state bodies. Other changes were designed to facilitate MAP's new roles in applying competition law to reforming regulated industries, such as the inclusion of discriminatory terms of access to necessary facilities as a form of abuse of dominance and authorising MAP to exercise *ex ante* as well as *ex post* control in this area by issuing orders concerning the public provision of information and other matters.

One of MAP's priorities in the current period is the further development of legislation and procedures facilitating the promotion and protection of competition during regulatory reform of natural monopolies. MAP has

devoted considerable attention to the design of these reforms, and expects the need for its involvement in policy analysis and advocacy for competition in policy design will increase as the reforms that are underway move toward more complex stages (such as the opening of retail electricity markets to competition). The restructuring process has already created new substantive tasks for MAP, including supervision of the conduct of the new trading administrator for the wholesale electricity market and enforcement of non-discriminatory access rules in electricity trading and transmission systems and with respect to rail infrastructure. Additional enforcement tasks will likely be created as the process continues. MAP is currently working on rules for the supervision of purchasing by natural monopolies to ensure competition, which will envision enforcement by MAP itself.

Another priority for MAP is the creation of a new law on competition. Although MAP took the lead in drafting the 2002 amendments and shepherded them through the passage process, it announced almost immediately after their passage that the overall structure and content of the competition law is no longer appropriate and a fundamentally new competition law is now needed by the Russian Federation. MAP expects to take the lead in drafting a new law and has begun work on its concept. The drafting effort will require a good deal of resources and is expected to take several years.

The Ministry is facing significant pressures in the short term future. New tasks and law enforcement responsibilities continue to be added to MAP's list of responsibilities, while it already manages an exceptionally large number of individual complaints and other enforcement duties not only under the competition laws, but also in the areas of consumer protection and advertising. It would be difficult for any single state body to perform all of these functions well. While MAP and its predecessors have made a significant contribution to building the legal institutions necessary to regulate market behaviour, the conception of the competition authority as broadly responsible for civilising markets and protecting the public and weaker parties in many contexts results in task overload and interferes with the ability to concentrate on serious competition problems. MAP needs to use the drafting process for a new competition law to focus its own attention more narrowly. The administrative reform process may also offer prospects for a broadening of responsibility for competition and a more efficient distribution of law enforcement responsibilities, as well as an opportunity to increase attention to the creation of competition as a central goal of economic policy.

## 2. Substantive Issues: Content of the Law on Competition

The Russian Federation's competition law is not directly modelled on the law of any other single jurisdiction. It contains several relatively unusual provisions, some of which were designed to meet the special concerns raised by Russia's early stage of economic transition in 1991, when the law on competition was passed. These include a seldom-used ability to divide enterprises after multiple violations of the law and a broad authority to enforce against state actions and decisions that limit competition. The latter continues to play a very important role in the Russian context, allowing MAP to address local and regional barriers to the movement of goods and services and providing it with the ability to supervise the behaviour of regulatory authorities and act to prevent them from favouring specific market participants or hindering the development of competition in newly restructured areas. Nonetheless, although some parts of the competition law are well-designed for Russia's particular circumstances, it is also the specific provisions of the law that create some of the most serious obstacles to effective enforcement and render an apparently significant commitment of resources inadequate to ensure vigorous competition in markets and a strong competition focus in policymaking. Because improvement in these areas is critical, this and the following section discuss the provisions in the law and the use of MAP's resources in some detail.

### BOX 3. THE COMPETITION POLICY TOOLKIT

General competition laws usually address the problems of monopoly power in three formal settings: relationships and agreements among otherwise independent firms, actions by a single firm, and structural combinations of independent firms. The first category, **agreements**, is often subdivided for analytic purposes into two groups: "horizontal" agreements among firms that do the same things, and "vertical" agreements among firms at different stages of production or distribution. The second category is termed "**monopolisation**" in some laws, and "**abuse of dominant position**" in others; the legal systems that use different labels have developed somewhat different approaches to the problem of single-firm economic power. The third category, often called "**mergers**" or "**concentrations**," usually includes other kinds of structural combination, such as share or asset acquisitions, joint ventures, cross-shareholdings and interlocking directorates.

**BOX 3. THE COMPETITION POLICY TOOLKIT (cont.)**

**Agreements** may permit the group of firms acting together to achieve some of the attributes of monopoly, of raising prices, limiting output, and preventing entry or innovation. The most troublesome **horizontal** agreements are those that prevent rivalry about the fundamental dynamics of market competition, price and output. Most contemporary competition laws treat naked agreements to fix prices, limit output, rig bids, or divide markets very harshly. To enforce such agreements, competitors may also agree on tactics to prevent new competition or to discipline firms that do not go along; thus, the laws also try to prevent and punish boycotts. Horizontal co-operation on other issues, such as product standards, research, and quality, may also affect competition, but whether the effect is positive or negative can depend on market conditions. Thus, most laws deal with these other kinds of agreement by assessing a larger range of possible benefits and harms, or by trying to design more detailed rules to identify and exempt beneficial conduct.

**Vertical agreements** try to control aspects of distribution. The reasons for concern are the same—that the agreements might lead to increased prices, lower quantity (or poorer quality), or prevention of entry and innovation. Because the competitive effects of vertical agreements can be more complex than those of horizontal agreements, the legal treatment of different kinds of vertical agreements varies even more than for horizontal agreements. One basic type of agreement is resale price maintenance: vertical agreements can control minimum, or maximum, prices. In some settings, the result can be to curb market abuses by distributors. In others, though, it can be to duplicate or enforce a horizontal cartel. Agreements granting exclusive dealing rights or territories can encourage greater effort to sell the supplier's product, or they can protect distributors from competition or prevent entry by other suppliers. Depending on the circumstances, agreements about product combinations, such as requiring distributors to carry full lines or tying different products together, can either facilitate or discourage introduction of new products. Franchising often involves a complex of vertical agreements with potential competitive significance: a franchise agreement may contain provisions about competition within geographic territories, about exclusive dealing for supplies, and about rights to intellectual property such as trademarks.

*BOX 3. THE COMPETITION POLICY TOOLKIT (cont.)*

**Abuse of dominance** or **monopolisation** are categories that are concerned principally with the conduct and circumstances of individual firms. A true monopoly, which faces no competition or threat of competition, will charge higher prices and produce less or lower quality output; it may also be less likely to introduce more efficient methods or innovative products. Laws against monopolisation are typically aimed at exclusionary tactics by which firms might try to obtain or protect monopoly positions. Laws against abuse of dominance address the same issues, and may also try to address the actual exercise of market power. For example under some abuse of dominance systems, charging unreasonably high prices can be a violation of the law.

**Merger control** tries to prevent the creation, through acquisitions or other structural combinations, of undertakings that will have the incentive and ability to exercise market power. In some cases, the test of legality is derived from the laws about dominance or restraints; in others, there is a separate test phrased in terms of likely effect on competition generally. The analytic process applied typically calls for characterising the products that compete, the firms that might offer competition, and the relative shares and strategic importance of those firms with respect to the product markets. An important factor is the likelihood of new entry and the existence of effective barriers to new entry. Most systems apply some form of market share test, either to guide further investigation or as a presumption about legality. Mergers in unusually concentrated markets, or that create firms with unusually high market shares, are thought more likely to affect competition. And most systems specify procedures for pre-notification to enforcement authorities in advance of larger, more important transactions, and special processes for expedited investigation, so problems can be identified and resolved before the restructuring is actually undertaken.

There are two laws on competition, one that applies generally and one that applies to the financial services sector. The primary law is the Federal Law “On Competition and the Restriction of Monopolistic Activity on Goods Markets” (hereinafter the Law on Competition), initially adopted in 1991. The definition of “goods” contained in the law specifically includes work and services, so it covers most markets. There is, however, a specific exemption (Art. 2(3)) for financial services (except where actions on those markets affect competition on goods markets). This exemption was intended, among other things, to prevent inappropriate application of the

Law on Competition to the early formation of securities markets during the privatisation process, and to allow development of more complex rules for markets in which concerns about financial reserves, prudential regulation and licensing must be taken into account in promoting competition. Competition in financial services markets is now explicitly covered by the Federal Law “On the Protection of Competition on the Market for Financial Services,” adopted in 1999 and also enforced by MAP. That law is discussed further in Section 4, below.

### **2.1 Anticompetitive agreements**

The Law on Competition in its current version specifically prohibits (Article 6.1) horizontal agreements concerning prices or any element of pricing behaviour (mark-ups, discounts), market division, restriction of market access, elimination of participants from the market, or boycott. Previously, finding any of these violations required a combined market share on the part of the violators of at least 35% of the relevant market. The latest amendment eliminated this market share “safe harbour” and also made them *per se* violations by removing the possibility for approval by the competition authority on the basis of positive effects.

Other types of horizontal agreements are prohibited if they prevent, restrict or eliminate competition (or may do so) and infringe upon the interests of other economic subjects (Article 6.2). The language of the provision as currently stated does appear to require both of these elements; that is, both the restriction of competition and the infringement upon the interests of other economic subjects. Since the definition of the term “economic subject” appears to exclude private citizens engaged in transactions for their own needs (consumers), it is not at all clear that this general provision, as it is currently formulated, applies to horizontal agreements in which the only injury was to individual consumers. Like the *per se* violations defined in Article 6.1, the other possible types of horizontal agreements are no longer subject to the collective 35% market share test.

Vertical agreements are prohibited “between economic subjects not competing on the corresponding market, receiving and supplying goods” if such agreements prevent, restrict or eliminate competition (Article 6.3). The provision is not applicable, however, to “economic subjects with a collective share of the market for a specific good of less than 35%.” It is not at all clear how this restriction is to be applied to vertical agreements since the participants in a vertical agreement may not have a “collective share” in any market at all. The entire article concerning agreements was rewritten more than once during the drafting process for the amendments, and at one point all agreements other than horizontal cartel agreements were covered in a single provision. The current wording may have been the result of a last

minute change in the organisation of the article's provisions that moved a market share requirement intended to apply to horizontal agreements other than cartels into the separate sub-point on vertical agreements. Whatever the original intent, however, it may be possible to interpret the provision to require that at least one of the participants in the vertical agreement have a share of more than 35% in a market affected by the agreement (although this would not be a "collective share"), which might limit enforcement to situations in which the agreement is somewhat more likely to have a restrictive effect.

There are no block exemptions in the Law on Competition and the law does not envision a process for the creation of such exemptions. In exceptional circumstances, the competition authority is authorised to allow specific horizontal or vertical agreements (except for horizontal cartel agreements listed in the first sub-point of the law), if it is shown that their positive effects outweigh their negative effects, or if the specific type of agreement is provided for by federal law. After the 2002 amendments, new language in this provision states that this may be done "through the procedure envisioned by Article 19.1 of this law." Article 19.1, which was also inserted into the law by the 2002 amendments, provides for a voluntary procedure for participants in an agreement to seek the prior approval of the competition authority for the agreement. It has been suggested that the amended language now allows for such approvals only at a preliminary stage and only if the participants have sought the approval/agreement voluntarily using the Article 19.1 procedure. This does not, however, appear to have yet been conclusively resolved. MAP is currently working to develop methodological guidance for staff members on the application of the balancing test indicating the kinds of factors that are to be considered.

A separate provision of Article 6 prohibits the coordination of entrepreneurial activity of commercial organisations that has or may have as its result the restriction of competition, and provides for MAP to seek liquidation of an association or organisation found to be carrying out such coordination by court order. Coordination of economic activities by industrial associations and by "unions" of enterprises conducting similar activities was a common practice under planning, and early enforcement efforts under the Law on Competition included a number of cases in which the competition authority objected to specific clauses and provisions in the founding documents of commercial associations, industry representative organisations and other similar bodies allowing them to exercise such direct coordination. Such cases have been rarer in recent years, but do still occur (see example number 2 in the text box below).

**BOX 4. RECENT PRACTICE -- RESTRICTIVE AGREEMENTS**

1. A territorial office of MAP conducted on its own initiative a “verification” of the activities of the airline occupying a dominant position in its region. During the verification it was learned that the three airlines serving the route between Moscow and the regional capitol had, for the period January 10-15, 2002, set the same price for coach class fares on that route. The territorial office noted that the common price represented a significant increase, and that it was imposed simultaneously by airlines with differing costs of service. This was classified as a violation of Article 6 of the Law on Competition and a formal case was opened in May of 2002. During the consideration of the case the airlines informed the territorial office about changes in their prices. The commission considering the case qualified this as a voluntary elimination of the violation and terminated proceedings in the case.

2. An agricultural association approached the MAP territorial office concerning cooperation with the agricultural union of the neighbouring region. In a Record of a session of the agricultural association that discussed cooperation proposals, the territorial office found suggestions that the supply of certain goods coming from the neighbouring region could be regulated by means of designation by the agricultural association of “primary” enterprises to handle those goods and definition of specialised wholesale markets for them with required use of particular storage facilities. This was to be done in order to maintain “pricing parity” and to protect local producers. The territorial office of MAP opened a formal case and found those proposals to amount to coordination by an association of the economic activities of its members in violation of Article 6 of the Law on Competition. An order was issued requiring that the relevant point (the proposals) to be stricken from the Record of the session.

3. In July of 2002, the central office of MAP received a complaint from the city government of Moscow concerning the simultaneous increase of cement prices by four producers supplying cement to the Moscow construction market. MAP opened a formal case concerning violation of Article 6 of the Law on Competition. During the consideration of the case, however, the companies offered evidence that the increase in prices was due to multiple increases in price for electricity, gas and rail transport, as well as prices for diesel fuel and spare parts for a machinery base that was described as 70% worn out. The commission was convinced by this evidence that the increases in prices had made cement production a loss-making endeavour, and this accounted for the price increase. The commission did not find a violation of competition law directed toward the receipt of additional profits.

*BOX 4. RECENT PRACTICE -- RESTRICTIVE AGREEMENTS (cont.)*

The same commission did find during the consideration of the case an agreement between three of the cement producers and the management of the architectural and construction complex for the reconstruction of the city of Moscow (responsible for construction of municipal housing and social infrastructure) for cement to be provided to organisations within the complex at a lower price than it was offered to other construction organisations. The commission found this to be an agreement on division of the market and therefore a violation of Article 8 of the law, which prevents agreements between state bodies and enterprises that restrict competition. The commission found that cement sold for social construction might be used instead for commercial production, creating super-profits for that organisation, and that commercial organisations were likely to complain about the differences in price for the same product made by the same producer. The mayor of Moscow was informed and the agreement was annulled.

*Source: MAP November 2003*

There have been relatively few cases concerning agreements during the life of the Law on Competition, and of those investigations that have been pursued only a small minority have been successful in showing an agreement. Pursuit of these kinds of cases has been hampered by a lack of complaints and, until the October 2002 amendments, also by the need to prove that the participants in an alleged horizontal agreement had a collective market share above 35%. Adequate proof of agreement or concerted action has also been an issue. Both MAP and the courts have had some difficulty in determining what the standard of proof should be, and the investigatory powers of the MAP do not appear to be adequate to support the kinds of coordinated investigations that are usually required to reveal cartel behaviour. The lack of sufficient investigative powers has meant that enforcement efforts have had to be based primarily on the appearance of coordinated pricing and the explanations of those involved for similar pricing behaviour, or on documentary evidence of an agreement.

Sanctions available against participants in anticompetitive agreements are very modest. Having found individual persons or enterprises to have participated in an illegal agreement, MAP may order them to cease the violation of the law. Article 12 of the Law on Competition authorises MAP also to obligate a violator to disgorge income received due to a violation of the law, but after recent amendments to the law it appears that this may apply only to income received if the violator continues the violation after an

order is issued (for example, during a period in which MAP's decision and order are being appealed to a court). Failure by those addressed by the order to fulfil its conditions within the relevant time period may result in a fine of between 40 and 50 times the minimum monthly wage for individuals and between 2000 and 5000 times the minimum monthly wage for legal entities. The "minimum wage" figure that is used for the calculation of fines and other amounts keyed to the wage rate is currently 100 roubles. Using this figure, the maximum fine that may be imposed on an individual is 5000 roubles, or the equivalent of about \$167 US, while the maximum fine that may be imposed upon a legal entity is 500,000 roubles, or about \$16,700 US.<sup>16</sup>

Criminal sanctions, available in theory, are untested. Article 178 of the Criminal Code concerns the "prevention, restriction or elimination" of competition and covers the division of markets, pricing agreements, and attempts to create barriers to entry or to remove competitors from the market, as well as the charging of monopolistically high or low prices, which are classified in the Law on Competition as types of abuse of dominance. Sanctions for a first offence may include fines of up to 200,000 roubles or the equivalent of the convicted person's income or salary for up to 18 months, arrest for a period of four to six months, or a term in a prison or penal colony of up to two years. Where the offence was committed by a group of persons or by prior conspiracy (which would appear to apply to all anticompetitive agreements), the sanctions increase to a maximum fine of 300,000 roubles or the convicted person's income for two years, and a maximum prison term of five years. Where violence or property destruction, or threats thereof, are involved, the potential prison term is from three to seven years, and this may be accompanied by a fine of up to 1 million roubles or the convicted persons income for up to five years. Direct prosecution of a criminal case, however, is not within MAP's authority, and would require that the procurator in the relevant jurisdiction undertake a criminal investigation and bring the case to a court of general jurisdiction with a formal charge. Moreover, both criminal and administrative penalties cannot be imposed for the same actions, so such a criminal charge would have to be viewed as an alternative to the imposition by MAP of an administrative sanction. There do not appear to have been any prosecutions under Article 178 of the Criminal Code to date.

## ***2.2 Abuse of dominance***

The Law on Competition defines dominance as an exclusive position of an economic subject that gives it the ability to exert decisive influence on the conditions of circulation of the relevant goods or to obstruct access of others to the market. Under the current definition, entities with a share of

the market equal to 65% or greater will be found to be dominant unless the entity proves the contrary, while those with a share of 35% or less may not be found to be dominant under any circumstances. Between the two percentages, firms may be found to be dominant if the competition authority can establish this based on all of the evidence.

MAP and its territorial offices keep a register of enterprises with a share of the relevant market of above 35%. Firms may be entered into the register on the basis of a finding made during the investigation of an alleged violation of the law, or on the basis of studies of the competitive environment on particular markets done by the MAP outside its direct enforcement work. If a firm disagrees with MAP's conclusion in this regard, it may make a petition for its removal, and may also appeal the decision to a court. The inclusion of a firm in the register has consequences for merger control requirements (see below), but does not otherwise formally impose specific duties or consequences on the firm. Several sources, however, have indicated that a firm listed in the register will experience increased scrutiny of its behaviour through MAP-initiated verifications, especially if it is registered as having above 65% of a market and therefore falling within the legal presumption of dominance. There is some evidence that both courts and parties mistake the nature of the market share registers, understanding them to be lists of monopolies or believing that entry into the register with any percentage of a market is evidence of dominance or market power. Elimination of the registers entirely might reduce both costs and confusions, but concern was expressed by some MAP staff members that this would deprive MAP of the ability to exercise concentration control in relation to smaller, more local markets and by some outside MAP that it would reduce the ability to prevent violations by supervising the behaviour of already dominant enterprises.

Abuse of dominance is defined as acts of a dominant subject that have or may have as their result the prevention, restriction or elimination of competition. Both acts and failures to act are specifically covered. An illustrative list of abusive practices in the law includes: withdrawal of goods from the market to create a deficit and/or raise prices; imposition of abusive terms of contract or terms not related to the subject of the contract on contracting partners; tying; creation of discriminatory conditions for access to the market or for sales and purchases for specific contracting partners; creation of barriers to entry or exit; violation of legally imposed pricing restrictions; establishment of monopolistically high or low prices; reduction or cessation of production of a good that is in demand and that can be produced without incurring losses; and boycott. The list is not exhaustive, but the vast majority of abuse cases fall within one of the listed types of abuse. The law permits MAP to recognise specific actions that fall within

the terms of Article 5 as acceptable if the firm proves that the positive effects of those actions exceed the negative consequences for the market. This provision is, however, rarely if ever used.

**BOX 5. RECENT ENFORCEMENT PRACTICE – ABUSE OF DOMINANCE**

1. A territorial office of MAP received complaints about repeated electricity service outages. It investigated the case and found that the company failed to take available steps to ensure supply. It characterised this as abuse of dominance. On appeal, the court reversed. It found the company’s explanations for supply interruption acceptable, but also ruled that an existing unresolved dispute over terms meant that no contract existed and there was no obligation to supply.

2. A bread company complained to MAP about the terms of contract offered to it by the local electricity provider. MAP reviewed the terms during its consideration of the case and found a number that were not in agreement with legal rules, such as stipulation that the price would be as agreed between the buyer and seller (prices are regulated), failure to provide for emergency service, and requirement of automatic bank payment of invoices. MAP’s decision finding this an abuse of dominance was appealed and upheld in full by the court.

3. A local transmission network used a contract term providing that if more than the contracted amount was provided, the customer would be charged additionally for the overage. The territorial office of MAP viewed the formulation of the term as allowing the network to over provide on its initiative and then increase charges, and found it to be an abuse and ordered a change. The network appealed. The court found that the term was not abusive and also that the transmission network was not dominant, since it did not produce and sell energy.

4. A local telephone company required telephone equipment purchased from someone else to be examined, for which it charged a fee. The territorial office found this an abuse and issued an order stopping the practice.

5. Although it had previously done so, a port facility refused to provide volume discounts on stevedoring to a shipper of raw sugar, deciding to provide them only to its shareholders – competitors of the company that was denied who shipped similar amounts of the same materials. MAP found the discrimination between similarly situated customers an abuse. The decision was appealed and reversed by the first instance and appeals court, but upheld by the cassational court.

*BOX 5. RECENT ENFORCEMENT PRACTICE – ABUSE OF DOMINANCE (cont.)*

6. A city firm responsible for maintenance of the city graveyard refused access to the burial grounds to a private funeral services firm attempting to compete with the city enterprise. The territorial office of MAP found this to be an abuse of dominance and issued a cease and desist order.

7. A forest products company that owned a road providing the only access to the facilities of a coal company set prices for road use on the basis of the cost to maintain all of its roads and demanded 85% of the access fees to be paid in advance. MAP's territorial office found both the charges and the payment procedure abusive. The decision was appealed and upheld by the court.

8. Nuclear plants producing electric energy signed a contract with a partner in the Republic of Georgia to supply electric energy through the transfer grid. RAO EES refused to conclude a contract with the suppliers for the transmission of the energy, claiming a legal monopoly on electricity export and demanding input into the contract terms. MAP found this an abuse and issued an order to conclude a contract. The order was not observed and MAP went to court and obtained an order for the contract to be concluded. Despite repeated attempts to secure the transmission contract and a number of court decisions supporting MAP, no contract was ever concluded.

*Source: MAP June 2003; cases provided by MAP for OECD programs; MAP website*

Abuse of dominance cases have always been a very large part of the Russian competition authority's case load, usually accounting for half or more of the large number of violation cases (that is, excluding merger control petitions) considered each year. Among those abuse cases, cases involving natural monopolies dominate, accounting for well over half, and in some years as much as three quarters, of the case load. Common types of cases include disputes over contract terms (such as penalties or prepayment requirements); refusals to contract with a new customer (including failure to respond to requests for service); tying problems and classification of necessary services as "additional" and unregulated; and manipulation or improper application of tariff scales. The majority of abuse cases (roughly 88%) come to MAP on the basis of a complaint by an affected customer and most address the behaviour of the dominant entity in relation to the specific

customer alone, rather than a broad policy or contracting practice of the dominant entity.

The pattern of sanctions for abuse of dominance mirrors that described above for cases concerning restrictive agreements. There are no immediate sanctions that may be applied upon the finding that the law has been violated. MAP issues a decision recognising the violation and an order instructing that it be stopped. Many of the cases in this category concern contract provisions, but MAP has no power to order that a contract be concluded on specific terms (only a court may do this), so its orders in relation to such cases will require that the violator cease violation of the law in the form of requirement of abusive contract terms, but may not state what contract terms precisely would not be considered abusive. If MAP's order is not executed, it may impose the fines listed above. It may also file suit in court to force a dominant entity to conclude a contract.

Although not all cases concerning abuse of dominance address natural monopolies or regulated utilities, many of the remaining cases also concern allegedly dominant enterprises with a market share at or well above the 65% that results in a presumption of dominance. Correspondingly, the cases tend to rely on the legal presumption and there is rarely any qualitative analysis of the market power of the respondent. MAP's focus in the majority of such cases is the question of whether the behaviour in question was abusive, although respondents do sometimes appeal the dominance determination, even in relation to natural monopolies. Staff members have indicated that a lack of resources to conduct research, poor official information sources and restrictive time frames all make it difficult for them to conduct significant economic analysis to define markets and clarify the market shares of multiple participants, and that as a result they may favour cases in which dominance appears obvious.

### **2.3 Merger control**

Merger control provisions apply to both mergers and similar combinations of entire firms (Article 17) and to transactions involving acquisitions of shares or transfers of control (Article 18). Basic thresholds are calculated on the basis of the most recent balance-sheet value of the assets of the companies involved, without reference to the value of the transaction itself or to the amount of economic activity currently conducted by the company.

Pre-merger notification and approval is required for mergers and other similar combinations of firms in which the combined value of the assets of the firms exceeds 200,000 times the minimum wage (20 million roubles or about \$668,000 US). The competition authority is to refuse permission for

the transaction if the transaction may lead to restriction of competition, including as a result of the creation or strengthening of a dominant position. Permission may also be refused if information in the filing that has significance for the decision is not correct. A transaction may be approved, even in the face of negative consequences for competition, if the petitioners show that the positive effects of the transaction exceed the negative consequences. The law specifically includes socio-economic effects among those to be considered in making this decision. The competition authority may issue an order requiring that certain conditions be observed in order to preserve competition.

Post-merger notification is required concerning mergers and other combinations where the combined balance-sheet value of the assets exceeds 100,000 times the minimum wage (10 million roubles or about \$334,000 US). Post-transaction notification is also required concerning the creation of a new commercial entity with a balance-sheet asset value of more than 200,000 times the minimum wage; concerning the creation, merger or other combination of non-commercial organisations if at least two commercial organisations are participants or members in the non-commercial organisations, and also concerning changes in the participants or members of non-commercial organisations if two or more commercial organisations are members. Requirements related to non-commercial organisations, however, apply only to those non-commercial organisations that carry out or have the intention to carry out coordination of the entrepreneurial activities of their members. Notification must be made within 45 days of state registration of the new entity or entry of the official notation concerning the change in members. If the competition authority concludes that the notified transaction may lead to the restriction of competition, it may issue an order requiring the participants to observe conditions designed to preserve competition.

Failure of firms to abide by the rules concerning pre- and post-merger notifications, and also failure to abide by the terms of an order of the competition authority designed to preserve competition, may serve as grounds for MAP to bring an action in court seeking the liquidation of the firm or non-commercial organisation involved, but such cases are rare. The far more common consequence of failure to file the required notification or petition is the imposition of a fine under Article 19.8 of the Code of Administrative Violations, which provides for fines of from 20 to 50 times the minimum monthly wage on individuals (a range of about \$67 US to about \$167 US) and from 500 to 5000 times the monthly wage on legal entities (about \$1670 to \$16,700 US). In 2002, MAP initiated 1558 cases concerning violations of Article 17's rules and imposed 1254 fines.

Pre-transaction notification and approval is required for the acquisition of more than 20% of the voting stock of a company, the acquisition of assets accounting for more than 10% of the asset value of a company, or the acquisition of the right to control the activity or serve as the executive body of a company, if the combined balance-sheet asset value of those involved exceeds 200 thousand times the minimum wage or one of the firms is listed in the Register of firms having a share of more than 35% of a market, or the acquirer in the transaction is a group that controls a firm listed in the register. The legal standards for approval or rejection are identical to those for full mergers, with the addition of a specific right to refuse the transaction if participants refuse to reveal the sources, conditions for use or amounts of the money or property required for the transactions. Permission for a transaction expires if the transaction has not been completed within a year of the issuance of the decision.

Post-transaction notification is required within 45 days of the completion of the same types of transactions if the combined balance-sheet asset value of the firms involved exceeds 100 thousand times the minimum wage. In addition, firms with a balance-sheet asset value of more than 100 thousand times the minimum wage and those that are listed in the Register of firms with more than 35% share of a market are required to notify MAP within 45 days concerning the election or appointment of individuals to their executive bodies and boards of directors or supervisory boards. For both pre- and post-transaction notifications, orders may be issued concerning specific actions that must be taken or conditions that must be met in order to preserve competition.

The overall merger control caseload is astonishingly large. In 2002, MAP as a whole received 10,198 petitions and 9461 notifications under Article 18 (covering securities transactions and corporate relationships) and an additional 779 petitions and 3592 notifications under Article 17 (covering mergers and asset purchases), for a total of more than 24,000 filings. The ability of Ministry staff members to conduct meaningful review of this number of transactions is at best questionable, and the combination of such high numbers of filings with relatively short time frames for review may hinder the performance of other duties and the conduct of other investigations. Although the threshold levels for both petitions and notifications were doubled by the October 2002 amendments to the law there appears to have been no reduction in the caseload. Petitions under Articles 17 and 18 for the first half of 2003 numbered 308 and 5292, respectively, which is well on track to equal the 2002 statistics.

Under Article 18, MAP may file suit to void transactions to which the pre- and post-transaction notification requirements apply if the transactions were completed in violation of legal requirements *and* the transaction can be

shown to have led to a restriction of competition. Failure of firms to abide by an issued decision of MAP or by the conditions contained in an order concerning preservation of competition is also legal grounds for a court to void the relevant transaction. As in relation to full mergers, however, this remedy is rarely pursued. In general, the consequence of failure to file the required notice or petition is the imposition of fines under Article 19.8 of the Code of Administrative Violations. In 2002, MAP opened 1670 cases on violation of Article 18's notification requirements concerning transactions and imposed fines in 1040 of them.

In contrast to the active enforcement of the requirement that filings be made, refusal of permission for a merger or transaction on the grounds of a threat to competition is quite rare. In 2002, MAP received 779 petitions under Article 17 and refused consent in only 9 instances, while 10,198 petitions were received under Article 18, with a total of 58 refused. In the first half of 2003 (under the newly increased threshold amounts), the relevant numbers were 308 petitions under Article 17 with one refusal, and 5292 petitions under Article 18 with 47 refusals. According to MAP staff members, conditions are imposed for the preservation of competition in about 4.4% of all cases. In the highly concentrated fuel and energy industries, the percentage of transactions in which conditions are imposed is higher – reaching about 10%. The large majority of the conditions currently imposed are behavioural conditions requiring that companies continue to serve particular markets or areas, maintain availability of particular products or services or concerning other aspects of business conduct. MAP would like to increase its use of structural remedies and is currently developing guidelines for the definition and imposition of structural conditions.

#### **BOX 6. RECENT PRACTICE -- MERGER CONTROL**

1. A territorial office of MAP conducted on its own initiative a "verification" of the activities of a local coal company listed in the register as dominant. During the verification, it was learned that the coal company, which had previously sold its product directly through a wholly owned subsidiary, had concluded an agency agreement with another company, allowing the agent to conclude agreements for sale of coal, for which the agent would receive a commission. In fact, the agent was a limited liability company newly formed by three individuals who had previously worked in the subsidiary responsible for the sale of coal for the dominant company. According to the agency contract, the new company's expenses were to be paid out of receipts for coal sales, and its commission would be added to the contract price for the coal, which was to be set by the coal company. In analysing the agreement, MAP found that the ability

**BOX 6. RECENT PRACTICE -- MERGER CONTROL (cont.)**

of the agent to pay its own expenses out of receipts for the coal made it able to define the expenses of the coal company, while its ability to arrange sales of coal made it able to define the overall income of the coal for which the agent would receive a commission. In fact, the agent was a limited liability company newly formed by three individuals who had previously worked in the subsidiary responsible for the sale of coal for the dominant company. According to the agency contract, the new company's expenses were to be paid out of receipts for coal sales, and its commission would be added to the contract price for the coal, which was to be set by the coal company. In analysing the agreement, MAP found that the ability of the agent to pay its own expenses out of receipts for the coal made it able to define the expenses of the coal company, while its ability to arrange sales of coal made it able to define the overall income of the coal company. On this basis, the agreement was qualified as granting the new limited liability company the ability to control the entrepreneurial activity of the dominant company. MAP fined the company for failure to petition for preliminary approval under Article 18, and also denied permission for the transaction overall on the grounds that it could lead to the dominance of the new limited liability agency company on the wholesale coal market.

2. Three investment companies controlled by Gazprom petitioned to buy 35.69% of the shares of the "Krasnoyarsk synthetic rubber plant." The Krasnoyarsk plant accounts for 85% of domestic production and is listed in the register. One other plant located in Voronezh produces the rest. When the petition was made Gazprom's group of companies controlled 69.39% of the voting shares of the Voronezh plant and already held 15.3% of the Krasnoyarsk plant (the latter held through Sibur, which is in turn 50.67% owned by Gazprom). In addition, the main supplier of raw material for production at the Krasnoyarsk plant was also Sibur. If the transaction were completed, the Gazprom group would hold 50.99% of the voting shares of the Krasnoyarsk synthetic rubber plant and could control 100% of the domestic production. Permission for the transaction was denied.

*Source: MAP June 2003; MAP January 2004*

In addition to controls on mergers and transactions, the law (Article 19) provides for the possibility of break-up of commercial firms or of non-commercial entities engaged in commercial activities, if the entity is dominant and engages "systematically" in monopolistic activities, which is currently defined as having twice been found to have engaged in such

activities within a three year period. “Monopolistic activity” under the law is either the abuse of a dominant position or participation in restrictive agreements. An order of this type may only be issued, however, if it will lead to the development of competition, if the technological ties between the parts of the firms to be divided are not tight, if the separated parts can be physically divided from one another and if the part to be separated does not provide more than 30% of its production for the consumption of the other parts of the original entity. In practice, this provision of the law has rarely been used. Only one such case was opened in each of the past three years for which statistics are available (2000, 2001 and 2002), and of these three only one resulted in an order separating a subdivision from the relevant entity.

#### ***2.4 Actions of state bodies, state aids and public purchasing***

The Law on Competition specifically prohibits acts, actions and agreements of state bodies that prevent, restrict or eliminate competition (Articles 7 and 8). Like the parallel provisions aimed at private conduct, the language of the provision does not cover distortion of competition. The prohibitions apply to federal bodies of the executive power, to all state bodies of the subjects of the Federation (its constituent parts), and to bodies of local self government, as well as to other bodies or organisations to which the functions or rights of such bodies have been delegated. They do not apply, though, to federal laws and other acts of the federal representative bodies (the State Duma and the Council of the Federation).

Actions and decisions of the stated bodies are prohibited by law if they restrict the independence of economic actors or create discriminatory conditions for the activities of particular firms and if those acts or decisions have or may have as their result the prevention, restriction or elimination of competition and infringement on the interests of economic actors. Sub-points of Article 7(1) specifically prohibit: restrictions on or obstruction of the formation of new economic actors in any sphere of activity or prohibitions on any form of activity or production of any product unless the prohibition is contained in federal law; obstruction of the economic activity of any economic actor; restriction or prohibition of trade among regions or localities or restrictions on the sale of goods or services; mandatory instructions concerning the priority supply of specific customers except where the priorities are established by federal law; and the provision without grounds of special advantages to one or more firms. This list is not exhaustive, however, and other acts or actions of state bodies may also be found to improperly restrict competition.

The combined requirement – that the act or decision both restrict competition and infringe upon the interests of an economic actor – is the

result of the October 2002 amendments to the law. Previously, the law made such acts illegal if they restricted competition *or* infringed upon the interests of one or more economic actors. This effectively made a large number of improper actions of state bodies violations of the Law on Competition due to their infringement on someone's interests, even where they had little or no effect on the level of competition in the relevant market. Cases under this article of the law have accounted for a significant part of the overall caseload for many years, but some studies have suggested that many of such cases relied on the illegal or improper nature of the act itself and the effect on the complaining party, so the new wording might be expected to reduce the Article 7 caseload considerably. However, statistical information for the first half of 2003 does not, in fact, show any such reduction.<sup>17</sup>

The same article of the law contains a general prohibition on the combination of commercial activity with the exercise of state power, whether in the form of commercial activity by state bodies or in the form of delegation of state powers to private commercial entities. An exception is made where such combinations are authorised by federal "legislative acts" – a concept that includes not only laws but also presidential edicts, acts of the Government, and other federal regulations. In practice, this broad exception has permitted quite a number of state bodies at various levels to engage in commercial activities, resulting in monopolisation of the relevant services and in some cases leading to tying of the commercial services to the performance of state functions. MAP has proposed that the language of this portion of the law be changed in order to eliminate the exception.

The law (Art. 8) also prohibits state bodies from engaging in agreements or coordinated actions, either among themselves or with firms or organisations, if these have or may have as their result the prevention, restriction or elimination of competition. The law specifically lists agreements that may affect prices, that divide markets, or that concern restriction of entry to the market or elimination of some competitors from it, but the list is not exhaustive and other agreements that meet the general criteria may be found to violate the law. There is a specific exception in the law for agreements envisioned by federal laws, acts of the President of the Russian Federation or acts of the Government of the Russian Federation.

The primary sanction applied to a violation by a state body is the same as that for abuse of dominance and agreements: recognition of the violation in a decision and the issuance of an order requiring cessation of the violation. It is not unusual in cases concerning violations by state bodies for the violation to be eliminated prior to the completion of the formal consideration of the case and the issuance of an order. In some of these cases, MAP completes the consideration of the case and issues a decision

recognising the act or action as a violation, although it does not issue an order concerning a remedy. The sanctions listed above for individuals can legally be applied to individual officials for failure to execute an order, although in practice questions of chain of command and job responsibility may cause complications.

Because cases under these articles have tended to focus on actions of state bodies that are per se illegal or on the infringement of the interests of a single firm, standards for a more complex analysis that take into account the needs that the state action was intended to meet, the means available to the state body to do so and the costs of the options have not been developed. Indeed, it is not clear that the provisions as written would support a more complex form of analysis, since they do not contain a “least restrictive means” standard, but rather a simple prohibition. Nonetheless, as practice under these articles moves away from simpler types of violations it seems clear that analyses that take these factors into account will be needed in order to prevent conflicts between the competition laws and the reasonable use by local and regional bodies of zoning rules, local taxation scales, and other common tools of local governance.

#### **BOX 7. RECENT PRACTICE -- STATE ACTIONS**

1. The State Tax Inspectorate established a simplified procedure for the refund of VAT to firms meeting certain criteria as “traditional exporters.” One of the criteria included was a requirement that the firm not use any of a list of banks that were identified by the State Tax Inspectorate as previously being used during attempts at improper VAT refunds. MAP opened a case after receiving a number of complaints from companies forced to choose between remaining with their banks and being able to use the special procedures, and found the rule to be an illegal restriction of competition in the market for financial services. In making its decision MAP also took into account the Tax Inspectorate’s practice of issuing such rules without state registration of the legal act and without publication.

2. An instruction of the Ministry of Railways required directors of railroads and heads of stations, enterprises and other railway organisations to provide space on an uncompensated basis to the state enterprise “RailPharmacy” (organised under the Ministry) to establish pharmacies and pharmacy kiosks at stations, stops, enterprises and other locations, and to cease provision of space for any “outside” organisation for this purpose.

**BOX 7. RECENT PRACTICE -- STATE ACTIONS**

Lease agreements were broken with a number of companies, and their spaces given to "RailPharmacy" for use. MAP found this to be a state action that improperly advantaged "RailPharmacy" and ordered the Ministry of Railways to make corresponding changes in the acts.

3. A territorial office of MAP considered a case concerning electricity rates set by the administration of a city. The rates differentiated among users of electric energy on the basis of the capacity of their connections and their electricity usage. This was found to be a state act that created a groundless obstruction to the activity of economic actors and restricted competition.

4. A territorial office of MAP received a complaint petition from an individual entrepreneur and opened a case concerning the refusal of the city to extend his lease on the plot on which he had established a kiosk. The territorial office found the decision not to extend the lease to be without grounds and therefore an illegal obstruction of his activity. Prior to the issuance of the decision the city reversed its decision, which was considered a voluntary elimination of the violation.

5. The head of a municipality refused to allow a limited liability company to change the zoning of certain premises from residential to non-residential for use as a pharmacy on the grounds that there were already a sufficient number of pharmacies in the municipality and the space was not located in an appropriate place for the organisation of retail trading. The territorial office of MAP found this to be violation of the provisions on state action, as it restricted the independence of the company in the use of its space and obstructed its activity in the retail pharmacy sphere.

*Source: MAP November 2003*

A special focus of enforcement efforts under Articles 7 and 8 has been restrictions imposed by regional and local governments on the movement of goods into or out of their areas. This practice was reasonably common during the mid-to-late 1990s. It was used by regional and local bodies and officials as a means to keep basic foodstuffs and other items of first necessity (sometimes subsidised by the same bodies) from being traded into other locations, as an indirect price control mechanism, and also as a means to protect local producers from competition in order to protect the jobs and other benefits they provide to the local economy. In some instances, local or

regional bodies faced with unfunded mandates concerning maintenance of social infrastructure may have essentially traded protective provisions for the agreement of enterprises to assist with some of these responsibilities. Prevention of the fragmentation of the Federation and provision for both a unified economic space and a uniform observance of the laws was and remains a high overall priority of the federal government, and correspondingly of MAP as well. Although there was a sharp spike in such activities immediately after the 1998 default, MAP's enforcement efforts in this area have paid off and there are far fewer direct prohibitions of this kind in evidence in recent years.

The provision of special assistance to specific enterprises or firms by a local or regional government or by the relevant federal ministry or other executive body would fall under the terms of either or both Articles 7 and 8. Moreover, Article 7 requires that any act of a covered state body or official that grants privileges or assistance to one or more specific enterprises be subject to the consent of MAP. If the assistance is provided under the terms of a federal law, however, or is within the scope of an agreement envisioned by such a law or by an act of the President or of the Government, it is outside the reach of the Law on Competition and would need to be addressed through the repeal or amendment of the act in question. MAP has recently taken action to address one such situation by promoting the inclusion in a recent package of reform legislation on rail transport of specific provisions disallowing separate agreements between the rail system and individual customers concerning privileged tariff rates.

State bodies are required by a separate law to make purchases of goods and services for state and local needs on the basis of competitive bid. The Law on Competition includes an article (Art. 9) setting out "antimonopoly requirements for the conduct of competitive bidding" in such cases, including prohibitions on the creation of advantages for some participants, granting of access to confidential information or reduced fees for participation, improper restriction of access to participation, and any coordination of the activities of the participants by the organiser of the competitive bidding. In the case of a violation of these rules, MAP may seek to have the results of the competitive bid declared void by a court.

### ***2.5 Unfair competition***

Unfair competition is covered by Article 10 of the Law on Competition. Forms of unfair competition specifically listed in the law include: distribution of false information capable of causing losses or injury to the business reputation of another economic actor; publication of incorrect comparisons of goods; falsification or confusion of consumers about the maker, quality or other information about goods; improper use of trade

marks or other intellectual property; and improper receipt or use of secret or proprietary information. Use of intellectual property rights owned by or registered to the violator for the purpose of unfair competition is also covered. The law provides that in the case of a violation of this type the question of early termination of such rights may be raised before the appropriate state body.

In most cases, the result of a finding of a violation is the issuance of a decision by MAP recognising the behaviour as a violation and ordering it to stop. Failure to abide by the order may result in a fine under the Code of Administrative Violations. In the case of publication of false or misleading information, MAP may require that a retraction or correction of the incorrect information be published at the expense of the violator in the same sources in which it was published.

Unfair competition cases are not a large part of the overall caseload, accounting for about 362 matters (petitions and those opened on the initiative of the MAP) in 2002 throughout the system. Just over a third of these concerned improper use of trade mark or other intellectual property, and another third concerned distribution of false information or the confusion of consumers about the origin, qualities, maker or other aspects of products. The central office of MAP dealt with a number of well-publicised cases concerning the close imitation of the trade dress and/or trade or brand name of popular imported consumer products (including such varied products as chewing gum, soap products, and insulin).

#### **BOX 8. RECENT PRACTICE -- UNFAIR COMPETITION**

MAP on its own initiative opened a case concerning the sale by a Russian company of white vermouth under the name "Martuni," with a label very similar to that used by Martini & Rossi SpA on its "Martini" white vermouth and registered in Russia. The Martini & Rossi company reported that it had demanded the use of the "Martuni" label be stopped, but had received no reply. The Russian company presented evidence that it had registered a label for wine with the name "Martuni," but upon examination this label was not the same as that actually used on the white vermouth. The Russian patent authority issued an opinion stating that the "Martini" and "Martuni" labels were similar to the point of consumer confusion. MAP found a violation of Article 10 and issued a cease and desist order.

*Source: MAP November 2003*

MAP itself does not have the power to estimate the damages caused to the complaining party or to order compensation. However, a private party may seek compensation for damages caused by unfair competition under the general tort claims provisions of the Civil Code, citing the decision by MAP as evidence of the violation. In recent years, several firms have successfully resorted to this means to obtain compensation. Compensation of damages that cannot be proven by specific evidence (e.g. cancelled contracts as opposed to “speculative” damages based on projected sales as a function of market share or similar evidence), however, is still a matter of some uncertainty under the law. There are no provisions for punitive damages.

## ***2.6 Consumer protection***

MAP plays a major role in the enforcement of consumer protection law, dealing directly with thousands of complaints each year. Consumer protection complaints can also be made directly by consumers to a court or to a local body for the resolution of consumer disputes. Consumer protection groups and the procuracy are authorised to bring actions under the consumer protection law to protect the interests of large or undetermined groups and the procuracy may also proceed for the purpose of protecting the general public interest. Violators may be subject to fines (which are relatively modest) and may be ordered to cease violations as well as to publish retractions of false information or other information that may inform a broad group of consumers about the resolution of a case and their rights. Individual consumers may obtain damages through a court of general jurisdiction, including compensation for moral harm as well as economic damages. Procedural law does not permit class actions and there are no provisions for punitive damages as such.

MAP’s role in enforcing consumer protection laws is particularly important given the current formulation of the Law on Competition. The competition law’s provisions generally require that a violation affect an “economic subject,” which term is defined to include commercial and some non-commercial entities, but not individuals in their private capacities. For this reason, some MAP offices have combined enforcement of the Law on Competition with the consumer protection law in order to reach violations affecting individual consumers.

**BOX 9. RECENT PRACTICE – COMBINING COMPETITION  
AND CONSUMER PROTECTION**

An energy provider made a habit of turning off hot water supply to entire buildings if any of the customers in the building had not paid the bill, or where they had paid but the housing authority had not transferred the payment to the company. The territorial office of MAP opened a case based on the abuse of dominance provisions of the Law on Competition and the provisions of the consumer protection law and ordered the practice stopped and a statement published in the papers informing consumers about their rights.

*Source: MAP June 2003*

### **3. Institutional Issues: Enforcement Structures and Practices**

Reform of regulated sectors of the economy can be less beneficial, or even harmful, if the competition authority cannot act vigorously to prevent abuses in developing markets. While MAP's resources may at first glance appear to be substantial, they are in practice insufficient due to the extraordinarily large number of tasks assigned to the Ministry and its large caseload under the Law on Competition. The Ministry's investigatory powers are quite weak and sanctions for violations of the competition laws are absent or at best very modest. If significant legal and institutional changes are not made to address these concerns, it will be difficult or impossible for MAP to make the improvements in law enforcement that are desirable and to meet the challenges presented by the large scale regulatory reforms now underway.

#### ***3.1 Competition policy institutions***

The MAP is a Ministry within the composition of the Russian Government, headed by a Minister who is appointed (upon nomination by the Prime Minister) and may be removed by the President of the Russian Federation. Deputy Ministers (of which there may be as many as seven) are appointed and may be removed by an act of the Government. Prior to 1998, the competition authority was a state committee, with a status somewhat junior to a ministry within the structure of the Government. The change had the advantage of raising the status and visibility of the competition authority, and also gave MAP direct access to a very broad range of policy discussion and planning at the highest level through the participation of the Minister in sessions of the government and through the practice of obtaining the comment or recommendation of all ministries on Government policy changes and planned decrees.

Its placement within the composition of the Government, however, does place MAP in a position of equality with other bodies against which it may need to enforce the law and which may have positions strongly opposed to MAP's regarding some competition issues. According to the standard working pattern of the Government, MAP must seek the comment and approval of the other ministries on its own legislative and regulatory initiatives as well as on those policy and legislative documents that it is assigned to develop (though this does not apply to enforcement actions). This may make it more difficult for MAP to gain approval for policy proposals or reform recommendations that are opposed by the industrial ministries affected. There has been some discussion at various times of the possibility of changing the nature of MAP to make it less subject to the

influence of the other members of the Government, perhaps by creating a more direct subordination to the President. This would, however, be a complicated change as there are few constitutional models for such a body and there is currently no concrete proposal being considered.

MAP has a broad set of responsibilities. In addition to the enforcement of the Law on Competition and the separate law on competition in financial markets, MAP also has primary enforcement responsibility under the federal law regulating advertising (reporting the consideration of 11,811 facts of such violations in 2002), and considerable responsibility for enforcement of the laws on consumer protection (reporting the consideration of 7913 petitions by MAP's territorial offices within the same period). MAP is also responsible for enforcing regulations on commodities exchanges and for federal programs for the promotion of entrepreneurial activity and the protection of small and medium sized businesses. MAP is currently serving as the tariff regulator for natural monopolies in the area of communications, including basic local telephone services and postal and telegraph services.

In addition to these tasks, MAP has also been required to expend substantial resources on its participation in the process of reform of infrastructure monopolies. MAP has sponsored a number of discussions and forums on the directions of reform and has been actively involved in developing its details. It was one of only two bodies to present a full plan to the Government for rail reform (the other being the Ministry of Railways). The plan of measures to be taken for structural reform of rail transport confirmed by the Government in May of 2003 requires MAP to take the lead in developing a set of rules for non-discriminatory access to rail infrastructure (adopted in December) and measures for the creation of competition in freight transport, and to participate actively with other bodies in the creation of 18 other sets of basic rules, analytical reports, policy recommendations or legal documents before the end of 2005. This plan addresses only the initial stage of reform and a similarly large assignment of work is expected for the development of further rules and legislation refining the system and creating further competition. Similar tasks are being performed by MAP in relation to the restructuring of electricity, and in this area MAP also sits on the supervisory council for the trading system and serves as the regulator overseeing the non-commercial partnership that administers the system. Reform of the gas and telecoms sectors is at a somewhat earlier stage, but MAP is already responsible for ensuring non-discriminatory access to the gas transport and distribution systems may be assigned other roles as reform of Gazprom moves forward. As the tariff regulator for communications, MAP has focused its attention on adjusting tariffs to eliminate cross-subsidisation and provide for competition where

that is possible. If the tariff regulation task is removed to another body as expected, MAP may play other roles in this area.

MAP consists of a central office and 75 territorial administrations that are located throughout the Russian Federation. The central office investigates cases with larger economic impact or involving national economic issues, and is responsible for organising law enforcement activities and providing for the functioning of the system as a whole, including budgetary support, educational measures, legislative work, analytical work and the creation of methodological guidance for investigations. It is divided into a number of departments and administrations responsible for the enforcement of specific laws (consumer protection, advertising, support of entrepreneurship) or for specific functions within the Ministry (legal department, personnel, finance and so forth). Activity in the enforcement of the Law on Competition is divided among three offices responsible for particular sectors of the economy: (1) fuel, energy, transport and communications; (2) industry and construction; and (3) agro and forest industries, chemicals and natural resources. This structure is thought to allow staff members to be more knowledgeable about the area in which they are enforcing the law than the previous structure, which divided enforcement among the areas of the law (agreements, abuse of dominance, merger control). Enforcement of competition law rules on unfair competition is combined with enforcement of the advertising law in a separate group, and another group is responsible for the laws on competition in financial markets and on commodity exchanges. The maximum number of staff of the central office is regulated by the Government, and as of the beginning of 2003 was 380. At that time, there were a total of 357 actually employed in the central office. This includes both professionals and support staff, but not security and maintenance personnel who are directly employed by the federal body responsible for maintenance of the building.

The territorial administrations are responsible for the enforcement of the laws in one or more of the constituent parts of the Russian Federation, and take part in analytical work, policy development, and prognosis of economic conditions in their areas. Recently, MAP assigned seven of the territorial administrations, one in each of the federal administrative districts, to act as "leading" offices within their districts, assisting in the coordination of enforcement efforts and also educational and other measures. The size of territorial administrations varies widely, from as few as 5 staff in total to 25 or more. The maximum staffing level of the territorial administrations as a whole, like that of the central office, is regulated by the Government, and at the beginning of 2003 was 1477, with 1408 actually employed.

As a rule, if a case involves more than five separate constituent parts of the Russian Federation a territorial office must hand the case off to the

central office of the Ministry or to seek its consent and cooperation in the investigation and initial decision. A set of rules also limits the territorial administrations in their consideration of petitions and notifications under the merger control provisions, providing maximum overall asset limits beyond which the matter must be addressed by the central office. In other respects, the territorial administrations act quite independently, being guided by methodological recommendations and other documents issued by MAP, but without needing to seek permissions or approvals in individual cases. According to MAP's procedural rules, the central office of MAP has the right to reverse the decisions or orders of the territorial offices if they are contrary to legislation or exceed the authority of the territorial office. In practice, however, this is a rare occurrence and decisions of the territorial offices are usually appealed directly to a local court. The central office collects brief statistical information from the territorial offices concerning each of their cases, and receives more detailed reports twice a year, but with many thousands of cases per year the collection and analysis of information is a serious challenge. The Ministry is currently working on the development of an optimal system for the computerised reporting, sharing and retrieval of information across MAP as a whole. Until such a system is in place, the ability of the central office to supervise the current work of the territorial administrations in detail will remain quite limited.

### ***3.2 Competition law enforcement***

MAP can act against violations of the Law on Competition on its own initiative or on the basis of a petition or complaint received. General procedures regarding violations of the law are currently governed by a set of Rules for the Consideration of Cases on Violations of Antimonopoly Legislation confirmed by order of the Ministry in 1996. Where a petition has been received concerning the violation, the Rules require response to the petitioner within a period of a month. If the petition does not appear to contain information indicating a violation, MAP will generally respond with a statement that the petitioner needs to submit documents confirming the facts of the violation. If such documents are not provided, the petitioner may be informed that the elements of a violation appear to be absent. However, MAP has absolutely no discretion to refuse to pursue any petition which appears to state, or may after further investigation state, a violation of the competition laws. It is obligated to investigate and respond to every such complaint or petition, without exception. It is irrelevant whether the possible violation is technical or is insignificant in nature or whether the violation fits within MAP's enforcement priorities. An improper refusal by MAP to pursue a case, and also failure to respond within the legally required time period, may be appealed by a petitioner to a court or be the subject of a

complaint to a procurator responsible for supervising the enforcement of the law by executive bodies. Both of these have occurred in practice.

If MAP is not certain whether a petition indicates a violation of the law, or if additional information is required at any stage of an investigation or consideration of a case, it may make demands for information from state and private bodies and persons under Article 14 of the Law on Competition. Article 14 provides for a written demand to be made for the presentation of documents or for the provision of oral or written explanations or other information necessary to MAP. Failure to provide the requested information, or to respond at all, may result in a fine, imposed by MAP under the Code of Administrative Violations. The fine, however, is small, particularly in relation to the resources of a large company – amounting to from 50,000 to 500,000 roubles, or about \$1670 to \$16,700 US. In practice, if information is still not provided after a fine has been imposed, MAP may be forced to make a new demand for the information and repeat the process of recognising a failure to provide it and fining the violator. It may also go to court to attempt to force the provision of the required information.

Under Article 13 of the law, MAP staff members also have a right of “unhindered access” to the premises of businesses and many state bodies for the purpose of collecting evidence and documents necessary for investigations, and they are to be assisted when necessary by the police and other bodies. In practice, however, this right is difficult for MAP to enforce and MAP really does not possess the capacity to conduct searches of premises, surveillance of suspected violators, or other investigatory activities that would be more promising in terms of evidence of hard core cartels. Nor does it have the kind of sanctioning authority that would allow it to be taken seriously when demanding information and conducting interviews with suspected participants in agreements or that would facilitate a leniency program. MAP currently must rely primarily on the time consuming procedures under Article 14 to obtain information.

Consideration of alleged violations of the competition laws takes place through a quasi-judicial procedure conducted within the MAP. The procedure requires the creation of a “commission” from among the staff members of the MAP to consider the case. The petitioner and respondent must be notified and be given a chance to be heard at a sitting of the commission, and third parties are sometimes heard as well. If the commission, after considering all of the evidence and testimony, comes to the conclusion that a violation of the law has been committed, it issues a decision stating this and an order (called a “prescription”) requiring the violator to cease violation of the law.

In the majority of cases, MAP's order to the respondent to cease the violation of the law is the only immediate response that MAP can make to a finding of a violation. The law contains no direct, immediate sanctions – either fines or other penalties – for violation of most of the provisions of the competition laws. Fines may be generally be imposed only for a failure by a respondent to execute the terms of MAP's order (as well as for failure to provide information or to file required petitions and notifications) and not for the violation itself. Fines for failure to execute an order may be imposed by MAP directly under the Code of Administrative Violations, which dictates the procedure to be followed.

This system essentially allows violators of the competition law a “free ride” – they are entirely free to violate the law and the consequence of being found in violation is only that the violating behaviour must be stopped, while the company is free to keep what it has earned up until that point through the violation. Even where a respondent fails to execute MAP's order to cease a violation, the direct fines available are small, with a maximum limit of 500,000 roubles (about \$16,700). Such limited sanctions are unlikely to deter behaviour that is even modestly beneficial to a violator, much less the most serious kinds of violations that may be worth very large sums.

Article 12 of the Law on Competition permits MAP to issue an order requiring that a violator eliminate the consequences of a violation or restore the situation prior to the violation of the law. This does not, however, include the ability to order specific compensation to be paid, and so the use of these provisions to provide credible sanctions against a violation is not an option. No statistics are available concerning the frequency with which these provisions are used or the costs of ordered actions, but the absence of appeals concerning this issue suggests that it is not common. Article 12 also states that MAP may order a violator to transfer income received as a result of the violation of the law into the federal budget. Apparently this does not authorise orders that would confiscate all of the income illegally received for the entire period during which the violation occurred. The October 2002 amendments to the law inserted Article 23<sup>1</sup> stating that the behaviour must be properly recognised as a violation of the law (through a decision of MAP, presumably) and that income from the illegal behaviour *which continued after an order was issued requiring cessation* may be confiscated. Confiscation of the income requires MAP to file a suit in court, and thus cannot be accomplished through an order.

In a few cases, MAP may be able to specify the actions that must be taken to remedy the violation, such as ordering that a contract be concluded with the petitioner in a case concerning refusal to deal or requiring publication of a retraction in an unfair competition case. MAP has no

power, however, to specify the terms of contract between a petitioner and respondent, or to dictate in its order the correct content of a decision of a state body that it has found to violate the law (although it may review and advise on this). If such violations are not corrected after the issuance of an order, MAP may directly impose the available fine for failure to execute the order, but to obtain actual performance it must file a case in court seeking a court decision requiring the conclusion of a specific contract or invalidating the illegal act or decision of the state body. And while the court may impose costs upon a party that improperly fails to comply, there are no provisions allowing the court to impose additional, punitive damages or fines upon the violator outside those envisioned in the Code of Administrative Violations and directly imposed by MAP.

If a respondent disagrees with MAP's decision or order, it may appeal the case in an arbitrazh court (a court handling economic disputes). In addition to the initial consideration of the case in a first instance court, full de novo reconsideration on appeal and a cassational reconsideration are also usually available. A "supervisory" review of the case may also be available through the highest court in the arbitrazh court system, but this is discretionary and most requests for such review are denied. For purposes of consideration of the case at any level of the courts, the burden of proof of the factual circumstances and of the correctness of its decision and order are placed upon MAP. In 2002, of 2103 orders and recommendations issued concerning violations of the law, 276 (about 13%) were appealed, and 73 of those (about 26% of those appealed) were overturned by the courts. Cases most likely to be appealed are those concerning Article 5 (abuse of dominant position) and Article 7 (anticompetitive actions of state bodies). Selective review of available court decisions suggests that courts have difficulty with questions of market definition and dominance and MAP has in some cases been forced through several levels of appeal on the issue of whether a regulated natural monopoly is dominant. Courts have also had difficulty in defining the limits of MAP's power to interfere in contractual relationships, even to protect a weaker party, and are sometimes confused about how the general rules on public contracts and contracts of adhesion that are contained in the Civil Code and the provisions of the Law on Competition related to contractual relationships relate to one another.

### ***3.3 Other enforcement methods***

Private action for damages is possible under a combination of direct prohibitions in the competition laws on particular behaviour with the general tort claims provisions of the Civil Code. Although there have been some debates in recent years concerning the limits of what constitutes improper behaviour sufficient to warrant civil tort liability, a long tradition of

interpretation of similar provisions of previous civil codes establishes that illegal behaviour that has been recognised as such by the proper authorities gives rise to the right. In recent years there have been at least a few cases of the successful use by parties of MAP's recognition of unfair competition as evidence of such illegal behaviour in a civil suit for damages. While the use of such provisions cannot substitute for the creation and enforcement of credible sanctions to be applied to violators, the facilitation and encouragement of similar cases may be an appropriate way for MAP to increase the effectiveness of the law and also public awareness of its principles and effects. The October 2002 amendments to the Law on Competition removed a general reference to the ability of private parties to seek damages through the usual procedures, but this was explained as being in accord with a legislative policy of removing provisions that amount to general restatements of existing legal rights and not an attempt to eliminate the right or discourage its use.

Article 26 of the Law on Competition contains a very broadly stated requirement that damages caused by illegal acts of federal executive bodies and other state bodies at the regional and local levels, *including* those caused by acts violating the antimonopoly legislation, as well as by failure of such bodies to fulfil their obligations or improper fulfilment of their obligations, are subject to compensation by the Russian Federation or the corresponding body of regional or local self government. Article 12 of the law gives MAP no corresponding ability to order the payment of such damages, and the presumed remedy would therefore be for the injured party to seek damages in court. Article 26 was inserted into the law by the October 2002 amendments and the breadth of the provision is somewhat surprising in light of the fact that the same set of amendments narrowed the prohibition on improper state actions to require that an effect on competition be shown. Read literally, it makes a statement of general state policy of compensation of damages caused by any improper behaviour of state bodies whatever, and there is some question how courts may interpret the inclusion of such a norm in the Law on Competition.

Another avenue for enforcement of competition law is through the procurator, or public prosecutor. Procurators have some legal responsibilities related to protection of the public and supervision over the proper observance of the laws by state bodies. In this capacity, procurators have sometimes brought suits in court demanding that the court void acts of state bodies that violate the competition law or related provisions, including those of Article 8 of the Constitution and Article 1(3) of the Civil Code regarding the free movement of goods and services. Procurators, through their authority to take actions to protect the public interest or to address violations that affect large or undetermined groups of persons, may also be

able to file suits in court or petitions with MAP concerning broad violations such as improper behaviour by a monopoly utility in relation to its customers across the board.

### ***3.4 International issues in competition law enforcement***

Article 2 of the Law on Competition states that the law is to be applied not only to conduct occurring in the Russian Federation, but also in all instances in which actions or agreements occurring outside the Russian Federation lead or may lead to the restriction of competition or to other negative consequences on the markets of the Russian Federation. Despite this broad mandate, however, there have long been practical questions about the means for international issues to be addressed in the regular practice of MAP in enforcement of the law. Information problems can make it quite difficult for territorial offices to take sales of goods produced outside the Russian Federation into account when the case deals with a localised market.

In practice, international issues arise most frequently in relation to merger control activities concerning stock purchases and corporate structure, in which the participation of foreign firms is relatively common. In 2002, just under 10% of pre-transaction petitions and just over 4% of post-transaction notifications under Article 18 involved foreign firms (a total of 1381 transactions). MAP has expressed serious concerns about its ability to adequately analyse these transactions, due to difficulties in obtaining accurate information on parties who are the beneficial owners of foreign corporate entities and shares or who otherwise control the behaviour of those entities. Refusal of permission for such transactions can nonetheless be difficult due to the high priority on the encouragement of inward investment.

In addressing competition issues with an international element, MAP takes account not only of the level of competition in the abstract, but also of other aspects of Russia's overall economic policy priorities, including provision for the national and economic security of the nation and strong concern for the competitiveness of domestic industry. In so doing, MAP attempts to balance the issue of the need for a sufficient level of competition in domestic markets and a unified economic space with account for the priorities of state policy concerning development of domestic producers. Where domestic producers are encountering international competition from globalising markets, MAP sees the question of competitiveness of domestic producers as strongly related not only to improvements in their technological processes but also in the need for the economic size of domestic producers to correspond to the size of foreign firms operating in the same international markets.<sup>18</sup> This focus may tend to push MAP toward

a policy of leniency with respect to merger control questions raised by companies arguing that size is necessary to allow them to compete internationally, even if they then dominate smaller domestic markets. MAP also takes the question of competitiveness and fair treatment of Russian enterprises into account in addressing such issues as tariff changes, and has supported tariff restrictions imposed in response to discriminatory treatment of Russian producers and proposed the elimination of import duties where the items are not available in a sufficient amount domestically to supply Russian producers' demand for them.

The Law on Competition specifically authorises MAP to conduct cooperation with international bodies and those of foreign countries and to participate in the development of international instruments and treaties that affect areas within its competence. It also specifically provides for MAP to engage in information exchange with international organisations and with foreign governments within its spheres of authority. (Article 12, points 12 and 13) MAP has used these authorities in its work as a member of the International Council on Antimonopoly Policy of the States of the Commonwealth of Independent States, within the framework of which it has developed a treaty on coordinated conduct of antimonopoly policy and a number of related agreements on cooperation and sharing of information. In addition to agreements within the CIS framework, MAP has also concluded agreements with other states, including Bulgaria, Poland, China, France, Hungary, the Czech Republic, Slovakia, Greece, Korea, Italy and others, covering various forms of cooperation including policy dialog, technical assistance and other measures. Most of these agreements have included provisions concerning the exchange of information covering legal materials and statistical information. The agreements with Hungary, Bulgaria, Romania, and Latvia include specific provisions concerning exchange of information in the conduct of specific investigations, including questions of the level of confidentiality. These agreements have facilitated investigations, including a 2001 investigation into possible anticompetitive agreements in forest products involving both Russian and Finnish participants, and an investigation into illegal trading of automobile parts in Bulgaria using a trade mark that copied that of a Russian producer.

### ***3.5 Competition body resources and caseload***

MAP's available staff resources have fluctuated only slightly in recent years. In 2000, staffing reductions were required across all federal bodies by the federal government as a cost saving measure. These resulted in drop of about 10% for MAP, which was in line with the overall reduction, while some federal bodies lost up to 30% of their staffing allocations. Reduction of the staffing limit by 35 persons in 2002 was the result of a shifting of

responsibility for tariff regulation of transportation monopolies from MAP to the Federal Energy Commission, with a corresponding shift in staffing. A modest increase in 2003 brought MAP back up to the overall staffing levels of 2000 and 2001, with the additional staff positions going primarily to the creation of two new territorial administrations.

The educational backgrounds of staff members are varied. As of the beginning of 2003, 275 of the 357 persons employed in the central office of MAP had completed a higher education, but only about half of these were in areas of study directly related to the work of the Ministry such as law or economics.<sup>19</sup> Graduate degrees are significantly less common, with 15 of the central staff members possessing degrees as candidates of sciences and 2 having doctoral degrees. The statistics for the territorial offices are quite similar.<sup>20</sup> Rapid loss of personnel is a problem for MAP, as for many competition authorities, in part due to the higher rates of pay for corresponding specialists in private employment. In 2002, the territorial offices of MAP lost a total of 254 staff members, or about 18% of the staff, while the central office of MAP lost a total of 97 employees, or about 27% of the staff.<sup>21</sup> Where only 50% of staff have educational backgrounds directly related to their duties, job experience and work-related training programs are a very important component in creating staff competence, and turnover rates of up to a quarter per year may make it impossible for MAP to maintain the necessary staff capabilities in economic and legal analysis required for high quality competition law enforcement. Such high turnover rates also imply a continuing need for high rates of expenditure on basic training activities, with impacts upon the resources available for other needs.

Allocation of budgetary funds has increased consistently year-to-year, with the most significant increases in 2000 and again in 2003. Changes in the total budget available to MAP do not, however, precisely mirror the changes in budgetary allocations, since MAP has also been allowed to expend a portion of the fees submitted with merger control petitions and notifications (noted in Table 3.1 as extra-budgetary funds) on its own needs, especially technology purchases. Beginning in 2002, the law on the federal budget has required that the Ministry move toward being supported solely by federal budgetary allocations, with fees from Ministry activities to go into the general federal budget as non-tax income. This change in the financing system resulted in a small decrease in the overall funding available from 2001 to 2002, but a large increase in the budgetary allocation resulted in an increase of more than 33% in the available budget for 2003. The change in the funding channels for the Ministry eliminates any conflict that MAP might have faced in relation to a change in the notification thresholds for merger control activities, as well as any incentive to maximise

fee income by concentrating resources on the enforcement of notification requirements.

**Table 3.1: Trends in Ministry Resources  
(thousands of roubles)**

| Year        | Person-years | Budget Allocation | Extra-budgetary Funds Available | Total Available Budget |
|-------------|--------------|-------------------|---------------------------------|------------------------|
| 2003 (plan) | 1857         | 390824.6          | 38000.0                         | 428824.6               |
| 2002        | 1822         | 266431.4          | 44540.2                         | 310971.6               |
| 2001        | 1857         | 242548.9          | 80546.8                         | 323095.7               |
| 2000        | 1857         | 180576.6          | 49470.2                         | 230046.6               |
| 1999        | 1907         | 96426.1           | 40743.0                         | 137169.1               |

Source: MAP November 2003

While the staffing complement and budgetary figures presented here may initially seem quite ample in comparison to those for other competition authorities, they may well be inadequate to address all of MAP's current duties. Far from 100% of the listed totals can be considered competition resources. In addition to its duties in the areas of competition law and policy, MAP is also responsible for enforcement of advertising law, consumer protection law, and laws on commodities exchanges, the promotion of entrepreneurial activity and the protection of small businesses, and the regulation of tariffs for natural monopolies in communications. MAP's financial reporting information does not permit separate identification of the budgetary and personnel resources expended on its differing areas of responsibility.

**Table 3.2: Trends in Enforcement Actions**

|                                   | <i>Abuse of dom.</i> | <i>Agmts</i> | <i>State Actions</i> | <i>Unfair Comp.</i> |
|-----------------------------------|----------------------|--------------|----------------------|---------------------|
| <b>2002</b>                       |                      |              |                      |                     |
| Matters considered <sup>(1)</sup> | 3566                 | 74           | 3110                 | 345                 |
| Violations found                  | 1420                 | 51           | 1751                 | 170                 |
| Eliminated informally             | 591                  | 5            | 726                  | 37                  |
| Formal cases pursued              | 829                  | 46           | 1025                 | 133                 |
| Agreement before decision         | 378                  | 20           | 318                  | 53                  |
| Formal decisions issued           | 451                  | 26           | 707                  | 80                  |

**Table 3.2: Trends in Enforcement Actions (cont.)**

|                           | <i>Abuse of dom.</i> | <i>Agmts</i> | <i>State Actions</i> | <i>Unfair Comp.</i> |
|---------------------------|----------------------|--------------|----------------------|---------------------|
| <b>2001</b>               |                      |              |                      |                     |
| Matters considered        | 3129                 | 45           | 2442                 | 343                 |
| Violations found          | 1537                 | 22           | 1315                 | 175                 |
| Eliminated informally     | 673                  | 7            | 325                  | 41                  |
| Formal cases pursued      | 846                  | 15           | 990                  | 134                 |
| Agreement before decision | 326                  | 5            | 252                  | 45                  |
| Formal decisions issued   | 538                  | 10           | 738                  | 80                  |
| <b>2000</b>               |                      |              |                      |                     |
| Matters considered        | 2478                 | 45           | 2386                 | 310                 |
| Violations found          | 1273                 | 18           | 1332                 | 191                 |
| Eliminated informally     | 545                  | 6            | 437                  | 27                  |
| Formal cases pursued      | 728                  | 12           | 895                  | 164                 |
| Agreement before decision | 290                  | 3            | 262                  | 53                  |
| Formal decision issued    | 438                  | 9            | 633                  | 111                 |

(1) Matters considered includes petitions received and matters investigated on the initiative of MAP.

**Table 3.3: Trends in Merger Control Activities**

| <b>Year</b> | <b>Art.17/<br/>Art. 18</b> | <b>Total petitions<br/>and notifications<br/>reviewed</b> | <b>Violations<br/>Investigated(1)</b> | <b>Violations<br/>found</b> |
|-------------|----------------------------|---|---------------------------------------|-----------------------------|
| 2002        | 4371/<br>19,659            | 24,030  | 3438                                  | 3307                        |
| 2001        | 4827/<br>16,165            | 20,992  | 5182                                  | 5071                        |
| 2000        | 3882/<br>12,092            | 15,974  | 4193                                  | 4000                        |

Source: MAP November 2003

(1) Violations in the context of merger control may include failure to file a petition or notification, failure to present necessary information or presentation of false information.

Tables 3.2 and 3.3 document a heavy caseload under the Law on Competition alone. Moreover, these tables understate somewhat, as they not include cases enforcing compliance with information requests. (These cases accounted for between 630 and 840 formal cases per year in 2000-2002.) Nor do they reflect the resources expended to defend the several hundred competition law cases per year that are appealed to court and that may remain in one or another stage of the judicial process for several years or the separate caseload under the law on competition in financial markets (198 formal cases in 2002). One must also factor in the resources expended on

review of proposed acts of state bodies for consistency with the competition law. MAP reviewed 2645 draft acts in 2002 and issued 697 negative conclusions explaining to the relevant state body why the proposed act was not consistent with the law.

When MAP's duties outside the enforcement of competition law are considered, the situation appears even more extreme. Taking into account only complaints concerning violations of the laws, petitions and notifications concerning transactions, and matters opened on MAP's initiative in the areas of competition, consumer protection and advertising, the number of matters to be addressed rises to over 100,000 per year, as shown in Table 3.4, below. This excludes policy work, competition advocacy activities, public education and public information activities, review of draft legislation, and all tasks related to the support of entrepreneurship and small businesses, commodities markets, or the regulation of monopoly communications tariffs.

**Table 3.4: Matters Addressed by MAP in 2002**

|   | <b>Complaints<br/>On<br/>Violations</b> | <b>Petitions<br/>for Consent</b> | <b>Notifications</b> | <b>Own<br/>Initiative</b> |
|---|---|----------------------------------|----------------------|---------------------------|
| <b>Law on Comp.<br/>On Financial Mkts<sup>(1)</sup></b> | 125                                     | 1052                             | 623                  | 412                       |
| <b>Law on Consumer<br/>Protection<sup>(2)</sup></b>     | 46,000                                  | Not relevant                     | Not relevant         | 5031                      |
| <b>Law on Advertising<sup>(3)</sup></b>                 | 2953                                    | Not relevant                     | Not relevant         | 8858                      |
| <b>Law on Comp.<br/>On Goods Mkts<sup>(4)</sup></b>     | 6717                                    | 10,977                           | 13,053               | 5046                      |
| <b>Total Matters<br/>Addressed</b>                      | <b>55,795</b>                           | <b>12,029</b>                    | <b>13,676</b>        | <b>19,347</b>             |

(1) Source: MAP 2003 (sbornik).

(2) Source: State Report on Competition for 2002. Complaints include both oral and written. It is assumed that all "verifications" listed were undertaken on own initiative.

(3) Source: State Report on Competition 2002. The report lists a total of 11, 811 cases, with  $\frac{3}{4}$  of these being undertaken on own initiative.

(4) Source: MAP 2003 (sbornik).

With respect to merger control activities, the high numbers are produced by a combination of low overall thresholds and the lack of criteria (such as value of the transaction reviewed or a minimum value for each of the participating companies) that would eliminate the need for large companies with an asset value above the combined threshold amount to file petitions or notifications for nearly any transaction they conduct. MAP has recently proposed a large increase in the combined asset value thresholds for review, suggesting that pre-merger notification thresholds be raised to a level equivalent to 100 or even 150 times the current amounts. An increase to

150 times the current levels would bring the pre-merger (pre-transaction) petition threshold to a combined balance sheet asset value of just over \$100,000,000. It is also proposed that the post-transaction notification threshold be increased to 200 million roubles, or about \$6,670,000. MAP staff estimated that this would greatly reduce the caseload across the Ministry as a whole, leaving it at about 10% of the current load, or about 2400 petitions and notifications per year in total. The reduction in the central office of MAP, which handles cases concerning the largest firms, would be less significant – perhaps to about 20% of current totals.

With respect to cases concerning actions and agreements of state bodies, the high caseload through 2002 appears to be due to a combination of the absence in the law of a requirement that the acts or agreements complained of have an effect on competition and MAP's lack of any kind of discretion to refuse investigation and prosecution of complaints that state a violation of the law. The recent amendment of the law to require a showing of an effect on competition could reduce the caseload under Articles 7 and 8 to a more reasonable level, provided that requirement is interpreted in a substantive manner requiring the careful definition and analysis of the market involved and that proof of restriction on one or a few competitors is not allowed to substitute for proof of effects on the level of competition. Questions arise, though, as to why the statistics for the first half of 2003 (after the amendments went into effect) don't appear to show any reduction in the caseload.

The high case load in the area of abuse of dominance is primarily accounted for by the large number of cases that concern abuses by natural monopolies or by entities operating in areas not legally defined as natural monopolies – such as generation and supply of electricity or sale of natural gas to consumers – but which are the sole operating supplier to many customers. Such cases account for more than half of all abuse cases in most years, and in some years quite a bit more than half. The high number of such cases appears to be due to a combination of factors, including very narrow regulation of natural monopolies, a lack of other bodies authorised to resolve the relevant disputes and the inability of MAP to impose serious sanctions or to issue orders requiring specific contract terms or preventing repetition of violations.

Russia's law on natural monopolies, passed in 1995, does envision the creation or designation of specific regulatory bodies for a narrow list of natural monopoly sectors, including transmission of electricity through the network and also of gas and oil through pipelines, services of ports and airports, basic local telephone services, railway services and also post and telegraph. The law defines the methods of regulation that are to be used by the regulators in these sectors, limiting them to price regulation (by means

of specific price setting or price caps), the specification of customers that must be served by the natural monopoly on a mandatory basis, and definition of the required volume of service to various customers if there is insufficient capacity to supply all of the relevant demand. Although the terms of contract are clearly vital to a regulator's ability to price properly, the law does not provide for any kind of direct regulation of contract forms or contract terms (other than prices and tariffs) by the regulatory bodies. In some areas, general rules relating to the provision of service and/or the use of the relevant systems by consumers, imposed by decrees of the Government or the relevant branch ministries, are in force and may regulate such matters as the type of technical documents that can be demanded by the monopoly as a condition of service. Even where such rules are in force, however, the regulatory bodies are not given the authority to enforce them directly or to resolve any disputes between regulated natural monopolies and specific customers except those concerning the regulated tariff. In effect, there is no general sectoral regulator with responsibility for overseeing most aspects of the behaviour of the natural monopoly entities. There is only a tariff setting body with a relatively narrow mandate. Thus, disputes over contract terms, refusals to contract and other similar matters, even in natural monopoly sectors, are often brought by the relevant customer to the MAP as an abuse by the regulated monopoly of its dominant position.

Because the law on natural monopolies contains a specific and exhaustive list of natural monopolies that are to have tariff regulation as specified by the law, other areas in which purchasers/consumers may still commonly face a sole supplier are not covered by the law on natural monopolies. Pricing in these areas may be regulated by various legal acts and adjustment of pricing may be assigned to a particular state body – in some cases the same body that regulates tariffs for natural monopolies in the same sphere. Rules may exist concerning the use and/or provision of the good or service, or governing specific aspects of the contract or of the breach and cessation of service. Enforcement of the rules, however, generally requires individual customers either to file suit in court or file a complaint with MAP concerning abuse of a dominant position. Moreover, existing rules do not cover all aspects of the contractual relationship, and parties objecting to the use by a *de facto* monopoly of specific terms of contract (for example, high penalties for minor changes in consumption) may have no recourse other than to characterise this as the abuse by the entity of its dominant position in a complaint to MAP. While in theory such a case could also be taken directly to court, court procedures are more formal than MAP's and the courts will not undertake an investigation in the way that MAP is obligated to do. In recent years, this type of case has been especially common in relation to electricity suppliers, which are not classified as natural monopolies (only transmission is covered by the law)

but which are very often operating in a monopoly position in relation to specific customers.

The lack of effective sanctions and an enforcement procedure not designed for policing the behaviour of regulated monopolies also contribute to maintaining the high abuse of dominance caseload. MAP's enforcement procedures were designed for application to competitive markets, and require that each element of a violation – including the existence of dominance and the abusive nature of the specific behaviour involved – be proven by MAP in each case, and if necessary defended in court on the basis of evidence developed by MAP at the time it made its decision. MAP cannot rely on its own earlier cases when addressing another instance of the same or similar conduct and it cannot issue an order broader than the individual case, such as one that might require the respondent to amend all contracts with provisions identical to those found abusive in response to a specific complaint. Thus, each complaint is addressed individually, and later plaintiffs may not know of or benefit from the decisions in earlier cases. If sanctions for violation of the law were significant, the respondents might have sufficient incentive to avoid a repeat violation even in the absence of a direct order to that effect, but since the only immediate consequence to the violator is an order to cease the violation, there is no such incentive.

There are several ways in which the large abuse of dominance caseload could be reduced and some of the repetition avoided. One strategy that is employed in many countries is for a substantial proportion of the relationships between natural monopolies and their customers, and between monopoly utilities and their customers until competition begins to occur, to be defined by legislation or by other forms of binding rules that are quite detailed. This can take the form of mandatory contract terms or contract forms, defined permissible ranges for some terms, detailed rules concerning establishment and termination of service, and other similar strategies. This additional clarity concerning the mandatory or the permissible terms of contract could eliminate a number of cases simply by eliminating doubt on the part of both monopolies and their customers about what kinds of behaviour will be found to constitute an abuse.

Another strategy would be to place broad powers – including the power to define permissible behaviour and contract terms – in the hands of a sectoral regulator. The regulator could likewise be assigned to resolve, at least in the first instance, disputes and complaints concerning the terms of such contracts using a short, efficient procedure that would have as its primary purpose the determination of whether the regulated monopoly violated the detailed rules contained in legislation or issued by the regulator. This would have the advantage of allowing the regulatory body to set tariffs

with full knowledge and control of all of the circumstances, including the sizes, reasons and frequencies of penalties and other charges, and avoiding lengthy legal wrangles about the existence of dominance or first principles of contract law. MAP would retain authority, through the legal provisions on state action, to challenge decisions or behaviour of the regulator that unduly restrict competition, but would not retain responsibility for the resolution of specific disputes.

**BOX 10. RECENT PRACTICE – NATURAL MONOPOLIES  
AND REGULATORS**

1. A city water provider included in its contracts for water connection to private houses a term requiring “voluntary participation in shared contribution to development of water system infrastructure” which was intended to cover costs incurred in laying new pipes and not covered by regulated tariffs. MAP’s territorial office found both an abuse of dominant position and a violation of consumer protection law. The water company appealed and MAP’s decision was reversed by the court on the grounds that the term was not within those regulated and the parties had the right to agree on whether or not to include such issues, so should conduct negotiations. The appeals and cassational courts reversed the court of the first instance and agreed with MAP that the term was abusive and was being forced on the customers.
2. MAP received complaints from gas distribution organisations in several regions that they are unable to compete in the gas market because the Federal Energy Commission has refused to set regulated mark-ups for their services as required by law. The regulated amount is what may be charged by the gas distribution organisation in addition to the regulated wholesale price of the gas. MAP has opened a case charging the Federal Energy Commission together with Gazprom and Mezhhregiongaz (its related regional supplier) with conclusion of an anticompetitive agreement intended to prevent the gas distribution companies from competing in the market and the Federal Energy Commission separately with state action restricting competition.

*Source: MAP June 2003; MAP website*

This option is not as simple as assigning the relevant function to existing tariff regulators. Some commentators have expressed concern about the possibility that “industry capture” of existing regulatory bodies would make such a system undesirable and itself a source of abuse. Even if this were not a concern, the existing regulatory bodies could not possibly take on an additional dispute resolution function. They are already overtasked, covering price setting in a number of widely varying activities in energy

supply (oil pipelines, gas pipelines, electricity transmission and traffic regulation), transportation (rail, ports, airports) and communications (telecoms, post, telegraph, broadcasting). As reform progresses, there will be an increasing number of service types and providers in each area of activity and an increasing need to consider the relationship of national rules and tariffs with those at the regional and local (retail) levels as markets are developed. Conflicts and complex inter-relationships between the regulated activities may also present problems as regulators are tempted or pressured to adjust interrelated tariff structures to benefit particular sectors or to meet other policy goals, rather than with the goal of covering appropriate costs and supporting competition. These concerns suggest that proposals for a unified tariff body or “mega regulator” for all natural monopoly sectors are not likely to lead to an effective structure for regulation and that it would be far preferable to increase the number of regulators in order to have separate regulators for differing industries. Attention may also need to be given to stronger guarantees of independence and accountability than are now in force. The creation of effective, independent regulatory bodies for all of the areas in which they are required will demand substantial additional resources, but they are a prerequisite for the long term success of reforms. MAP cannot efficiently substitute for them and its ability to meet its other obligations will continue to suffer if it is forced to try.

## **4. Limits of Competition Policy: Exemptions and Special Regulatory Regimes**

### ***4.1 Economy-wide exemptions and special treatment***

The Law on Competition contains very few explicit exemptions. According to Article 2 of the law, relationships connected with intellectual property are not covered except in instances where agreements connected with their use may lead to restriction of competition or where the acquisition, use or violation of intellectual property rights may lead to unfair competition. The same article exempts issues of monopolistic activity and unfair competition on financial markets, stating that they are to be regulated by other federal law except where they affect competition on goods markets.

By its terms, the prohibition in Article 7 on state acts and actions restricting competition applies on the federal level only to acts and actions of executive bodies, which exempts federal laws. A federal law that seriously restricted competition, and in particular a law that created barriers to the movement of goods and services within Russia, might conceivably be found to violate the constitutional provisions discussed in part 1, but this would require a decision of the Constitutional Court, which would be required to determine whether the limitation was for constitutionally acceptable purposes (e.g. protection of life and health) and was proportional to the purpose served. Standing before the Constitutional Court is strictly limited, however, and such a case could only be submitted by a private party whose rights were violated by application of the law in a specific case, by a court called upon to apply the law, or by one of a limited number of state bodies that does not include MAP.

Part 3 of Article 7 contains a broader exemption from the prohibition on combination of the functions of state bodies and those of an “economic subject,” allowing such combination in instances where this is provided for by “legislation of the Russian Federation.” The concept of “legislation” includes not only laws but also other legal acts and this language would therefore allow such combinations of functions where authorised not only by a federal law but also by decrees of the Government or other similar acts. An exemption from Article 8’s prohibition on agreements of state bodies that concern pricing is also provided; such agreements may be concluded where they are authorised by federal law, or by a normative legal act of the President or the Government of the Russian Federation. The limitation of the exemption to “normative” legal acts means that only an act stating a general rule would qualify, so the exemption might not apply to a non-normative act that created a special pricing situation for a single firm.

The term “economic subject” is used throughout the law to refer to participants in commercial or entrepreneurial activities whose rights and obligations are defined by the law or whose interests are being protected. Article 4 of the law defines “economic subjects” as Russian and foreign commercial and non-commercial organisations, excepting those that do not engage in entrepreneurial activity, and including agricultural cooperatives and individual entrepreneurs. Entrepreneurial activity does not have a strict legal definition, but is usually defined as activity that is directed toward the receipt of profits, so the wording of the definition might well exclude the application of much of the law to non-commercial entities whose economic activities are not undertaken for profit, even where they may have a significant effect on competition in a market. Certainly it appears to exclude the interests of such non-commercial entities from protection under some of the provisions of Article 5 (such as that preventing a dominant enterprise from discriminating among economic subjects) and of Article 7 (where infringement upon the interests of an economic subject is a qualifying element of a violation, together with an effect on competition).

There are no exemptions or special treatments under the law for small enterprises, nor is there a *de minimis* rule applicable to most of the law’s provisions. As discussed above, provisions on vertical agreements do not apply to economic subjects “whose collective share on the market for a specific good” does not exceed 35%, but it is not clear how this provision will be applied in practice. There are no block exemptions under the Law on Competition and no procedure for their creation.

## **4.2 Sector-specific Rules and Exemptions**

### *Regulation and reform of natural monopolies*

The federal law on natural monopolies requires that the prices and tariffs charged by such monopolies be regulated by the bodies created or assigned for this purpose by the Government. The law contains an exhaustive list of the types of activities that are to be considered natural monopolies, and includes:

- transportation of oil and petroleum products through main pipelines;
- transportation of gas through pipelines;
- rail transportation;
- services of terminals, airports and ports;
- basic local telephone services;

- telegraphic services and postal services and some services related to the transmission of television and radio programs;
- the transmission of electric energy;
- the transmission of heat energy; and
- the operative-dispatcher service controlling transmission in the market for electric energy.

The tariff regulator for monopolies in the spheres of energy and of transportation is the Federal Energy Commission, and for monopolies in the sphere of communications is MAP. The regulation envisioned by the law on natural monopolies is quite narrow and extends only to pricing and some aspects of investment decisions, as well as to the definition of what customers must be served by the monopolies and distribution of the relevant good or service among customers if demand cannot be met completely. Other aspects of the behaviour of the natural monopolies are not directly regulated by the law on natural monopolies and the designated tariff regulator is not authorised to create new regulations covering issues not directly addressed in the law.

There is no exemption from the Law on Competition for natural monopolies. Prohibitions in that law related to pricing abuses by dominant enterprises and to pricing agreements or priority service assignments by state bodies contain exemptions for situations in which the behaviour is required by federal acts, and so there is no conflict between the competition law's provisions and those of the acts regulating natural monopolies. Potential problems such as the tying of other goods and services to those in which there is a natural monopoly, discrimination among customers, refusal of service and other similar issues are not addressed by the regulatory bodies, but rather by MAP on a case-by-case basis. The effects of this practice on MAP caseloads and the possible efficiency concerns raised by a post-hoc, case-by-case method of addressing these issues were discussed above in Part 3.

Regulatory reform processes underway in a number of natural monopoly sectors plan progressive changes in the regulatory scheme applying to particular natural monopolies or to their potentially competitive parts, but do not at this time include any plans for a fundamental change in the division of regulatory responsibility between tariff regulators and MAP. In fact, the 2002 amendments to the Law on Competition included the insertion of specific language on non-discriminatory access to markets and infrastructure, which will be applied by MAP to prevent remaining

infrastructure monopolies from discriminating in favour of particular companies as competition begins to be created for access to their services.

The regulatory reform process may in some cases result in clearer and/or more detailed regulation of monopoly behaviour during the reform process and in “competitive” sectors of the market than has so far been in effect under full monopolisation of the same goods and services. For example, the rail reform has included the passage of a set of specific rules concerning non-discriminatory access to rail infrastructure adopted in December 2003 and envisions a separate statute on competition in rail transport. Violations of these rules will still, apparently, be addressed by MAP, either on the basis of complaints or on MAP’s own initiative, but if the rules are sufficiently clear and detailed they may reduce uncertainty and thereby the need for MAP to address repetitive instances of similar violations. MAP has taken the lead responsibility for the drafting of these new rules and the statute, and is basing them in significant part on its experiences in addressing railway cases under the abuse of dominance provisions. There is no indication, however, that the sanctions for violation of the rules will be any greater than those that apply generally to violations of the competition law, which may reduce the effectiveness of the rules.

Similarly, existing provisions on reform in the electricity sector involve the passage of detailed rules concerning use of the market, access to transmission services, and other aspects of the wholesale system, with very detailed rules planned to be issued at a later stage concerning contracting with smaller end users and citizens who will not be involved in the wholesale market. Rules will also require participants in the market to make available a specific list of information, including some information related to contract terms. This may allow customers to demand appropriate terms ‘up front’ in the contracting process and reduce the ability of those with market power to impose abusive or discriminatory terms on contracting partners who are unaware of the terms offered to others, correspondingly reducing the need for MAP to address abuses on a case-by-case basis at a later stage. The new system may also, however, create new opportunities for abuse. For example, after the establishment of the wholesale market for electric energy, MAP has begun to receive complaints concerning attempts by RAO EES and its associated regional companies to prevent enterprises from entering the national wholesale electricity market, due to concerns that this will result in large tariff increases for the remaining customers of the regional companies.

The new systems will also create new roles for, and demands upon, MAP. In the electricity sector in particular, MAP has been assigned to regulate the behaviour of the administrator of the electricity trading system to ensure non-discriminatory access. The administrator itself is a non-

commercial partnership in which all of the interested parties participate. MAP proposed this structure and believes that it facilitates open communication about the reform process and may reduce the likelihood of abuses. There is also a supervisory council in which MAP participates. The law establishes some specific requirements in the area of electricity provision and some specific powers for the body regulating the system administrator and its participants (that is, MAP). Enforcement will apply the existing procedures under the Law on Competition.

#### *Financial services markets*

Competition in financial services markets is regulated by the 1999 law “On the Protection of Competition on Markets for Financial Services,” which is enforced by MAP. The law defines financial services markets to include securities markets, markets for banking services, markets for insurance services, services in trust management of assets, financial leasing arrangements and “other services of a financial nature.” Although separately passed, the law on competition in financial markets was based heavily on the Law on Competition and designed primarily to close the gap left by a specific exemption in the Law on Competition, rather than to impose a radically different regime of competition law control on financial markets. The structures of the two laws are very similar, as are a number of their provisions. The law on competition in financial markets, however, imposes considerably tighter control on both agreements and concentration through preliminary review and notification requirements. The main substantive differences include the following:

Abuse of dominance by a financial organisation is defined very broadly as actions that create barriers to entry into the market by other financial organisations or “exert a negative influence on the general conditions for the provision of financial services on the market.” (Article 5) An illustrative list of such abuses includes: inclusion of discriminatory conditions in contracts that result in advantage or disadvantage to particular financial organisations; tying of unrelated or disadvantageous conditions; and establishment of groundlessly high or low prices for the financial services provided. It may be noted that the first two sub-points in the list refer specifically to disadvantage to “financial organisations” which would appear to exclude such behaviour directed toward customers or contracting partners that are not themselves financial organisations. Since the list is not exhaustive, however, this is not definitive.

The law on competition in financial markets contains a single provision (Article 6) covering all types of restrictive agreements of financial organisations: agreements concluded with one another, those with other legal entities, and those with regulatory bodies or other state bodies. Such

agreements are prohibited if they have or may have as their result the restriction of competition. The illustrative list includes agreements that are directly or indirectly intended to: establish prices or mark-ups; rig bids at auctions or tenders; divide markets; restrict access to the market or eliminate other financial organisations from it; or establish groundless criteria for membership in payments or other systems without which a financial organisation cannot compete that serve as barriers to entry. The illustrative list does refer to agreements “directed toward” these outcomes, but this does not appear to have caused questions about an intent standard, perhaps due to the earlier statement in the same article that the agreements are prohibited on the basis of their effects or possible effects on competition.

Article 7 of the law on competition in financial markets does contain four specific block exemptions for agreements covering: (1) unification of standards for the activities of financial organisations; (2) the conduct of joint scientific research and development; (3) joint purchase of technical equipment for the conduct of core activities; and (4) use of unified programming or technical equipment for the processing of information or unified data bases. The same article provides that additional block exemptions may be established by the Government of the Russian Federation, including exemptions for specific types of financial organisations.

Unlike the Law on Competition, the law on competition in financial markets contains a mandatory notification procedure for agreements (Articles 8 and 9). Agreements must be notified to MAP within 15 days of their conclusion where the participants in the agreement account for a minimum percentage of turnover in the relevant market (currently 10%)<sup>22</sup>. This includes not only agreements between financial organisations, but also all other agreements covered by the unified provision – agreements of financial organisations with bodies of executive power of any level, with bodies of local self government and also with any other legal entity concerning the conduct of joint activities. MAP is required to respond to such a notification within 30 days of its receipt of all of the required information, or may extend consideration for up to 30 days if additional verification is required. Copies of the agreement and all appendices, information on the basic activities of the participants and the amount of their turnover in these areas, and copies of the financial reports required by the Central Bank and the local bodies of executive power are to be attached to notifications and MAP is not permitted to request any other information. If MAP finds the agreement to limit competition, it may require the participants to annul it, cease activities under it or to alter it to preserve competition in the market. Agreements that are not annulled or altered to

preserve competition by the participants may be voided by a court on the basis of a suit by MAP.

Merger control procedures under the law on competition in financial markets require either preliminary consent from MAP or post-transaction notification to MAP in all instances when more than 10 per cent of the assets or 20 per cent of the shares of a financial organisation are acquired; acquisition by means of release of rights of claim of a value of shares in a financial organisation that exceeds the amount set by the Government of the Russian Federation; acquisition of the right to control the activity of a financial organisation (including by contract); any merger of financial organisations; and the creation of a financial organisation or a change in its charter capital. Whether the transaction requires preliminary consent or a post-transaction notification depends upon whether the size of the charter capital of the organisation (for creation or change in charter capital) or the amount of stock or assets acquired exceed a value set by the Government of the Russian Federation.<sup>23</sup>

For preliminary consent, a petition must be filed with MAP containing the information specified in the law (Article 17.2). MAP may not require the submission of any other information, and must issue a written response to the petition within a maximum of 45 days of its receipt. Post-transaction notification must be made within 30 days of its completion and the scheme for MAP review mirrors that for preliminary consent. Consent may be withheld (or the notified transaction objected to) if the transaction will result in the creation or strengthening of a dominant position on the financial services market and the restriction of competition. MAP may impose conditions intended to protect competition in the relevant market, and may consent to a transaction despite negative consequences if the participants show that its positive effects will outweigh its negative effects. MAP may also permit the transaction if the participants prove that they are holding the relevant shares solely for the purpose of the receipt of income associated with them. In this case, the shares may be held for not more than one year following their acquisition and the only rights that may be exercised in relation to them are the right to receive income and to dispose of the shares. Completion of transactions in violation of the requirements for preliminary consent or notification or failure to abide by conditions imposed by MAP are grounds for the transactions to be voided by a court on the basis of a suit filed by MAP.

Provisions prohibiting state acts and actions that restrict competition in financial markets are very similar to those contained in the Law on Competition, as are those related to unfair competition. The law on competition in financial services contains a direct requirement that financial organisations conducting operations with budgetary funds be chosen by

open competitive tender, and a requirement that the terms of such tenders be submitted by the executive bodies of the corresponding level for the consent of MAP. Failure to abide by this rule is grounds for the results of the tender to be voided. MAP has been actively enforcing these rules, reviewing in detail the tender conditions, processes and results of tenders of various regional and local bodies and issuing corresponding orders for changes or voiding the results.

### *Natural gas*

Pricing for natural gas (with the exception of gas sold by small producers not affiliated with any of the large companies that dominate gas production) is regulated by the Federal Energy Commission on the basis of several Presidential decrees. The powers of FEC in relation to natural gas are the same as those defined in the law on natural monopolies for the tariff regulator – it can set prices by means of direct dictation of specific price, or by the definition of upper limits, mark-ups or maximum coefficients for price changes. The price for gas produced as a by-product of petroleum extraction and sold to a gas processing facility for further processing is regulated by the Ministry for Economic Development and Trade by the same means. The Law on Competition is applied in full measure by MAP.

A number of steps have been taken towards regulatory reform in the gas sector, including the restructuring of Gazprom as an open joint stock company, the separation of types of business activities (production, transportation, distribution and sales) into different legal entities and the separation of accounting for subsidiary and related entities within the Gazprom group of companies. Rules for non-discriminatory access to the gas transportation and gas distribution networks have been adopted and the share of independent participants in the gas sector has risen over the past ten years from none to about 15%. Further reform of Gazprom, including divestment of holdings outside its core functions, isolation of natural monopoly functions and creation of competition in other parts of the natural gas sector has been widely discussed in the press and in policy circles and is expected in the future, but no specific commitments have been made concerning the specifics of such reform or its time frame.

### *Telecoms*

Prices for basic telephone services through the traditional network are regulated as a natural monopoly area, with the tariff regulation service currently functioning under MAP. In its work in this area, MAP has focused its efforts on reforming tariffs to eliminate cross-subsidisation and to allow competition in areas where the conditions for it are present, as well as on ensuring that tariffs actually cover the costs of running the network and of

modernisation and development. Cases indicate that in some locations there have been problems with the conduct of companies that have obtained (usually by contract) the right to operate a small part of the network in a specific geographic area, or with the relationship between these companies and others operating other parts of the system. With more than 100 licensed companies, competition is developing actively in mobile and satellite telephone services, but price differences currently keep these modes from competing directly with the traditional network in the provision of basic services.

*Licensing requirements and other barriers to entry*

In 2001, the federal law “On the Licensing of Specific Types of Activities” was adopted to provide a general framework for the licensing of various kinds of activities. Although licensing activities are in general carried out by the regional and local bodies, the federal law is characterised as an exercise of the constitutional power of the federal government to provide for a unified economic space and one of its primary purposes was to prevent the multiplication of licensing requirements at regional and local levels and to require that licenses issued by one regional or locality be honoured by others (after proper notification of the existence of a valid license), thus reducing barriers to the movement of goods and services. The law establishes the general principle that licensing may be required only for those types of activities the conduct of which may result in infringement on the rights and legal interests of citizens, or result in damage to the defence capability or security of the state, to the cultural heritage of the peoples of the Russian Federation, and which cannot be adequately controlled by any other means than licensing (Article 4).

The law contains an exhaustive list (in Article 17) of the types of activities for which a license may be required, and federal, regional and local bodies are forbidden to establish licensing requirements for other types of activity. Activities in the list are generally limited to those raising questions of safety and include work related to information security (encoding and decoding of financial information, electronic signatures, printing of securities and others), work involving weapons and dangerous substances (explosives, chemicals, oil and gas, disease agents), transportation services, and medical, veterinary and pharmaceutical activities. There are some items in the list that may raise questions, such as requirements for the licensing of tourist agencies and tour operators, work in the area of cartography, the running of movie theatres, the storage and processing of grain and the sale or processing of scrap metals. Some of the entries in the list are worded quite broadly, including “activities related to” the relevant listing, which may permit the extension of licensing

requirements beyond that necessary to protect the public interest. The extent of any limitation on competition, however, would depend upon the nature of the specific licensing requirements in each area.

A significant number of activities are exempted entirely from the provisions of the federal law on licensing. Most of these are regulated by more complex sectoral legislation and regulations that cover separately the issues of licensing and supervision. Exceptions include credit organisations, communications activities, activities related to customs rules, production and sale of alcoholic beverages, insurance, securities markets and other exchanges, radio and television broadcasting, natural resource extraction (except fishing which is covered by the licensing law), atomic energy, education and the protection of state secrets.

The elimination not only of unnecessary licensing requirements, but also other administrative barriers to entry and to the conduct of entrepreneurial activity has been a priority area of state policy initiative in recent years. In addition to the law on licensing, federal laws on the registration of legal entities (simplifying the registration process) and on the protection of businesses and individual entrepreneurs from abuse related to inspections and supervisory powers have also been recently passed. In June of 2001, a decree of the Government created the Commission of the Government of the Russian Federation for the Reduction of Administrative Restrictions on Entrepreneurial Activity and Optimisation of the Expenditures of the Federal Budget on State Administration in the work of which MAP participates. The priority goal of the Commission's work is the elimination of excessive, ineffective or overlapping administrative regulation of such activities. By an initiative of MAP, commissions for the elimination of administrative barriers have been formed in 40 of the regions of the Russian Federation. Representatives of the territorial offices of MAP participate in these regional commissions.

It should be noted that price controls are also applied in some of the areas in which licensing is required, as well as in areas exempted from the application of the law on licensing and covered by special sectoral regulation. Examples of this include:

- military products and products related to the nuclear fuel cycle, circulation of which is very restricted and handling of which requires licensing. Pricing for these items is regulated by the Ministry of Economic Development and Trade;
- raw diamonds and other precious stones, production and circulation of which are regulated by laws on mining and natural resources and a specific federal law "on precious metals and precious stones. Pricing of these items is regulated by the Ministry of Finance;

- loading and unloading services at ports and rail terminals, and passenger and freight services at airports, which require licensing under the law on licensing. Pricing for these services is regulated by the Federal Energy Commission.
- vodka and other alcoholic beverages (above 28% alcohol by volume), which are exempted from the law on licensing and regulated by a special federal law controlling their production and circulation and applying both to domestically produced and imported products. Pricing for these products is regulated by the Ministry of Economic Development and Trade.

The presence of direct price controls in addition to entry restrictions may suggest that entry restrictions are being applied too tightly – resulting in perceived shortages of necessary services, or that licensing and other entry controls are being applied for reasons other than or additional to protection of public interests.

*Price controls on basic goods and services for citizens*

A list of the most basic goods and services used by citizens remains subject to price control under decrees of the President and of the Government that were issued in 1995. Prices are controlled primarily due to concern about the possible inability of citizens with lower incomes to have access to basic necessities, and the prices are regulated by the bodies of executive power of the subjects of the Federation. According to MAP's information, prices for the following goods and services are generally controlled:

- natural gas sold to citizens or to housing cooperatives;
- bottled gas sold to citizens for everyday needs, except where used for automobile transport;
- electricity and heat;
- kerosene, hard fuels and consumer fuels for heating stoves;
- water and sewer services;
- public transportation services within a city and serving suburban areas (except trains);
- apartment rents and communal services fees for non-privatised apartments;
- funeral services;

- social services provided by state and municipal service institutions;
- trade mark-ups on the prices of medicines and medical products.

In addition, the same executive bodies are permitted to regulate prices or mark-ups on the following types of services provided by transport, supply and trading organisations:

- mark-ups on products sold in the Far North and other regions where the ability to move freight is seasonally restricted;
- mark-ups on products sold to organisations providing food services for schools, technical training centers, and middle and higher educational institutions;
- trade mark-ups on the prices of baby foods (including food concentrates);
- passenger and baggage transport on suburban rail transport (by agreement with the Ministry of Railways and if losses are compensated by the budget);
- passenger and baggage transport on routes within the subject and between subjects of the Federation, including taxis;
- passenger and baggage transport on local air transport and on local river transportation and river crossings;
- transport of passengers, baggage and freight by sea, air or river transport into the regions of the Far North and those equated with them;
- transportation services on spur lines provided by organisations providing industrial rail services and other economic subjects, except for federal rail transport organisations.

A few of the goods and services on these lists are in or related to areas of natural monopoly (e.g. natural gas piped into living premises, water and sewer services), where the creation of competition is unlikely or will be a more complicated process that will need to be addressed by staged regulatory reform plans. Some, however, are areas in which competition should be efficient and relatively easy (e.g. automobile transportation of passengers and baggage, trade in baby foods) and it seems likely that price controls imposed in these areas may limit supply and thereby create a vicious circle in which supply limitations are interpreted as a general shortage, which is in turn used to justify continuing price controls.

For those goods and services in which competition is possible, the goal of provision for low income citizens can be met more efficiently by providing subsidies directly to those citizens rather than subsidising the price of the relevant goods for all citizens – whether they require this or not. The creation of a more direct subsidy system for those living in poverty or at low income levels has been under discussion for a number of years, but it is a complex process and the difficulties in the creation of such a system must be acknowledged, particularly in a country in which a substantial percentage of the population falls into the “low income” category and in which incomes from the cash economy may be significant, making verification of income levels and qualification for income subsidies difficult.

### *Professional services*

Professional associations or self-regulating organisations exist for a number of business areas and professional activities. Depending upon the legal regulation of such bodies, they may restrict competition through entry restrictions or through fee guidelines, practice area restrictions, advertising restrictions or other means. MAP has previously taken action on both the federal and the regional level concerning competition restriction by professional or business associations. Examples include objection by the central MAP office to a legal provision making membership in a self-regulating professional association mandatory for professional participants in the stock market, after which this requirement was rescinded, and actions by territorial offices against price setting by local realtors’ groups. MAP also participates in some associations, such as the Russian Advertising Board, in which representatives of advertisers, consumer protection bodies and representatives of MAP participate.

There is no unified legal regulation of professional and business associations and their authorities. Specific laws concerning professional activities make references to such associations and may list their primary purposes or their specific powers and authorities. Provisions in the laws concerning auditors associations, evaluators associations and associations of professional participants in the stock market all permit the associations to establish professional standards for their members and to apply sanctions where they are violated. None of the laws specifies the permissible content of such rules and standards. None of these laws appear to make membership in a professional association mandatory, so there is no direct control over entry, but close cooperation of the associations with regulatory bodies may provide influence over entry conditions, as well as in state disciplinary proceedings. The law on auditing activity, for example, permits accredited auditors associations to take part in the certification of auditors by the authorised federal body, to monitor the compliance of individual auditors or

auditing organisations with rules, and to seek sanctions against specific auditors or organisations and to the granting, suspension or annulment of qualifications certificates.

There may be competition problems in relation to specific areas of professional services that need to be addressed, although the number and extent of these is not certain. Some types of legal services may only be provided by members of a collegium of advocates, which collegia are relatively free to set their own membership requirements and entry restrictions. Persons performing services related to the conduct of bankruptcy proceedings for enterprises are apparently required to receive licenses and to obtain membership in a professional association. It is not clear whether similar arrangements may exist in relation to medical services.

In at least some instances, potential restrictions are a product of treatment of a profession as a quasi-public or quasi-state activity rather than as a business activity. The services of notaries may serve as an example.<sup>24</sup> Notarial chambers work together with the Ministry of Justice and regional departments of justice in defining the number of notary positions that will be formed in each notarial district, both for state employed and for privately practicing notaries. Persons are assigned to fill these positions as they become free, on the basis of a recommendation of the notarial chamber. Candidates for the receipt of a position as a notary must complete a one year *stage* with a practicing notary and possess a license obtained after passage of a qualifying examination. The number of available *stages* and the procedure for and content of the qualifying examination are also determined jointly by the Ministry of Justice and the notarial chambers.<sup>25</sup> A candidate for a position as a private notary must be a member of notarial chamber. The law treats notarial services as a special, quasi-judicial category of activity – restricting the other earnings of notaries to fees from publishing and teaching activities (the same restrictions are applied to judges) and specifically stating that notarial service is not considered entrepreneurial activity. However, private notaries are free to set their fees on the many notarial services that are not state mandated (on legally required notarisations all notaries are required to charge the fees set by the state) and their earnings are their own to keep. While it is clear that the system of notarial districts is a direct restriction on entry and notarial fees are reported to be high, the legal definition of notarial activity as “not entrepreneurial activity” means that the Competition Law does not apply.

## **5. Competition Advocacy for Regulatory Reform**

The legislative and policy development work performed by state bodies of the Russian federal government takes place within a very structured set of procedures that emphasizes planning and the formal assignment of specific tasks. Much of MAP's competition advocacy in relation to federal policies and legislative measures takes place within this framework and relies on its role and functions as defined by official procedures rather than on independent agitation for reform. While MAP should certainly make use of this important means for promoting competition, the cooperative structure of Government procedures and a strong tradition of seeking consensus may lead to a need for compromise to prevent log-jams and preserve working relationships, which in turn may prevent MAP from continuing to seek further improvements after Governmental approval has been given. The breadth of MAP's responsibility leads to a large number of task assignments and may prevent concentration of attention on the most important competition issues.

### ***5.1 Participation in policy formation and legislative drafting***

As a Ministry within the composition of the Government of the Russian Federation, MAP is represented at all sessions of the Government and has the opportunity to comment on any draft law or draft decree of the Government or general policy change that is discussed. In addition, as a part of the Government the Ministry takes an active part in the formation of the plans that are drafted each year concerning the work to be undertaken by the Government in the coming period, including the Plan of Measures of the Government of the Russian Federation for the Medium Term and the Plan for Legislative Drafting Activities of the Government of the Russian Federation. These plans define the priorities of the Government concerning the drafting of legislation, policy documents and other matters and assign primary and cooperative responsibilities for their completion to the ministries and other bodies within the Government. One of the most important ways in which MAP currently engages in competition advocacy is its work to include important pro-competition legislative and policy changes in these plans. In addition to tasks included in the plans, additional tasks concerning draft legislation or work on policy documents are assigned to MAP and other ministries as necessary during sessions of the Government.

In 2002, MAP served as the primary ministry for the drafting and submission to the Government of a total of 9 draft laws, including the law amending the Law on Competition that was passed in October of that year. In addition, MAP participated as a cooperating ministry in the drafting of 30 other draft laws. In the legislative drafting plan for 2003, approved in

February, MAP is assigned as the primary ministry for drafting of amendments to the law on advertising, and as a cooperating ministry for work on drafts of new laws on the regulation of international trade and on the legal protection of business names, and on amendments to the law on the postal service and to the law on natural monopolies. In addition, the Ministry of Economic Development and Trade, with the cooperation of MAP, was given a separate assignment concerning an amendment to the Law on Competition increasing the threshold amounts for merger control. The corresponding draft was submitted to the Government by MEDT on August 15, 2003.

In the separate plan for activities of the Government for 2003, a section is included on measures to be taken for the purpose of implementing policies on socio-economic development of the Russian Federation that includes work on the reform of state administration, institutional and infrastructure reforms, and stimulation of economic diversification and openness, as well as other issues. Within this section of the plan alone, MAP is assigned as the primary ministry for 2 activities and the cooperating ministry for 20 additional measures. Among these are work on elimination of combinations of exercise of state power with participation in entrepreneurial activities (as part of administrative reform), preparation of a procedure for exercise by MAP of supervision over tenders for purchasing by natural monopolies, and development of draft federal laws concerning a procedure for proving the need for state intervention in the economy and a requirement for periodic re-evaluation of the effectiveness of regulatory measures. MAP is also assigned to participate in the preparation of plans for reform in the area of electricity provision for 2003, development of measures for carrying out rail reform in 2003-2005, work on legislation related to self-regulating organisations, work on issues of accounting and the use of international standards, development of a conception for a system of export guarantees for industrial products and in work on conforming Russian legislation to the requirements of the WTO, as well as others measures. The list of tasks emphasizes how many of the questions related to major economic and administrative reform programs have significant competition aspects, and also how many resources MAP would need to expend to take an active part in all of the listed work. While all of the listed areas of work are important, the large number of tasks and their varied nature may prevent MAP from focusing its available resources on core competition issues.

For very broad or complex issues, those on which the interests and opinions of different parts of the Government may be at odds, and where an inter-departmental approach is needed on an ongoing basis, government commissions or other advisory bodies may be created in which MAP may participate and which provide additional opportunities for advocacy of pro-

competition policies. Examples of MAP's participation in such commissions include its role in the government commission addressing regulatory reforms in infrastructure industries, and its membership in the commission on protective measures in international trade and the setting of tariffs.

The procedure for the work of the Government also gives MAP opportunities to comment upon and, where required, object to the drafts and proposals submitted by others, even where MAP was not included among the bodies assigned to develop the draft. As a rule, such drafts are circulated to all of the bodies that make up the Government for comment prior to their passage, and substantial efforts are made to eliminate objections before the document is approved. This includes draft laws and other documents that are not submitted by Government but rather by legislators, by regional bodies, by courts or by others possessing the authority to submit legislation directly to the Federation Council. The procedure followed by the State Duma concerning such drafts requires that they be submitted to the Government for the receipt of a formal conclusion, which involves the same opportunity for commentary by the members of the Government.

Although the cooperative structure for the work of the Government gives MAP many opportunities for competition advocacy in the form of comment on legal and policy proposals, it may have negative as well as positive aspects. For example, while the fact that efforts are made to resolve objections and achieve consensus approval mean that MAP's own objections will be seriously considered, it also means that objections of other ministries to MAP's drafts and proposals will be equally seriously considered and may weaken pro-competitive positions. In both instances, pressure to move forward with the large burden of work may require compromises, after which MAP may not be in a position to reopen the question and press for the compromise to be rejected.

## ***5.2 Participation of MAP staff members on corporate boards***

A somewhat unusual opportunity for competition advocacy is created by the fact that MAP staff members at both the federal (central) and territorial levels sometimes sit as members of corporate boards for companies in which the state has a large ownership interest. This practice is not limited to representatives of MAP, and other officials also sit on corporate boards as representatives of the state. The interests of the state are often defined by specific policies in relation to the company or sphere of activity articulated in plans or other statements, and in many cases the board member receives specific directives from the corresponding state bodies or the Government concerning the vote that is to be cast on concrete issues. MAP staff members have been assigned to fulfil this role in some corporate entities in

areas of natural monopoly where there may be significant competition issues, such as Gazprom, RAO UES, railways and so forth. Whether or not the promotion of competition has been specifically articulated as the Government policy, MAP staff members see one of their tasks in relation to such companies as raising competition issues in relation to strategy proposals and discussions within the board. For example, in one board meeting a representative of MAP urged against the conclusion of agreements between insurance companies and the railway on the grounds that it would limit competition.

Although this practice raises interesting possibilities for competition advocacy at the level of individual, influential firms, it also raises concerns about potential conflicts between participation in the formation of corporate strategy and corporate decision making and MAP's role in enforcing the law. One means by which MAP attempts to avoid such conflicts is by the use of abstentions during board votes. This strategy is most commonly used in relation to votes concerning transactions which, if approved by the board, will have to be the subject of MAP review to determine whether they may restrict competition.

### ***5.3 Competition advocacy and public education***

While public education and information activities and competition advocacy are usually considered to be separate functions, they are closely related and effective competition advocacy is unlikely to be possible where general understanding of the goals and benefits of competition are weak and there are indications that this is the case in Russia. Although MAP's activities receive quite a bit of press coverage, that coverage tends to be brief and is often limited to reporting only the fact of an action taken or decision made without explanation of the reasoning. MAP has taken a number of steps in recent years to improve public access to information, including the relatively recent establishment of a substantial website containing copies of relevant legislation and some information on MAP's activities in each of its areas of responsibility. Low rates of Internet use, however, means that the website's ability to serve as a source of information to the general public is limited. MAP also publishes a bulletin containing articles and analysis, but a lack of resources severely limits the press run and the bulletin is currently provided primarily to MAP's own departments and territorial offices and to other state bodies.

While some progress is being made in this area, there is a need for significant improvement. Materials addressed to a general public audience explaining the purpose and benefit of competition and the basic content of the competition laws are not available either in print or on MAP's website, nor are clear, plain language guides to MAP's procedures and requirements.

A few of MAP's case decisions are published or described on its website, but the vast majority are not regularly published in any form. This makes it difficult for anyone other than the parties to learn of them and for lawyers and businesses to develop an accurate sense of MAP's approach to specific questions in the application of the law and to conform business behaviour accordingly. The website does contain an increasingly large selection of MAP's analyses of specific markets, which is a useful innovation. The opportunity for advocacy that this presents, though, is not always effectively used, since many of the market reports are limited to description and only a minority contain direct discussion of specific competition problems that are encountered in the market or specific recommendations for changes that need to be made to increase competition. Production of publications is expensive and resource limitations play a large role in preventing more rapid progress in this area. Nonetheless, MAP needs to find means to inform the public concerning the requirements the competition law places on market behaviour and to make at least its more important decisions readily available.

## 6. Conclusions and Recommendations

### 6.1 Overview

Despite some periods of instability, Russia has completed the transformation of a large number of basic economic and legal institutions, replacing many of them with completely new structures. The creation of a competition-based market economy has been articulated as a central goal of the restructuring process, with support for competition strongly expressed in the new Constitution and Civil Code, as well as in the early creation of a competition law and competition authority.

In practice, the competition authority – MAP and its predecessors – has faced a shifting policy environment that has not always supported the immediate creation of competition or the direct enforcement of competition law above other policy goals such as rapid privatisation, crisis recovery and the creation of internationally competitive structures. Despite this, it has made significant contributions to the creation of a competitive market environment both through enforcement and through participation in policy formation and legislative drafting efforts. These include the substantial reduction of direct barriers to the movement of goods and services within the country and a leading role in the creation of the basic legislative frameworks for consumer protection, advertising regulation and other tasks necessary to allow markets to function in a civilised manner.

The competition authority has also played a central role in regulatory reform efforts directed at natural monopoly sectors. It led the drafting effort for the initial law on natural monopolies, creating a narrow definition of natural monopoly and separating tariff regulation in those sectors from other, potentially competitive areas of activity. As current regulatory reforms move forward, MAP continues to play an active role in the process – proposing models for the restructured industries and supervising the conduct of their newly formed components to ensure non-discriminatory access for competitors. Strong public and business interest in structural and regulatory reforms, particularly in the energy sectors, may result in a heightened profile for competition issues and opportunities for MAP to improve support for enforcement of competition law across the board. Care will need to be taken, however, to ensure that adequate regulatory structures are in place and that MAP is not assigned more responsibilities for supervision and enforcement in these areas than it can reasonably perform.

Some serious structural and legal problems currently interfere with MAP's ability to effectively enforce competition law and undertake focused competition advocacy, both in relation to regulatory reform and in the economy overall. Chief among the structural problems is the breadth of

MAP's responsibilities. MAP and its predecessors played an important role during the first decade of transition in identifying and helping to fill major gaps in legal and institutional structures for the regulation of activities of companies in the market. Most of these basic structures are now in place, however, and Russia's markets have been developing rapidly. The mission of the competition authority needs to shift away from broad responsibility for the creation and regulation of market activity to a clear focus on the creation and protection of competition. Other state functions related to business activity, such as the support of small businesses, advertising regulation, and supervision of commodities exchanges, are not unimportant but they require differing sets of skills and different types of activities and should be performed by other bodies.

The substantive competition law, while relatively complete in terms of its areas of coverage, does not contain credible sanctions and fails to provide MAP with sufficient investigative authority. A lack of discretion to refuse cases, broad wording of some provisions of the law, and low merger control thresholds combine to produce unrealistically large workloads containing many matters unlikely to have any effect on competition as a whole. MAP expends large amounts of resources resolving individual disputes between entrepreneurs and state bodies and between utility providers and their customers – functions that do not appreciably increase levels of competition and that could be more efficiently and effectively performed by other bodies. Unless these structural and legal problems are addressed, it will be difficult for MAP to move toward more effective responses to the most serious competition problems and to meet the challenges of enforcement in newly deregulated sectors of the economy.

## ***6.2 Specific policy options for consideration***

### *6.2.1 Narrow MAP's focus to competition issues alone*

MAP's tasks are too broad and too varied in their nature for any single body to be able to devote adequate attention to monitoring, law enforcement, public education and policy development in each of those areas of responsibility. The various tasks demand different types of analysis and different information sources, imply differing patterns for law enforcement activities, and require cooperation with different groups of state bodies, firms and citizens. In order for MAP to address the most serious competition issues facing the Russian economy, participate appropriately in the major reforms of infrastructure industries now underway, and develop the legislation and law enforcement methods that will prevent markets from becoming a source of abuse rather than of wealth and efficiency, it will need to be relieved of many of its non-competition-related responsibilities.

The process of redistribution of authority that now appears to be underway in which tariff regulation functions are being moved out of MAP should be completed, with communications tariffs moved to one or more state bodies outside MAP. Other functions not directly related to the promotion and protection of competition, including the enforcement of legislation and regulations on advertising, the support of small and medium businesses and the supervision of commodities exchanges, should also be moved to other bodies. This could be accomplished either by the creation (or re-creation) of separate bodies for these purposes or by the assignment of some of the relevant enforcement responsibilities to existing bodies. (For example, existing bodies already carrying out licensing and supervision of broadcasting and publication activities might take on the enforcement of advertising legislation in the respective media.)

MAP's close coordination with consumer protection bodies is complementary to its competition responsibilities and an ability to draw upon the consumer protection law may be required, at least under the current competition law, to allow MAP to reach situations in which consumers (rather than commercial actors) are the primary victims of anticompetitive behaviour. Consideration should be given, however, to a redistribution of enforcement authority that would move some of MAP's responsibility for responding to individual consumer complaints to other bodies and would allow it to focus its attention on problems related to competition issues affecting consumers.

### *6.2.2 Broaden responsibility for support of competition*

Assignment of all competition concerns only to the competition authority leads to an unrealistic multiplication of its tasks and responsibilities and may foster counterproductive attitudes and behaviour on the part of other bodies (branch ministries, privatisation authorities, sectoral regulators, fiscal and auditing bodies, and others) that are unaware of competition issues or view their primary responsibilities as unrelated to competition concerns. Inclusion of specific responsibilities for promotion of competition or elimination of competition restrictions in the mandates of ministries, regulators and other bodies would broaden appreciation of the centrality of competition. One area in which broader distribution of responsibility for competition could have a significant impact would be further reform in the areas of price regulation, licensing and other restrictions. While MAP can act on its own initiative against improperly imposed price limits, licensing and other competition restrictions, exemptions where these are imposed by certain kinds of government acts appear still to cover a broad group of existing restraints administered by a variety of state bodies. Making the state bodies administering such

restrictions responsible for reviewing them and removing (or proposing the removal of) as many as possible would require the bodies to explicitly consider the competition impacts of government regulation in their spheres and evaluate alternatives, creating a valuable skill as well as promoting further regulatory reform. MAP could provide consultation and serve as the coordinator for such a project, receiving the analysis and proposals of the various state bodies and combining them into proposals for the amendment or repeal of the relevant legislation. Similarly, the task of ensuring fair competition for state purchasing contracts could be moved to fiscal or auditing bodies, while dispute resolution functions currently being performed by MAP in relation to state actions and utilities contracts can be more efficiently performed by courts and sectoral regulators.

### *6.2.3 Provide credible sanctions against violators*

Provide credible sanctions against violators in the form of substantial fines or other penalties to be imposed upon a finding of a violation. Fines must be high enough to provide a serious deterrence to violations, which may require that they be adjusted to take the size and economic position of the violator into account (an example of this is the percentage of turnover measures in use in some jurisdictions). It would also be desirable to encourage private actions for damages as both a supplementary form of sanction against violators and as a means to raise awareness of competition issues in the business community. As MAP becomes more able to concentrate on and successfully investigate the most serious forms of violation, it would be appropriate to address the possibility of criminal prosecutions and to move toward changes in the law and the organisation of cooperation with prosecutorial bodies that would be required. Priority in the short term, though, should be given to increasing civil and administrative penalties and enforcing them effectively.

Increases in sanctions should be made simultaneously with measures to restrict MAP's caseload to the most serious violations, but if the presence of a considerable number of minor violations in past practice raises concerns about the imposition of significant sanctions, an alternative would be provisions that tie the amounts of fines to the amount of damages caused by the violation. This solution would probably require that legislation contain specific measures for the estimation of damages to avoid the importation of restrictive concepts of damages and strict standards of proof from other areas of the law. There may be difficulties with the imposition of increased sanctions of the type recommended through the Code of Administrative Violations (as are current fines for failure to execute an order), as they would greatly exceed its general limitations on penalties and are not well suited to imposition through its simplified proceedings. If necessary, the

law could provide for the sanctions to be imposed by a court on the basis of an action by MAP.

*6.2.4 Substantially reduce merger control submissions and strengthen economic analysis, information requirements and the use of structural remedies for those most likely to affect competition*

Very significant increases in the merger control thresholds along the lines of those currently proposed by MAP will certainly be required to give competition authority staff the ability to do more than a brief review of submitted files for completeness. Strong consideration should also be given to the addition of criteria that would prevent companies whose own asset values meet the single, combined threshold from being required to notify (and MAP required to review) every transaction they conduct. A minimum value for the second company participating in the transaction could serve this purpose and be workable under current accounting conditions. As accounting practices move toward international standards and objective market valuations of transactions become more readily available, merger control rules should move away from overall asset value criteria toward the use of measures that more accurately reflect the economic activity of the participants in the transaction (e.g. turnover).

Even with a reduced burden, it may be appropriate to institute a two-tiered review system, allowing mergers unlikely to affect competition to be dealt with quickly and on the basis of limited information, while providing more generous time frames for the analysis of those that are of greatest concern. Parties to transactions should not be allowed to hide their true corporate structures and control relationships behind offshore ownership and pressure to facilitate inward investment should not result in the approval of transactions where parties have failed to provide adequate information on beneficial ownership and control. Increased use of structural remedies should allow MAP to accommodate mergers designed to increase international competitiveness without permitting monopolization or abuses on domestic markets.

*6.2.5 Focus enforcement on state action that has an effect on competition*

Recent change in the law appears to require an effect (or likely effect) on competition before a violation of the state action rules may be found. This provision should be strictly interpreted to protect competition rather than individual competitors. Cases concerning individual license denials, lease renewals, zoning disputes, land rents and similar matters should be

referred to courts or other dispute resolution facilities and resolved on the basis of standards for decision reflected in the relevant laws. MAP should not be responsible for reviewing such matters to determine whether a state body's decision is "groundless" and therefore an improper interference with an economic actor. For cases in which a state action or policy does affect competition, a more complex standard for evaluation needs to be developed that balances the effect on competition against the legitimate needs and responsibilities of the state actors. Achieving a clearer focus in this area may require a change in legislation to eliminate vague prohibitions on "groundless" actions by state bodies and more clearly articulate the elements of a violation.

*6.2.6 Relieve MAP of the burden of case-by-case dispute resolution concerning contracting practices by natural monopolies and regulated entities*

The absence of comprehensive regulation of natural monopoly activity has left MAP with a large burden of abuse of dominance cases that are in essence individual disputes between a regulated monopoly and its customer concerning service obligations, applicable tariffs or contract terms. MAP must resolve these cases by applying its quasi-judicial procedures, which require a showing in each individual case that the regulated monopoly is dominant and that the specific contract terms or behaviour meet the standard for abuse, and permit a remedy that applies only to the specific contract considered. This is a very inefficient means for the resolution of these issues, leading to repetitive consideration of issues, and in some instances to lengthy court appeals concerning the dominance of regulated monopolies and the abusive nature of specific behaviour, the outcomes of which sometimes vary.

A far more efficient resolution of this problem would involve a more detailed and comprehensive regulation of contract terms and service obligations by sectoral regulators. The regulators should possess the power to resolve complaints and disputes about such matters through simplified proceedings and to impose a solution that will bind the regulated entity in all similar situations. This would allow the regulator to make decisions on such matters as permissible types and levels of penalties that are consistent with the pricing models being used to set tariffs, and would avoid the repetition and inconsistencies inherent in the current system. MAP would continue to serve in a supervisory role, able to address undue restriction of competition by the regulator through its authority over anticompetitive actions and decisions of state bodies, but no longer required to serve as the initial forum for the resolution of thousands of specific complaints.

### *6.2.7 Increase MAP's investigative powers*

Increase MAP's investigative powers to allow in practice the conduct of searches of premises without advance warning, the taking of evidence from those premises and the interview of staff and witnesses. More significant and immediate sanctions should also be provided for failure to provide information in response to written requests, with a possibility for increasing penalties with increased delay. Deliberate provision of false information should be separated from failures or delays and should be subject to greater penalties.

### *6.2.8 Reduce or eliminate MAP's responsibilities for general supervision of state purchasing and resist assignment to MAP of similar tasks during regulatory reform*

The recent addition to the Law on Competition of "antimonopoly requirements" applied to all competitive bidding for state purchases appears to make MAP responsible for supervising all such activity and seeking to void tenders where improper conduct or conditions were present. In the financial services sector, MAP's responsibilities go further, with not only a general requirement that services for state bodies be obtained through tender, but also a requirement that the terms for tenders for all purchases of financial services with budgetary funds be approved by MAP. The volume of state purchasing is enormous, and these provisions may impose a nearly unlimited drain on MAP's resources as it attempts to monitor state purchasing at all levels and is drawn into disputes concerning whether the specific requirements contained in a tender are appropriate or are designed to advantage a particular supplier. While a requirement that state bodies use competitive purchasing procedures may stimulate competition in a variety of markets, enforcement of that requirement should be entrusted to state financial and/or auditing bodies, backed up by a system for private complaint. It has been proposed that MAP take on similar supervisory responsibilities in relation to the purchasing activities of natural monopolies within the newly formed regulatory structures, in order to ensure that these do not advantage related companies or otherwise restrict competition. Concern about such activities may well be appropriate in the Russian environment, where divestiture of non-core holdings by infrastructure monopolies is being conducted in some areas simultaneously with, rather than prior to, the first stages of other structural reform (e.g. railways). Detailed supervision of such purchasing activities, however, would entail many of the same problems as detailed control of state purchasing, and is a task more appropriate to sectoral regulators than to the competition authority.

### *6.2.9 Resolve uncertainties concerning legal treatment of agreements through clear interpretation or amendment*

Uncertainty concerning the application of the collective 35% share requirement for vertical agreements and the apparent inability to exempt horizontal agreements other than cartels unless they have been voluntarily submitted for preliminary approval (both resulting from the 2002 amendments) could make an otherwise desirable enforcement focus on agreements difficult and lead to counterproductive results. While both of these issues may be resolved when MAP completes its planned draft of a fundamentally new law, the drafting, submission and adoption process for such a law is likely to take several years, and functional provisions on agreements cannot wait that long. If possible, steps should be taken to deal with the problem by interpreting the new language in a reasonable manner, so that the 35% market share requirement applies if either of the participants possesses it (just as collective asset value criteria for merger control are considered to be met when one of the participants accounts for the entire sum), and non-cartel horizontal agreements may be approved through the same process as that used for preliminary approval, even if they come to light during an investigation and were not voluntarily submitted. If such an interpretation cannot be made, or if it is rejected by the courts, it may be necessary to seek corrective amendment, perhaps at the same time that the current proposal on increase of merger control thresholds is considered.

### *6.2.10 Improve the economic analysis and information gathering capabilities of MAP staff*

Staff members report that they do not have the time to undertake such standard tasks as telephone interviews of market participants or the distribution of questionnaires for the purpose of market definition, nor do they receive timely and accurate information. The reductions of enforcement burdens and increased investigatory powers recommended above may themselves lead to improved economic analysis by providing more opportunities for such work to be performed and better quality information. Information held by other government bodies, including the state statistics agency, branch ministries and bodies supervising state enterprises, should be available to MAP where necessary for investigations and analyses. Receipt and circulation of firm-specific information by all state bodies is complicated by a lack of clear legal rules on confidential business information. Many state bodies and officials are subject to a general requirement to compensate damages caused by improper revelation of confidential information, and in the absence of clearer definitions of what may be confidential and specific rules on what is sufficient protection of such information, the liability provisions tend to discourage information

sharing. This is a long-standing problem that needs to be resolved by general legislation on the issue.

Although improvements in workloads and information flow may be helpful, the marked lack of in-depth economic analysis in individual cases, the lack of advanced economics training among staff and the high staff turnover rates suggest that practical training in economic analysis and the attraction and retention of qualified staff will need to be a high priority. One possibility for consideration might be the creation within MAP of a specialised economic analysis department that would both assist other departments on economic issues and prepare training materials and guidelines to give staff members practical training on case investigation and analysis using realistically available information sources.

#### *6.2.11 Improve transparency of MAP policies and actions and public understanding of the benefits of competition and the provisions of competition law*

A first-order priority should be the preparation and dissemination of informational materials designed for the general public and for the business community explaining competition and the provisions of the competition laws. Without clear notice concerning the contents of the law, enforcement actions raise procedural fairness questions. And better appreciation of the benefits of competition and the provisions of the competition laws will allow the public and the business community to be active partners with MAP in the promotion of competition and the discovery of violations.

Priority should also be given to improving access to MAP's written decisions and to ensuring that public notices and information contain not only the fact that specific actions or decisions have been taken, but also a clear statement about the reasoning behind them. This will allow those interested to develop an accurate understanding of MAP's approach to the interpretation and enforcement of the law and allow them to conform their conduct appropriately. Moreover, transparency is required to reassure the public and the business community about the quality of MAP's analysis and the adequacy of its motivations. In its absence, decisions may seem random or suggestions of inappropriate motivations for particular actions may appear credible, leading to an atmosphere of insecurity and mistrust that are not conducive investment and growth.

## NOTES

1. The Law of the USSR "On Enterprises," for example, passed in 1990, included provisions for the control of prices resulting from monopoly and allowed the state to undertake measures against monopolization and to impose various penalties on enterprises which violated the relevant controls. (Articles 26-34).
2. Difficulties in defining the roles to be played by the USSR and by its constituent republics in legislation and regulation were also a factor during the early stages of development of competition law and policy. A competition law was, in fact, passed at the Union level as well as at the Russian level, although the Union law was considerably less detailed. A Law of the USSR "On the Limitation of Monopolistic Activity in the USSR" was adopted on July 10, 1991. (Ведомости Съезда Народных Депутатов и Верховного Совета СССР, 1991, No. 31, Item 885) Although forgotten by many commentators in the wake of the enormous changes that have occurred in the ensuing years, these tensions were an important consideration at the time.
3. The body responsible for enforcement of competition law in the Russian Federation was originally called the State Committee of the Russian Federation for Antimonopoly Policy and the Support of New Economic Structures, often abbreviated as GKAP, and thereafter the State Antimonopoly Committee, or GAK. In 1998 it became the Ministry for Antimonopoly Policy and the Support of New Economic Structures, usually referred to simply as the Ministry for Antimonopoly Policy or MAP.
4. Law "On Competition and the Limitation of Monopolistic Activity on Goods Markets," Ведомости Съезда Народных Депутатов РСФСР и Верховного Совета РСФСР, 1991, No. 16, Item 499. The law has since been amended eight times by: Law of the RF No. 3119-1 of 24 June 1992; Law of the RF No. 3310-1 of 15 July 1992; Federal Law of the RF No. 83-FZ of 25 May 1995; Federal Law of the RF No. 70-FZ of 6 May 1998, Federal Law of the RF No. 3-FZ of 2 January 2000; Federal Law of the RF No. 196-FZ of 30 December 2001; Federal Law of the RF No. 31-FZ of 21 March 2002; and Federal Law of the RF No. 122-FZ of 9 October 2002.
5. For example, Decree of the Government of the Russian Federation, No. 576, of August 11, 1992, "On State Regulation of Prices and Tariffs on the Products and Services of Enterprise Monopolists in 1992-93" established state regulation of pricing, mandatory declaration of price increases and profitability limitations on goods produced by enterprise-monopolists.
6. See, *e.g.*, Рынок и Антимонопольное Законодательство России (The Market and Russian Antimonopoly Legislation) Iustitsinform: Moscow 1992 -- the first major publication of the new committee. The book contained an explanation of the proper application of the core articles of the Competition Law --

Комментарии к основным статьям закона с учётом практики его применения (Commentary to the Fundamental Articles of the Law in Light of the Practice of Its Application) (Yu. Burlinov, A. Podlesnyi, B.J. Phillips and S.J. Reynolds), which was developed by the new committee in cooperation with the OECD's Competition Division.

7. The Committee's general report on its activities STATE REPORT ON THE DEVELOPMENT OF COMPETITION ON THE MARKETS OF THE RUSSIAN FEDERATION AT THE FEDERAL AND REGIONAL (LOCAL) LEVEL, which was issued in 1995 and summarized the Committee's experiences through 1994, commented on the unsatisfactory results of the Register in this respect and described the change to a monitoring system. (pages 31-33)
8. Law of the Russian Federation "On Natural Monopolies," Собрание законодательства РФ (Collected Legislation of the Russian Federation) 1995, No. 34, Item 3426.
9. Edict of the President of the Russian Federation "On the Creation of the State Committee of the Russian Federation for the Support of Small Entrepreneurship," Собрание законодательства РФ (Collected Legislation of the Russian Federation) 1995, No. 24, Item 2262. A set of general principles for state support of small enterprise was articulated in the Law of the Russian Federation "On State Support for Small Entrepreneurship," Собрание законодательства РФ (Collected Legislation of the Russian Federation) 1995, No. 25, item 2343.
10. Federal Law of the Russian Federation "On Advertising" Собрание законодательства РФ (Collected Legislation of the Russian Federation) 1995, No. 30, Item 2864.
11. Decree No. 191 of the Government of the Russian Federation, "On the State Program of Demonopolisation of the Economy and Development of Competition on the Markets of the Russian Federation (Basic Provisions and Priority Measures)" March 1994.
12. See the Law of the Russian Federation "On the Insertion of Amendments and Additions into the Law of the RSFSR "On Competition and the Limitation of Monopolistic Activities on Goods Markets," Собрание законодательства РФ (Collected Legislation of the Russian Federation) 1995, No. 22, Item 1977.
13. The regulatory bodies were slow to be created after the passage of the Law on Natural Monopolies. It took until 1997 for the legal acts creating all three bodies (one for energy, one for communications and one for transportation) to be passed, and by the time of the 1998 financial crisis only the Federal Energy Commission had really been staffed.
14. Federal Law of the Russian Federation No. 117-FZ "On the Protection of Competition on the Market for Financial Services," June 23, 1999. [official publication cite]

15. Edict No. 1091 of the President of the Russian Federation of 4 September 2001 “On Amendment of Edict No. 1194 of the President of the Russian Federation of 29 November 1995 “On the Federal Energy Commission of the Russian Federation.”
16. For simplicity an exchange rate of 30 rubles to 1 US dollar is used throughout this chapter.
17. According to MAP’s statistical reporting, the first half of 2003 saw 1401 petitions and 486 cases initiated. This is an increase over the first half of 2002, for which the corresponding numbers were 1278 petitions and 437 cases initiated. (MAP December 2003.)
18. MAP November 2003.
19. The figure is about 47%, with 56 university degrees in law and 73 in economics or management.
20. Of the 1408 staff members in the territorial offices, 1218 had higher educations, with about 50% of those being degrees in law or in economics or management. The figures for the territorial offices were 302 university degrees in law and 408 in economics or management. 56 territorial office employees had candidates degrees, and 3 doctoral degrees. Figures were provided by the central MAP office responsible for personnel issues. A number of staff members also obtained second university degrees with a new concentration, often through part-time programs sponsored by the Russian Academy of State Service. Although some of these second degrees are in the areas of law or economics, they are not counted separately here since there appears to be significant overlap (e.g. a number of senior staff members in the central MAP office with initial training in economics took “second degrees” in law through this program).
21. These figures include both those who were fired and those who left voluntarily. If only those leaving of their own volition are counted, the loss percentages are 15.6% for the territorial offices and 23% for the central office for 2002.
22. The percentage is defined by the Government of the Russian Federation. The current provision is Decree No. 194 of 7 March 2000, which establishes the 10% turnover figure and also confirms an appended procedure for definition of the turnover and of the boundaries of the relevant financial market.
23. At present the amounts are defined by Decree No. 194 of the Government of the Russian Federation of 7 March 2000, and are 160 million rubles in charter capital for credit organizations, 10 million rubles for insurance organizations, and 5 million rubles for other financial organizations.

24. The general law governing notaries in the Russian Federation is the Fundamental Principles of Legislation of the Russian Federation on the Notariat, No. 4462-1, of 11 February 1993. (Ведомости Съезда Народных Депутатов и Верховного Совета РСФСР, 1993, No. 10, Item 357.)
25. Order No. 179 of the Ministry of Justice of the Russian Federation of 21 June 2000.