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REVIEW OF LAND AND REAL ESTATE CASES

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List of Acronyms

FAS	Russia Federal Antimonopoly Service
FIAS	Foreign Investment Advisory Service, a joint service of the International Finance Corporation (IFC) and the World Bank

Review of Land and Real Estate Cases for Russia Federal Antimonopoly Service

At the request of the Federal Antimonopoly Service, (FAS) the Foreign Investment Advisory Service (FIAS), a joint service of the International Finance Corporation and the World Bank, has carried out a review of a sample of cases handled by FAS in recent years concerning land and real estate transactions where there are concerns about the possible anti-competitive behavior of public sector bodies. This project arises out of earlier projects between FAS and FIAS to identify administrative barriers to investment. These earlier projects, which were carried out in twelve subjects of the Russian Federation between 2000 and 2004, clearly showed that administrative barriers in access to land, real estate, and construction permits were among the most severe obstacles to investment, and were not yet being adequately addressed.

This project is working in close cooperation with a related project to assist the Ministry of Economic Development and Trade to revise Federal legislation in the areas of land, real estate, and construction permits in order to improve the transparency, consistency, and efficiency of the relevant administrative procedures. Another component of the project is also preparing a baseline survey to monitor the impact of reforms in these areas over time. It is expected that the baseline surveys of investors and “intermediaries” (firms who provide services to help other firms through administrative procedures in the areas of land, real estate and construction permits), which are taking place in 15 subjects of the Russian Federation, will also help FAS in its analysis of the impact of the actions of state bodies on competition in the relevant markets.

Executive Summary

The majority of the competition authority’s cases concerning land and premises concern acts or actions of state and local bodies and were decided with the application of Article 7 of the Law on Competition. As a group, they exhibit characteristics that have been common to cases conducted by the Russian competition authority under Article 7 in years past. In particular, there is a near total absence of economic analysis of the market that the action of the local body is alleged to have affected and of any statistical or analytical material supporting claims that the action had or could have a restrictive effect on competition. Many of the cases focus instead on the legality or propriety of the act or action itself, with FAS bodies making strong efforts to show that the action itself violated some law or requirement outside the Law on Competition. This illegality is then used to argue that the action of the local body falls under provisions of Article 7 prohibiting the “groundless obstruction” of the activities of the firm or entrepreneur affected, or those forbidding state bodies to “groundlessly” provide advantages to one or more competitors over others.

The absence of economic analysis and of evidence of restriction of competition is somewhat surprising, given an amendment to the Law on Competition in 2002 that made restriction or potential restriction in competition a required element of a violation of Article 7. Instead of an increase in the amount of investigation into market conditions and analysis of the effects of the actions in question, however, the cases in the sample set suggest that some of the offices of the competition authority have been

meeting this requirement by making increasingly broad arguments about what constitutes a restriction of competition. In a number of the cases on land reviewed for this report, FAS has extended its definition of a “restriction of competition” to include any act or action that increases the costs or otherwise negatively affects even a single competitor, thereby affecting its pricing or other behavior in the markets in which it competes. This is a completely untenable definition of a restriction of competition that, if extended, could deprive much of the Law on Competition of meaning. One of the most important and urgent things that FAS can do in handling land cases and any other kind of case under Article 7 of the Law on Competition is to impose a reasonable definition of “restriction of competition” for those cases in which such a restriction must be shown. Provision of clarity on this issue and an appropriate separation of cases into those requiring greater or lesser proof of competition restriction should also be a priority in further work on the new draft law on competition. Cases that do not meet the required standard should be handed off to other bodies authorized to respond to improper actions of state bodies that do not necessarily affect competition, or should be addressed by creation of a separate dispute resolution body with the participation of FAS and other qualified state agencies.

Cases in the sample materials fell into five groupings containing similar fact patterns or issues: (1) municipal acts resulting in the monopolization of services related to land or premises; (2) refusal or withdrawal of land or premises in order to benefit a specific competitor; (3) manipulation of the rules concerning allocation of land plots by assignment or by auction to favor specific purchasers or to force payments from purchasers; (4) differentiation of payment rates for land rent; and (5) demands by city authorities for “infrastructure” payments related to the allocation of land or construction permits.

Monopolization of Services

Monopolization of services in these cases resulted from municipal acts that required them to be purchased from a specific provider, or contracts between the municipality and provider having the same effect. The competition restricting, or more accurately competition preventing, effect of such a rule is clear and FAS was successful in convincing the courts in the two cases that were appealed. **Legislative clarification of the responsibility of municipalities to provide certain documents and responses at their own expense would help to avoid the problem in future.** The facts of some of the cases, however, raised questions about the ability of municipalities to pay for the necessary staff to accomplish the required tasks. It may be necessary for clearer assignment of the municipal tasks to be accompanied by provision of the means to finance them, such as a reasonable fee the proceeds of which would be directed to the corresponding expense. In the alternative, petitioners for land plots could be required to provide the required documents. This would involve rules concerning access to necessary documents and records, and would still require that the municipality (or some other authority) be responsible for checking the quality of the documents submitted.

In relation to the new draft of the competition law, it would be useful to consider a separation of those kinds of state and local actions that are always or nearly always competition restricting (like those in these cases) from those that must be more carefully evaluated. The first category could be treated as *per se* violations of the law, or could be subject to a presumption that they restrict competition unless the state or local body proves otherwise. The second would require a more

serious showing of a restriction of competition. This would allow efficient use of enforcement resources – preserving a requirement for more significant proof of restriction of competition where it is really needed, but not burdening competition authority staff with the need for time consuming collection and analysis of data and statistics where the restriction is clear.

Refusal or Withdrawal of Land or Premises to Benefit a Specific Competitor

In these cases municipal authorities refused land or premises to some petitioners for the express purpose of providing it to a competitor or protecting that competitor's interests. Two cases were appealed, producing opposing court opinions. Both courts recognized that the transaction between the municipality and the lessee concerning the lease on land or the lease on premises is a civil law transaction. One court, however, found that the civil law nature of the transaction means that Article 7 of the current law does not apply at all, while the other found that the municipal body must nonetheless exercise the state function of allocation of land in accordance with Article 7's requirements and may not advantage a particular competitor. The differing results may also be related to the fact that one court apparently assumed (with little argument in the filings) that the municipality had a monopoly on the lease of land for construction of gas stations, while the other apparently assumed (with equally little argument in the filings) that there were other sources from which a lease on premises for business use could be obtained. While recent surveys of businesses' rights in land and real estate suggest that these factual assumptions may well be valid, the courts' opinions do not openly rely on them, focusing instead on the general applicability of the Law on Competition.

These cases suggest that FAS needs to clarify its position on how the Law on Competition applies to the civil law transactions of state and local bodies, particularly those related to allocation of state property for use, and to make this position clear in its presentations to courts. Are these activities subject to the restrictions in Article 7, regardless of the percentage of the market accounted for by the state? Is the defining question whether the act is in exercise of a state function? Is the sale or lease of state land or premises a “state function” if the state does not dominate these markets? These questions are particularly pressing in relation to land and premises, since the individual transactions by which land or premises are sold or leased will always be civil law transactions and the clear monopoly of state and/or municipal bodies in allocation of land that may tend to support FAS' decisions when they are appealed will erode as reform moves forward. In completing work on the new law, FAS should seek to clarify this issue, as it is quite likely to continue to arise for some time to come.

FAS may also wish to advocate for a legislative change that would recognize the special position of state and municipal bodies in allocation of land and premises, at least until further progress is made in the formation of robust markets for immovable property. For example, changes might be considered that would insert a qualification on language in some related legislation that currently defines terms of such transactions (e.g. leases on land) as free expressions of the will of the parties, limiting that definition to markets in which parties seeking land or premises actually have alternative sources. FAS should share its analysis on desirable changes of this nature with MEDT, which is currently working on further reforms to legislation in this area.

Manipulation of Allocation Processes to Benefit or Punish a Specific Firm

In these cases, both the failure to use an auction to allocate land and the use of an auction to allocate land were found to violate the Law on Competition. In one instance, a city granted an exclusive, short-term lease to one firm out of many interested in a land plot for construction. That firm was the only firm that had applied for a lease under rules that allowed the lease of the land for preparatory work to determine the suitability of the land for the project, surveying and definition of the plot to be allocated and so forth. The land was later to be allocated by auction or tender. Upon the complaint of another interested firm, the competition authority found that the general legal rule for allocation of land requires the use of auction or tender, and that directed allocation is allowed only for those instances specifically envisioned in the law. Therefore, it found that the failure to hold an auction for the lease right was a restriction of competition. The courts disagreed with this conclusion, finding that the city followed the legal rules and that no legal priority was granted to the short-term lessee.

In other cases, firms in the process of receiving land through the non-auction procedure for agreement on a plot found that the land was moved into the auction procedure after they refused to conclude contracts envisioning payment to the municipality for steps in the allocation procedures. Upon complaint of the firms, which had already incurred some expense in relation to the allocation of the land and which believed the payment demands to be illegal, FAS found that the general legal rule for the allocation of land requires the use of the agreement procedure, and the auction procedure may be used only in those instances specifically envisioned in the law. Therefore, it found that the use of the auction procedure was groundless obstruction of the activity of the firms involved and a violation of the Law on Competition. The courts disagreed with this conclusion as well, finding the auction to be competition-promoting and showing little concern about the proposal for compensation of some allocation steps.

Clearly, these cases indicate a need for FAS to develop a consistent position on the question of what is required by the legal rules in effect concerning the allocation of land through auction procedures and preliminary agreement procedures, and to communicate that position to its territorial bodies. They also indicate a need for FAS to focus on the question of restriction of competition. Each of the cases focused only on an alleged impropriety involving the allocation of one specific piece of land. No analysis was presented in any case showing why this action restricted competition (or could do so) in the entire market in question. **If there is reason to believe that this kind of abuse is widespread and is having an effect on the ability of firms to enter markets in general, or that when taken as a whole such practices benefit particular competitors and significantly distort competition, FAS should seek an appropriate means to address the problem that does not require it to maintain the fiction that each instance taken individually has or may have a direct effect on competition.** One possibility would be the legislative creation of a joint panel on which FAS would participate with other interested state bodies in the efficient consideration of disputes and allegations of abuse in land allocation.

These cases also raise the question of what steps in the allocation procedures may involve payment to municipal authorities – whether in the form of lease payments during work on proposals for a large development or contractual payments for the completion of pre-agreed allocations. The prospect of creation of many small,

financially strapped municipal formations that is created by the current reform of local self government makes clarification on this issue rather important if constant dispute is to be avoided. **FAS should work with MEDT and other interested bodies on appropriate legislative amendment or to advocate for the issuance of rules at the federal level that would clarify when state and municipal bodies may accept payments in relation to land allocations.**

Differentiation of Payment Rates for Land Rent

Cases involving differentiated payment rates for land rent included differentiation based on ownership (municipal or other) or place of registration of the payer, type of activity undertaken or of goods sold by the payer, and type of structure standing on the land to be leased. All of the differentiated rates were expressed as variations in the coefficient to be applied to the base rate for land tax per-square-meter, and the legal act establishing the different coefficients was held by FAS to be discriminatory on its face if the differing categories included entities that might compete with one another. FAS took the fact that some of the differing categories of lessee competed with one another as an obvious matter, not requiring statistical proof or further analysis, and did not provide any specific evidence of the alleged restriction of competition (e.g. changes in market shares or profit margins in particular categories).

Most of FAS' decisions in this group were appealed, and the results varied considerably, although FAS lost more final decisions than it won. Courts ruling against FAS often cited the provisions of the Land Code, which specifically defines land leases as freely negotiated expressions of the will of the parties, and Civil Code provisions concerning freedom of contract. They also cited provisions of the Law on Payment for Land specifically authorizing the creation of differentiated base rent rates for land by types of use and categories of users. In several instances, FAS attempted to prove that the bodies in question were legally obligated to use other categories for the differentiation, but these arguments were weak and had the predictable effect of focusing the court on that aspect of technical legality rather than on the question of competition restriction. Where FAS admitted the general legality of the action taken, but argued that the body in question was obligated not to restrict competition in exercising its powers, it had somewhat better luck.

This group of cases again emphasizes the need for FAS to address and clarify the question of how the Law on Competition applies to civil law transactions conducted by state and local bodies. Interestingly, in the case of land rents, the state bodies in question hold a clearly dominant position in most areas. This is not, however, the grounds on which the differentiation cases were argued or decided, since FAS presented arguments based primarily upon the unqualified prohibitions in Article 7 and the alleged illegality of the differentiations.

These cases also illustrate the need for FAS to move toward better economic analysis. A few courts, in ruling against FAS, noted generally that it had “not showed a restriction of competition.” Because FAS did not present any analysis in the cases beyond a quantification of the differing per-square-meter rates paid by different users, it is not clear whether some analysis of the effects in the market would have been sufficient for those courts to have ruled in its favor. Moreover, the absence of that analysis leaves the question of whether there was, in fact, any effect on competition unresolved.

Finally, these cases raise squarely the question of balance of effects on competition with other goals of state or local policy. In several instances, the differentiated land rents were arguably the result of attempts by the relevant body to discourage expensive or aesthetically disfavored uses by making them more costly or to encourage the provision of particular consumer goods or services by using budgetary funds (an agreement to accept less land rent) to offset some of their costs. It is not clear that a legal rule making all such discriminations impermissible will be to the benefit of the population or of competition. **Particularly in relation to the new competition law, FAS should consider whether it would be appropriate to create a balancing test for some kinds of competition restriction by state and local bodies.** This could be structured in a manner similar to the provisions requiring such a balance to be considered in relation to some kinds of agreements.

Imposition of Charges for “Infrastructure”

In these cases, municipal bodies demanded payments from firms and entrepreneurs as contributions to infrastructure, with denial of construction permits or of final use or occupancy permits the result of refusal to pay. In most cases, the amount demanded appeared to be calculated on the basis of the cost of the construction rather than in relation to specific infrastructure needs. Payments were demanded both for new construction and for renovation projects, and the description of the infrastructure to be supported varied from broad, general-use infrastructure to specification of the water and sewer system. FAS treated the demands variously as interference with the independence of economic subjects (where a contract with a special city body was required), as “groundless obstruction” of the activities of the firms (where construction was delayed as a result of refusal), and also as discriminatory treatment of some firms (where some types of construction was exempted) and as an illegal imposition of a tax or fee by a body of local self government. It provided little or no analysis of the markets involved, arguing that the prevention of the single firm in question from completing its project or the imposition of improper fees affected its ability to compete and therefore restricted competition.

Despite the weak arguments concerning restriction of competition, the courts supported FAS’ decisions in these cases. The courts focused on questions of freedom of contract and on civil law provisions that make contributions to infrastructure voluntary and/or allow for shared participation in its construction – a term that implies shared ownership of the end result rather than a simple transfer of funds from one party to the other. Having found the various payment demands to be legally flawed, the courts did not require FAS to make any real showing of restriction of competition.

Although the individual cases appear to be more allegations of individual improper payment demands than they are competition issues, there may be reason for FAS to be particularly concerned about these cases. FAS continues to play a significant role in regulating the contracting and other behavior of natural monopolies and other dominant and monopoly providers of utility services. The “infrastructure” charges imposed in these cases are not well defined and it is not always possible to tell whether they represent a charge for something that is intended to already be covered by regulated utility charges – that is, a means of avoidance of rate regulation by municipalities or municipal enterprises providing utility services. To the extent that this is the case, it is a concern of both of FAS and of the tariff regulatory authorities.

In addition, FAS has had to deal under abuse of dominance provisions with a significant number of cases involving problems with owners of parts of the transmission network infrastructure (often municipalities, but also private parties). These have included mutual hold-up between monopoly network owners and the dominant providers of energy, gas or other goods transmitted, maintenance and billing problems related to financial problems of network owners, and a variety of other problems related to the ownership and maintenance of “infrastructure.” **Pending changes in local self government appear likely to create a large number of new, smaller municipal entities with responsibilities for the infrastructure (including network transmission infrastructure) within their territories, and with significant budgetary challenges. If the new municipal entities follow patterns seen earlier with municipal network holders and with private parties controlling parts of the transmission network to other users, there may well be a significant increase in complaints to FAS about abuse by new municipalities of their control over parts of the transmission network.** These may include attempts to exact additional payments from local business users, from companies selling a transmitted product or from down stream users of the network, as well as other behaviors. FAS’ experience in addressing previous cases of this type may be especially valuable in helping to define means for these problems to be mitigated or avoided. **It would be wise for FAS to take the opportunity presented by current discussions of the reform to make specific proposals for rules on the funding and control of infrastructure at the municipal level.**

In sum, FIAS recommends that FAS undertake work in four related directions: First, FAS should examine its own case practices and set forth clear policy guidance for FAS staff pursuing cases of the kind reviewed here. In particular, this guidance needs to address the question of what constitutes a restriction of competition sufficient to justify FAS action under Article 7, and the proper application of the Law on Competition to civil law transactions of state bodies concerning land. It may also be useful to provide guidance on several more specific points on which territorial bodies of FAS disagree. Second, FAS should make proposals for changes in legislation that would eliminate questions or clarify problems revealed by these cases. Third, FAS should consider whether it is appropriate, given the effect of the problems observed on entry into markets overall, to advocate for the creation of a joint body that would address and efficiently resolve disputes connected with land matters. In considering this issue, FAS should make full use of the soon-to-be-released survey of businesses and intermediaries regarding land and real estate transactions. And in relation to both the second and third directions of work, FAS should share its findings and proposals with MEDT and other interested bodies working on reforms in relevant federal legislation. Finally, FAS should consider amendments in the draft law on competition now in the legislative process that would resolve issues and problems raised in these cases.

I. Introduction and Background

Purpose of this Review

Although acquisition of land and premises had not previously been a particular area of focus for the Russian competition authority, a number of recent events have drawn attention to the issue. Studies of barriers to business formation and development

have indicated that difficulties in the acquisition of business premises are a serious barrier to entry and expansion in many regions.¹ Rapid increases in real estate prices in a number of areas have fostered questions about access to real estate and construction markets and the contribution that restrictive agreements, monopolization of related goods and services or anticompetitive behavior by state bodies might be making to observed price increases. Changes in legislation on land and real estate require the definition of land plots and regularization of the legal terms of ownership and use – a process that is currently underway, but as yet far from complete. And while these changes have been made for the purposes, *inter alia*, of increasing the availability of land and premises, improving affordability, promoting efficient use and facilitating the development of markets, concerns have also been expressed that exclusionary or anticompetitive behavior during the process by state and/or private actors may frustrate this purpose.

In response to these developments, the Russian competition authority – the Federal Antimonopoly Service of the Russian Federation (hereinafter FAS or the competition authority²) is taking steps to identify competition problems in the developing markets for land and real estate. In particular, FAS wishes to identify and address anticompetitive actions by state and municipal authorities affecting those markets. As a part of that effort, a review was undertaken of a sample set of past cases that have concerned the behavior of state and local bodies in relation to land and real estate or closely related topics. The analysis seeks to identify patterns in the types of violations addressed and to glean any insights that the cases might provide that could lead to improvement in enforcement patterns and practices, in the legislation on competition, or in other applicable legislation.

This report presents the results of an analysis of a representative sample of cases on land and related issues that was provided by FAS for review. Following this Introduction, Section II provides a review of the legal provisions under which the examined cases were decided and discusses two general problems related to their interpretation and application that appear repeatedly in the sample cases and affect their resolution. Section III continues with an overview of the cases in the sample and a description of the five groupings of cases with similar fact patterns that can be identified. Sections IV-VIII discuss each of these five types of case in more detail, including the legal and economic issues raised and the treatment of the cases by courts on appeal where relevant. Finally, Section IX considers the ways in which the treatment of land and real estate cases might change as a result of the passage of new competition legislation that is currently moving through the legislative process, as well as the implications of the analysis for the provisions of that draft legislation.

¹ See, for example, the June 2004 report ADMINISTRATIVE BARRIERS TO INVESTMENT WITHIN SUBJECTS OF THE RUSSIAN FEDERATION produced by the Foreign Investment Advisory Service, as well as Monitoring of Administrative Barriers to Small Business Development in Russia produced by the Center for Economic and Financial Research (CEFIR, www.cefir.org).

² The name and status of the Russian competition authority has changed a number of times since its formation in 1991. Many of the cases submitted by competition authority for analysis in this report are based on decisions or actions of the Ministry of the Russian Federation for Antimonopoly Policy, the predecessor body to the Federal Antimonopoly Service, which existed from 1998 until the restructuring of the Russian federal government in 2004. To avoid unnecessary confusion, however, this report will refer in all cases to the decisions or actions of “FAS” or of the “competition authority.”

General Background

Before proceeding to consideration of the facts of specific cases and their treatment under the law, it may be useful to make brief mention of some of the broader factual circumstances in which many of these cases arose. The vast majority of the cases reviewed concern the acts and actions of bodies of local self government in relation to land and to premises that may be used for business purposes and that are in state or municipal ownership. Although a significant portion of all land and premises owned by the state is owned at the federal or regional levels, municipalities may own a significant share of the land and premises within their borders, including a large share of the premises that may be leased for business use. Moreover, municipal bodies have been assigned to perform administrative functions in relation to land owned at other state levels, increasing the amount of land under their control. Municipal bodies also control the processes leading to the issuance of construction permits, both for new construction and for renovation, and the processes leading to the purchase or the lease of a plot of land. The high concentration of ownership in state and municipal hands and the strong role of municipal bodies in allocating state- and municipally-owned land and premises for use have arguably placed municipal bodies in the position of dominant or monopoly suppliers in the relevant markets.

At the same time, many municipalities face serious financial difficulties. The sources available for the generation of income for municipal budgets have been strictly limited by federal law while transition processes have resulted in the transfer of social institutions and infrastructure out of the responsibility of enterprises and onto municipal budgets. Services and staffs have in many areas been significantly reduced and some municipalities have difficulty in performing basic functions and paying current expenses. Under these circumstances, the pressure to make the most of those sources of budgetary income that are permitted (including land tax and land rent, as well as lease payments on city premises) is likely to be strong, as is the temptation to use the leverage provided by effective dominance in markets for land and premises to exact other kinds of payments or to shift costs out of the budget onto other parties. In part due to these pressures, as well as to general concerns about inappropriate market interference by officials and deliberate obstruction of business activity, concerns have been raised about rules that provide discretion to municipal bodies. Clear rules and clear processes for resolution of disputes or appeals of illegal actions may be needed in order to provide those affected by municipal decision-making with effective recourse where these pressures result in extreme or abusive behavior.

It is also important to be aware of the changes occurring in these conditions. Recent legislation related to land and real estate requires a broad series of measures to be accomplished within the next several years, including regularization of the status of land under buildings in which private parties have rights in the form of its sale to those parties or the conclusion of a land lease with the state or municipal owner. A significant reform of the laws defining the boundaries, nature and powers of local self government was passed in 2003 and was scheduled to come into force only on January 1, 2006. Concern over the complications involved, however, has resulted in proposals for delay in the implementation of that reform.³ It is not yet clear to what degree such changes

³ In July of 2005, the State Duma passed on first reading a draft law that would delay the implementation of the reform of local self government for several years. The Government opposes the delay, but has expressed its willingness to work with the Duma to make amendments in the reform legislation to address

will be successful in reducing the dominance and control of municipal bodies in markets for land and premises. Some reports, for example, have suggested that such bodies are actively discouraging those with rights in buildings from seeking to acquire ownership or are attempting by various means to minimize the area of land transferred.⁴ The process of change, however, makes it important for the competition authority to pay attention to the underlying causes for the problems reflected in the cases and to give consideration to the ways in which any changes in legal rules or enforcement practices made to address them may function in a changing environment.

II. Acts and Actions of State Bodies Under the Law on Competition

In principle, acts and actions of federal executive bodies and of all bodies of government at the regional and local levels may fall under the provisions of several articles of the basic law on competition, the Law of the Russian Federation “On Competition and the Restriction of Monopolistic Activity on Goods Markets” (hereinafter the Law or the Law on Competition). Article 7 prohibits acts and actions of state bodies that limit the independence of firms or discriminate among them, provided such acts or actions have or may have as their result the prevention, restriction or elimination of competition and infringement upon the interests of economic subjects. Article 8 prohibits state bodies from preventing, restricting or eliminating competition as the result of an agreement among themselves or between a state body and one or more firms. Article 9 contains “antimonopoly requirements” that apply to the process for competitive bid for purchases of goods and services for state and local needs. The requirement itself that such procedures be used and the exceptions from that requirement are, however, established by other legislation.

Article 7. Acts and Actions of Federal Bodies of Executive Power, Bodies of State Power of the Subjects of the Russian Federation, Bodies of Local Self Government and Other Bodies or Organizations Delegated the Functions or Powers of the Stated Bodies of Power

1. Federal bodies of executive power, bodies of state power of the subjects of the Russian Federation, bodies of local self government and other bodies or organizations delegated the functions or powers of the stated bodies of power shall be forbidden to adopt acts and/or to take actions that restrict the independence of economic subjects, create discriminatory conditions of activity for specific economic subjects if such acts or actions have or may have as their result the prevention, restriction or elimination of competition and the infringement of the interests of economic subjects, including the following:

to place restrictions on the creation of new economic subjects in any sphere of activity whatever, as well as to establish prohibitions on the conduct of specific types of activity or the production of specific types of goods, with the exception of the instances established by the legislation of the Russian Federation;

to obstruct without grounds the conduct of the activity of economic subjects in any sphere whatever;

concerns about budgetary provision for the new municipal formations, their control of infrastructure, and other matters.

⁴ E.g. weekly “Yurist” (“Lawyer”), No. 24, 2005.

to establish a prohibition on the sale (purchase, exchange, acquisition) of goods between one region of the Russian Federation (republic, territory, region, raion, city, raion within a city) and another or by other means restrict the right of economic subjects to the sale (acquisition, purchase, exchange) of goods;

to give economic subjects instructions on the priority supply of goods (performance of work, provision of services) to a defined group of purchasers (order placers) or on the priority conclusion of contracts without account for the priorities established by the legislation or other normative acts of the Russian Federation;

to obstruct without grounds the creation of new economic subjects in any sphere of activity whatever;

to provide without grounds to a specific economic subject or several economic subjects advantages that place them in a privileged position in relation to other economic subjects working on the market for the same good.

In practice, nearly all of the cases submitted by FAS for this review were decided by the application of part 1 of Article 7 of the Law.⁵ Most fall within the second subpoint of part 1 – which forbids the groundless obstruction of economic activity – or under the sixth subpoint of part 1 – which forbids the provision of advantages to only some of the participants in a market, or both. While the application of Article 7 to specific types of cases concerning land or premises is discussed in Sections IV-VII below, there are two significant, overarching issues in the interpretation and application of this article that arise repeatedly in the sample cases and that deserve general discussion before proceeding to case specifics.

What Constitutes a Restriction of Competition?

The prohibition currently contained in Article 7, part 1 applies to acts and actions of state bodies that “have or may have as their result the prevention, restriction or elimination of competition and infringement on the interests of economic subjects.” The quoted language, however, is a result of amendments made to the Law on Competition in 2002. Prior to those amendments, the provision prohibited the relevant acts and actions of state bodies “if such acts or actions have or may have as a result the restriction of competition *and/or* infringement on the interests of economic entities or citizens” (emphasis provided). Thus, the literal wording of the article in effect made state actions a violation of the Law on Competition if they infringed upon the interests of an economic subject, regardless of their effect on competition. This resulted in a case load under Article 7 that was dominated by two groups of cases, both of which focused on the legality and propriety of the acts in question to the exclusion of any economic analysis of the market affected.

⁵ Although a number of the cases alleged the deliberate provision of a benefit to a specific recipient or agreement between a local body and an enterprise, there were only a few applications of Article 8. This is consistent with the overall distribution of the competition authority’s caseload on state actions over a number of years, and it is no surprise since there is clearly scope for a significant amount of overlap between the two articles. Since many of the actions of a state body that might be taken under an anticompetitive agreement would, in any case, violate Article 7, it is simpler for the competition authority to bring the case under Article 7 and eliminate the need to prove the agreement itself (not always a simple matter).

The first were cases in which a specific firm or entrepreneur filed a complaint with the competition authority objecting to a specific decision or action taken by a state body. Common examples included denial of a license or permit, objection to the definition of the terms of a specific tender, or similar matters. Although the effect of such an action on competition in the market might be small or nonexistent, Article 7 also prohibited acts that infringed upon the interests of an economic subject so the competition authority would investigate whether the action taken was proper and would find it to be a violation if it concluded that it was not. Since an effect on competition was not required to prove a violation, an analysis of the competition effects of such acts was rarely, if ever, presented.

The second were cases concerning acts or actions of state and local bodies that were illegal or improper in and of themselves. This might be because they violated the provisions of other laws or because the body in question did not have the authority to issue the act or take the action. It might also be because the act in question violated one of the more specific subpoints of Article 7, for example by establishing a barrier to the movement of goods or a general prohibition on a certain kind of economic activity. Since it could be assumed that the application to firms or entrepreneurs of an illegal rule infringed upon their interests, and since the literal wording of Article 7 allowed this to be sufficient to show a violation, these cases consisted primarily of an analysis of the legality of the act or action in question. A significant portion of this type of case was opened on the initiative of the competition authority, after a review of the legal acts issued by the relevant state body.

After the amendment of Article 7 in 2002, the language of the article would seem to require that the competition authority show both that the act or action of the state body infringed upon the interests of economic subjects and that it resulted in the prevention, restriction or elimination of competition, or could do so. It might also have been expected that the proportion of cases concerning violations of Article 7 might decline noticeably, since many of the “technical” violations of the law that concerned only a single firm might have a rather limited effect on competition overall on the relevant market. Recent statistics, however, indicate that precisely the opposite has occurred – both the absolute number and the overall percentage of cases concerning state actions have increased.⁶ Court pleadings filed in the cases reviewed for this report suggest a possible cause. In their written pleadings related to appeals of their decisions, territorial offices of the FAS provided the following definitions of what constitutes a restriction of competition under Article 7 (emphasis provided):

“ . . . in accordance with Article 7 of the [Law on Competition] bodies of local self government are forbidden to groundlessly obstruct the conduct of activity by economic subjects in any sphere whatever. Restriction of competition is possible not only by obstruction in the sphere of entrepreneurial activity, but also in any other sphere of the economic activity of an economic subject. Thus, *any groundless, and even more any illegal actions of bodies of local self*

⁶ Preliminary statistical reports on the work of the competition authority for 2002-2004 published by FAS in early 2005 indicate that violations by state and local bodies have increased in each year covered, both in raw number and in their percentage of the total number of violations addressed by FAS.

government (as in this instance) that infringe upon the interests of economic subjects and obstruct their activities are anticompetitive.”⁷

“ . . . the illegal decision . . . deprived them of the right to conclude a lease contract for the given land plots, concerning which they had already incurred financial expenses All of this could not help but influence the material condition of the given subjects and their ability to participate in competitive relationships on markets for the sale of products . . . which could lead to restriction of competition on the stated markets.”⁸

According to these definitions, any improper action of a state or local body that results in any imposition of costs on a firm or entrepreneur or infringes upon their interests is, by definition, a restriction or potential restriction of competition in any market in which that firm competes. In these cases, the amendment to Article 7 did not result in the performance of an economic analysis showing a restriction of competition by the action of the state or local body. Rather, the concept of a “restriction of competition” has been redefined to be synonymous with any cost or other difficulty imposed on a single firm or entrepreneur – that is, as synonymous with infringement upon the interests of an economic subject.

Dangers of a Broad Definition

This raises serious concerns. The majority of “improper” actions of state or local bodies – including breaches of contract,⁹ torts and even simple mistakes – will have some kind of negative effect on at least one firm or entrepreneur. As a practical matter, definition of “restriction of competition” as any imposition of cost or other negative consequences on a single competitor turns the competition authority into a body exercising broad, general oversight over the legality and sufficiency of grounds for all of the actions of state and local bodies that affect any firm. It is not normally the function of a competition authority to exercise this kind of oversight, which is resource-draining and duplicates the functions of other bodies such as the courts and the procuracy. Moreover, because Article 7 of the Law on Competition prohibits the listed acts and actions of state bodies not only when they in fact have had the effect of restricting (preventing, eliminating) competition, but also when they *may* have such an effect, a definition of “restriction of competition” as any negative consequence or cost to any firm or entrepreneur makes the ability of the competition authority to reevaluate the legal acts of state bodies very broad indeed. In fact, in one case submitted for this review a territorial office of FAS reviewed a legal document containing municipal rules on lease of premises, and found the failure to adequately define the “unusual

⁷ Perm Division of the FAS, cassational appeal filing concerning an infrastructure charge imposed in relation to remodeling by a firm of its own building.

⁸ Novosibirsk Division of the FAS in a cassational appeal concerning withdrawal of a plot preliminarily allotted to a firm and its placement for auction.

⁹ Indeed, breaches of contract have been addressed in the past under the provisions of Article 7. An example is a case in which a lessee whose lease was breached on city property claimed that the city had done so in order to use the property for a competing business of its own. The competition authority found the breach to be a violation of the competition law.

circumstances” in which sublease was to be permitted to be a violation of the Law on Competition, since it did not adequately restrict the municipal authority and therefore it might allow it to make decisions that would restrict competition.¹⁰ Such an argument would make every legal rule that provides any kind of discretion to a state or municipal body open to challenge under the Law on Competition on the grounds that the state body might, at some undetermined time in the future and in some undefined manner, use that discretion in a way that would restrict competition.

An equally serious problem is the potential effect of this definition on the remainder of the Law. The concept of a restriction of competition is central to the Law on Competition as a whole. Agreements between economic subjects under Article 6 are analyzed on the basis of whether they restrict competition. Under the definition used in the quoted cases, if an agreement between two other firms raises my costs in any way – it results in a restriction of competition on any market in which I compete and can be found to be illegal. FAS is empowered to impose conditions on mergers and acquisitions to minimize possible restrictions of competition. What conditions – other than full price control – could be imposed to ensure that no firm encounters additional cost as a result of a merger? Dominant firms may be found to have violated Article 5 of the law if their actions result in a restriction of competition. If a restriction of competition is simply an increase in any firm’s costs, dominant firms can never change prices without restricting competition in every market in which their customers participate.

It seems on first examination that this expansion of the definition is related to special concerns about abuses by state bodies and officials and a desire to address them even when they may not affect competition in any measurable way. That might lead to the expectation that the use of the expansive argument would be limited to cases under Article 7 concerning such abuses. There is at least some evidence that this is not the case. In one of the few cases submitted for use in this review that did not apply Article 7, a territorial office of FAS argued under the abuse of dominance provisions of Article 5 that:

“The exaction of additional payment. . . will lead to an increase in the cost of the objects . . . as a result of which the economic subjects may be forced from the market . . . , which may lead to the restriction of competition and infringement on their interests.”¹¹

The situation being created by these developments is considerably worse than the one that existed prior to the 2002 amendments. So long as *either* an infringement on

¹⁰ The Irkutsk Division of the FAS, in its response filing on the complaint appealing its decision, stated: “Thus, within the framework of a general rule forbidding the sublease of municipal, non-residential premises, the stated norm nonetheless provides for the possibility for economic subjects in specific instances to transfer municipal, non-residential premises into sublease. However, the provision does not establish a list of the exceptional circumstances in which municipal, non-residential premises may be sublet. The Irkutsk Territorial Office [of FAS] considers that in this version, without a list defining the exceptional circumstances . . . point 5.10 of the Statute might result in the granting to one or several economic subjects, without grounds, of advantages placing them in a privileged position in relation to other economic subjects.”

¹¹ Penza Division of FAS, Decision finding the actions of the city water system in imposing certain payments for connection to the system to be an abuse of dominance.

the interests of a single firm *or* a restriction of competition was sufficient to justify enforcement actions, the competition authority could enforce against state action that injured an individual firm solely on the grounds that such infringement had occurred. While there is serious doubt that such a general enforcement role should belong to the competition authority, at least that version of the Law did not result in the distortion of the concept of a restriction of competition. Definition of that term to mean any cost or difficulty encountered by a single firm threatens to deprive significant portions of the law -- and the concept of competition in general -- of any meaning at all. If FAS intends to continue to pursue cases of injury to an individual firm or entrepreneur and to enforce against them without reference to any economic analysis of the market involved, it is important for it to find a means to do so without maintaining the fiction that the cause is a restriction of competition.

When the 2002 amendments to the Law on Competition were discussed, the requirement that economic analysis show a restriction of competition before state action would be found to violate the law gave rise to a number of concerns. Some felt that this added an unnecessary expense and complication to cases concerning behavior that is always harmful and “should” be a *per se* violation of the law. Others feared that such a change would leave individual firms and entrepreneurs without an effective remedy against state and local bodies that are biased or predatory, believing that other available remedies are too slow, too costly, unable to take differential treatment of other firms into account, or simply not inclined to protect businesses against state and local bodies. Still others felt that individual complaints serve as an important source of signals to the competition authority that a general pattern or practice needs to be investigated. An even broader view urged that, at least in the early stages of development of markets, and in light of the effort to overcome a strong history of interference by state bodies in economic activity, strict protection of each individual competitor from any kind of improper or illegal state action is required to establish standards of behavior for those bodies and encourage entry and growth.

All of these concerns have merit, and a careful look at the type of harm that each raises may help in considering solutions. The protection of individual firms and entrepreneurs from illegal or improper acts by state bodies is certainly an important goal, as is the establishment of a strict environment in which actions of state and local bodies must be both technically legal and well founded. If improper behavior of state and local bodies is a significant factor in restricting entry and slowing the growth of competition in general, it would be entirely appropriate for the competition authority to advocate for -- and in limited circumstances participate in -- prompt and effective mechanisms for review of such actions. This could be done, however, with the acknowledgement that the problem is being addressed as an overall barrier to development of robust and competitive markets rather than due to the actual effect on the level of competition in each specific instance. Likewise, it may be that some provisions of legal acts or actions by state bodies are so commonly abused and/or so harmful to competition that they should be considered violations of the Law on Competition *per se*, not requiring separate evidence of the restriction of competition. If this is desired, however, these instances should be defined by the law and separated from those in which a true showing of restriction of competition is required. Options for treatment of the specific types of violations reflected in the sample cases are discussed in more detail below.

State Functions and Restriction of Competition – What Balance?

A related problem in the interpretation and application of Article 7 concerns the balance to be struck between the achievement of legitimate goals of state and local bodies and effects on competition that may result from the means used. The standard to be applied in this area is not a question that has been addressed directly by the competition authority. This may in part be a result of the characteristics of the Article 7 case load over time. As discussed in part A of this section, cases under Article 7 have most often involved either a challenge to a specific action in relation to a specific economic subject as being illegal or without basis or a challenge to a specific legal act as being illegal in and of itself. In both instances, the question of the need to balance competition effects against a legitimate policy goal did not arise, as the focus of the inquiry was the technical legality of or grounds for the act in question.

It is interesting to note, however, that even in cases in which the act or action in question is within the authority of the state or municipal body the question is not posed of whether, in carrying out the state function, the body in question could have achieved its aim in any other way. Most of these cases concern allegations of discrimination among economic actors by some form of differentiated treatment, for example, the refusal of a license or permission to some while granting it to others or the imposition of differing burdens on economic subjects. And in most cases the simple presence of some form of differentiation is, on its face, enough to cause the relevant act to be found to be a violation. No economic analysis is performed to evaluate the actual impact of the differentiation on competition in the relevant market, as differential treatment is assumed to have a competitive effect. And no inquiry is made into whether the purpose served by the act could be achieved by some other means that would be less competition restricting. Indeed, it is not clear that such an inquiry is authorized under the current wording of Article 7, which, read literally, contains an absolute prohibition on differentiated treatment of competing firms, without reference to the goal or reason.

Such an absolute prohibition, although clear and simple, is likely to be overbroad. Certainly, the list of responsibilities assigned to the types of state bodies covered by Article 7 varies substantially across legal systems. Their degree of autonomy and available tools in meeting those responsibilities also vary widely – and especially across local bodies and those operating in federal systems with differing balances between levels of state authority. Nonetheless, even if it is assumed that the state bodies in question are intentionally given a very limited autonomy, an absolute prohibition may go too far. It may deprive state bodies to which it applies of simple tools that are commonly used in other systems to allow local governments and other state bodies to manage and control the costs imposed by various private activities, provide incentives and meet obligations to provide services to citizens. An absolute prohibition on any kind of differentiation, rather than promoting the benefits of competition, including efficiency and cost reduction, may instead increase budgetary costs or require that policies more restrictive of entry or of economic activity be chosen in order to avoid any differential treatment of firms. Some forms of differentiation or discrimination in legal acts – such as those that name specific firms for special or exclusive treatment or discriminate on the basis of location or form of ownership – may be so harmful that they should be absolutely prohibited in all circumstances. But for other kinds of differentiation, and perhaps other types of restriction of competition, it will be necessary for more complex standards of evaluation to be developed that take

into account the authority of the body, the goals of the act or action and the alternatives open to reach them.

III. Land and Real Estate Issues in the Competition Caseload

The Sample Set of Cases

This review was conducted primarily on the basis of a sample set of about 40 cases¹² collected for this purpose. Some of the cases were collected by means of an initial request by the central office of FAS to territorial offices asking for cases related to land use issues. Others were identified during a broader review of cases by the central office of FAS that was conducted for other purposes. Some additional cases and materials were submitted by a number of staff members of territorial offices of FAS that attended a project meeting on March 31, 2005. In some instances, reference is also made in the review to cases known to the author from prior work with the Russian competition authority.

The majority of the cases concern matters addressed by the competition authority in the period from late 2002 through 2004, with a few earlier outliers. Some of the cases were still actively being appealed at the time of review. Available statistics do not contain information that would indicate what portion of all cases on land and related issues is accounted for by the cases in the sample. Initial difficulty in generating cases for review appeared to suggest that there were very few cases in this area. At a meeting with representatives of seven territorial offices, however, a number of the attending staff members submitted additional case files for review and/or summary accounts of problems encountered in their own or neighboring regions listing repetitive instances of some of the problems addressed. Discussion of some types of problem during the meeting called forth statements from those attending that similar problems had been encountered in their own regions, although no case had been identified by the initial request. This suggests that at least some of the problems in the sample are more wide spread than the initial numbers of cases generated may indicate. The fact that cases concerning the actions of state bodies are sometimes resolved without the initiation of a formal case or before the issuance of a decision and order in the case may also need to be taken into account. Such “voluntary” resolutions of problems are rarely submitted in response to a request for cases for discussion, and tend to show up clearly only in narrative reports on the activities of territorial offices. In sum, the percentage of FAS’ overall caseload that involves land and related issues remains uncertain.¹³

¹² The approximate rather than exact number of cases stems from the fact that the materials provided include both detailed files on specific cases and several narrative reports describing the experience of one or more regions and giving brief descriptions of cases, which may in a few instances have resulted in some overlap. In some instances, cases and court opinions known to the author through other work with the competition authority have also been used.

¹³ It seems likely that an accurate estimate of the overall number of cases would require a very specific inquiry from the central office of FAS in which examples of the types of cases that are of interest are provided. The initial request appeared to be somewhat misunderstood, resulting in cases concerning such matters as contracts for the management of municipal trash dumps.

The cases cover a broad geographical area. Matters handled by the territorial offices of the competition authority in the regions of Kursk, Rostov, Moscow, Pskov, St. Petersburg, Tver, Bashkortostan, Udmurtia, Chita, Ryazan, Tambov, Tula, Penza, Perm, Tomsk, Irkutsk and Novosibirsk were included in the materials submitted for analysis by FAS.¹⁴ There does not appear to be any significant geographic bias in the sample.

Most, although not all, of the cases submitted involve an appeal of the decision of the FAS territorial office and its review by at least one court. A number involve an additional consideration by an appeals court or a cassational court or both. It is likely that there is some bias toward cases with a difficult or interesting court appeal history – as such cases are often the first to be brought to the attention of the central office or proposed for further discussion.

Significant Groupings

The cases in the sample form five groups with similar fact patterns or legal issues addressed – three smaller and two somewhat larger in number. The three smaller groupings are: (1) cases concerning state acts resulting in the monopolization of services related to land or premises; (2) cases concerning refusal or withdrawal of land or premises in order to benefit a specific competitor; and (3) cases concerning alleged manipulation of the rules concerning allocation of land plots by assignment and by auction to favor specific purchasers or to force payments from purchasers. Slightly larger groups of cases concerned (4) differentiated payments for land rent, and (5) demands by city authorities for payments related to the allocation of land or premises or the issuance of a building permit. These groups are discussed in more detail, below.

The few cases that fall outside these groupings are a mixed lot, with most raising issues not directly related to land and premises. They include cases concerning rules related to competitive bid requirements for state and local purchases of services, a case concerning an illegal imposition of licensing on certain kinds of recreational resources use, and so forth. Two cases were reported in summaries in which the FAS received a complaint concerning the failure of a municipal body to respond to a petition for allocation of a land plot within the time period specified by law, in one case involving very significant delay. Orders were issued to the municipalities to make a response. This was presumably on the reasoning that the failure to allocate land to the petitioners prevented them from conducting or expanding their business activities and therefore resulted in a restriction of competition. As these cases appear in summary reports, there are few details. Neither they nor the other cases that fall outside the five groupings will be further discussed here.

¹⁴ Cases cited from the author's files would add a number of additional regions, including Sverdlovsk, Dagestan, Amur and Vladimir.

IV. Monopolization of Required Services

Nature of the Cases

Cases concerning the monopolization of services all followed a similar fact pattern. Businesses desiring to obtain land were obligated to obtain one or more of the necessary preparatory services from a single, specified enterprise. Often this was accomplished by a formal requirement contained in local legislation or procedural rules on allocation of land, though this was not always the case. The service in question was often related to the preparation of documents defining a land plot not yet reflected in the cadastral plan, such as proposal of draft boundaries, mapping, certification of the amount of land in the plot, and preparation of the corresponding documents for registration. In a few instances the services included the preparation of official documents – draft letters, responses to inquiries and decrees – to be issued by the municipal body responsible for land allocation.¹⁵ Where the form of the specified enterprise was indicated in the case file, it was generally a municipal enterprise, although in a few the specified firm was privately organized (but in at least one case headed by an ex-employee of the municipality). Although the sample group of cases contains only a few cases that continued through the formal case hearing process to the issuance of a decision and order by FAS, summary materials submitted by some territorial offices and discussion at the spring project meeting suggest that such requirements in local procedural rules are not uncommon, and are in some cases eliminated after a suggestion by the competition authority. Regional representatives indicated that the enterprise in question is often a previous department or unit of the local government that has been “corporatized” due to the locality’s inability to support it from the budget. In some instances, the “enterprise” is located in the offices of the local government and those petitioning for land are directed to it to obtain the necessary services/documents.

Most of the instances of this type were discovered by territorial offices on the basis of review of the relevant local legislation and regulations or the circulation of inquiries to localities on their own initiative. This some times occurred, however, after a complaint alerted the territorial office to the possibility of this problem. Two of the sample cases were the result of a complaint to FAS. In one of these, an individual entrepreneur complained to a territorial office of the competition authority that when petitioning for allocation of a land plot he had been directed to a company with offices in the municipal building to complete necessary documents. The company required a fee for this service. On investigation, the territorial office found similar arrangements in effect in a number of localities.

In a second case, the complainant had actually contracted with an alternate provider for the necessary work, but was nonetheless asked to conclude a contract with the municipal enterprise for the “confirmation of the task definition.” The local authorities justified this requirement by reference to municipal statutes. These required that, in the absence of a cadastral map for the

¹⁵ In one case, the service provided was the preparation of drafts of the decree to be issued by the local authorities granting the plot of land.

land plot, the relevant authorities must provide for the drafting of boundaries within a one month period, for which purpose they should conclude a contract with the named municipal enterprise for preparation of the boundaries at the expense of funds received from the company requesting the plot. They also required that the city property committee and city architect (and not the petitioning company) define the task to be done by the surveying company in drafting boundaries. After a complaint to the competition authority by the company, FAS considered the case and issued a decision and order requiring the local government bodies to amend the procedural documents to remove reference to the specific municipal company and to allow the company ordering the work (and not the local government bodies) to choose with whom to contract and to confirm the tasks to be performed at its expense.

This last was the only case in the sample in which the facts concern competition between potential suppliers of the service. It is interesting to note that in that case the organization providing competition to the municipal enterprise was a state enterprise rather than a private business, apparently organized at the regional rather than the municipal level. This may reflect the relatively early stage of development of land markets in some areas and is consistent with reports by territorial staff that there is often only a single provider within a significant distance of smaller towns.

Application of the Law, Treatment of the Cases by the Courts

The cases that came to FAS by complaint were also the cases in which FAS' decision was appealed to a court.¹⁶ In the first case, where firms and entrepreneurs were directed to a private company to complete necessary documents, most of the municipalities responded to decisions and orders requiring them to abrogate the contracts with the private companies. One municipality, however, appealed. The first instance court upheld FAS' decision, but the appeals court reversed. That court stated that since the contract only provided for "consultation" on the various questions, it did not – as FAS had claimed – delegate the functions of a state body to an economic subject in violation of Article 7 of the Competition Law. The appeals court also took note of the argument that the municipality did not have the resources to sustain a sufficient staff for the relevant tasks, and found that the contract with the firm (which was headed by the prior chief architect of the municipality) allowed the municipality to meet its obligations to the public. FAS appealed further to the cassational court, which reversed the decree of the appeals court and confirmed the legality of the competition authority's decision.

In the second case, where the municipal enterprise was required to "confirm the task" related to drawing draft boundaries for the plot, the local bodies argued that the land laws and associated legal regulation place specific legal responsibilities upon them that require them to be able to control the process of land allocation and the quality of cadastral records. They stated that it is the local bodies, and not the petitioner for allocation of the land, that are

¹⁶ In one additional case, an appeal was made that addressed only the question of whether the competition authority's order requiring a change in local legal regulation was addressed to the proper body or official.

required by law to provide for the creation of a draft of the boundaries of a land plot within one month of receipt of a petition for allocation of land not reflected in a cadastral map, and that they were responsible in general for the accuracy of cadastral records. Therefore, they argued, the drafting and confirmation of boundaries for land plots is not a service freely traded in the market but a legally regulated function of the local authorities, and therefore they must be permitted to control the process by relying on the municipal company and on confirmation of task orders by city bodies. The court did not find these arguments convincing, however, and agreed with FAS that the provisions violated Article 7 of the Law “On Competition” in restricting the independence of those petitioning for land plots and in disadvantaging companies other than the municipal company named in the statute.

There is little question that the kinds of problems encountered in this group fall within the provisions of Article 7 of the Law on Competition. A direct specification of the enterprise with which a petitioner for a land plot must contract for services restricts the independence of the petitioner in choosing a source for the work, would seem to qualify as a instruction regarding the priority conclusion of contracts with particular sellers of services, and would certainly qualify as an advantage provided to the specified firm. With respect to the requirement of a restriction of competition, specification of a single enterprise for the purchase of specific services by definition prevents competition for such services from developing. Thus, where the municipality requires that business be done with a specific firm, the violation is clear.

One of the cases in the sample raises the question of whether municipal authorities may require services to be purchased from a specific firm for instances in which the authorities themselves are making the purchase. While the municipality certainly would not be prevented from purchasing the services from a municipal enterprise, a legal provision requiring that this take place might violate laws requiring that purchases of goods and services for state and local needs be made on the basis of competitive bid. If the rule were not to specify a specific enterprise but rather that the services must be purchased from municipally owned rather than other firms, this would appear to violate the constitutional provision guaranteeing equality of all forms of property, as well as the provisions of Article 7 concerning conclusion of priority contracts with particular sellers and the provision of advantages to particular competitors. As with a single, specified enterprise, there is little question that this kind of legal provision would restrict the development of competition.

It is sometimes pointed out that in sparsely settled or remote areas there might exist only one enterprise providing the services and the argument that the area cannot support more than one – and that there is therefore no competition to be restricted, no competitive bidding is possible, or the local enterprise must receive all of the relevant business in order to survive. This cannot be accepted as a rationale for the legal direction of all business to a single firm. While the amount of (for example) mapping and surveying business generated in a single municipality may – taken alone – be limited, such services are extremely portable and do not require a constant presence in the place where they are performed. There is no reason that several companies based a considerable distance from one another could not compete in overlapping territories. Similar arguments were commonly made in earlier stages of economic transition about a wide variety of goods and services in which competition is now well developed or

developing. Indeed, the argument that the specific local business must be supported or might fail and leave the market is an indirect admission that others might take some of its business – that is, that competition is possible and the purpose of the rule is to prevent it. If other providers truly can't or won't provide services to the area in question, then the local enterprise will in any case receive all available business without any need for restrictive legal rules.

Issues to Be Addressed, Options for Consideration

Clarification in Related Legislation

Although neither the court nor the FAS took up the argument in a detailed way, the municipality in the second example case above was not incorrect in the claim that it bears some legal responsibility for ensuring that draft boundaries for a land plot are created within a specified time period after a petition is received. The relevant portion of the Land Code of the Russian Federation (paragraph 1 of part 7 of Article 36) states that in cases when there is no cadastral map of a land plot, the local authority must provide for the creation of draft boundaries on the basis of existing documents within a one month period of its receipt of the petition for the land. The term used in the provision is one which is usually interpreted as an assignment of responsibility to the named body and not as permission for that body to require that others obtain the required result.¹⁷ Moreover, in other instances where payment is to be made by the petitioner for the land, the Land Code seems clear about that fact.¹⁸ Thus, there is a fairly strong argument to be made that the bodies in question are themselves legally responsible for providing a draft plan of the plot using their own resources or purchasing the services necessary to do so. A similar argument based on the general responsibility of state and municipal bodies to conduct their own business could be made concerning such other services as drafting of the decree to be issued by the municipality concerning allocation of the land plot and other documents that are expressions of the exercise of state power.

Clear recognition of these rules and strict imposition of these legal responsibilities upon the local body was a solution to the underlying problem that received support during discussion with the competition authority. Such a rule was seen as consistent with the responsibility of a state body to clearly define the state resource that it is offering for sale or lease, and with the rule that will come into force at a later date requiring that land to be transferred through sale be fully registered in the cadastre. Indeed, some were inclined to advocate that more of the responsibilities for production

¹⁷ The formulation requires the relevant body to “provide for” (обеспечить – also sometimes translated as “ensure”) the creation of draft boundaries of the land plot. While this term is not uncommon in legislation, it is somewhat vague, in that it does not specify the means by which this is to be achieved. It would be considerably clearer for the legal provision in question to require that the municipality “prepare” the draft boundaries or “issue to the petitioner” a draft of the boundaries if the intention is to make the municipality responsible for accomplishing the task with its own resources. (Other uses have included legal requirements that a state body or the state as a whole “provide for” the conditions necessary for citizens to exercise particular rights – a broader goal concerning which precise means would be difficult or impossible to define in law.)

¹⁸ Indeed, in the very next part of Article 36 (paragraph 2 of part 8), it is clearly stated that the establishment of the boundaries of the land plot on the ground and the preparation of a cadastral map of the land plot are to be done on the basis of the draft of the boundaries “at the expense of the stated persons.”

of the necessary documentation be placed upon the relevant municipal body, including some that are now the responsibility of petitioners for land or are performed at their expense.

There are a number of attractive aspects to this type of rule. With respect to cases concerning the purchase of these services, a rule that more clearly placed the responsibility for issuing the required documents on the municipality might help to eliminate temptations to use petitioners' funds to finance municipal enterprises selling these services. Application of rules concerning state purchasing by competitive bid could help to develop some competition for services purchased by localities. And the development of such competition might conceivably be aided by the reduction in the size of municipal bodies that is contemplated by the reform of local self government, since these smaller bodies may be more likely to need to purchase such services and less likely to be "tied" to firms that are in essence former departments of the older municipal bodies. The placement of clear responsibility on the municipality for the production of these documents is also consistent with their responsibility to ensure that the work is of a sufficient quality that confusion or other undesirable consequences of poor land records do not follow. And in this respect it may reduce or remove incentives for quality concerns to be used as a cover for discrimination in favor of particular providers. For functions concerning which the legal rule is clear, delegation of the function to a firm is a clear violation of the prohibition, in Article 7, of delegation of the functions of state bodies to economic subjects.

Effect of Costs

The first of the appealed cases, however, suggests a complication with an enforcement strategy and competition advocacy position that focuses on insistence that municipal bodies perform their obligations under the law and on the assignment of additional responsibilities to them in the process. The "services" that petitioners are being directed to purchase from specific firms appear in a number of cases to be basic tasks that would normally be performed by municipal employees – such as document preparation – rather than a very specialized service. The municipality in the example case above argued that the reason for the use of an outside firm was the simple absence of resources in the municipal budget to accomplish the tasks assigned – an argument the appeals court found convincing after examining the staffing and budget. While the territorial office of the competition authority argued that this was more a result of poor resource use than of a true lack of funds,¹⁹ the inadequacy of the budgets of municipal bodies in a significant number of areas appears to be generally acknowledged. If it is genuinely the case that some significant number of municipal bodies can afford neither the staff to perform the tasks nor the fees to purchase them from others, a legal rule simply insisting that they do so may ultimately result in significant delay in the allocation of land and perhaps in very poor quality land records.

¹⁹ The appeals court in examining the first example case requested information from the municipal body on its staff in support of its claim that it simply could not perform the functions without the help of the outside firm with which it had contracted. The competition authority noted that although the municipality only had one architect and one lawyer, the salary of the architect was high, and also that the court did not consider how many deputies the head of the municipality had and the amounts of their salaries. While it may well be that too much of the municipal budget was going into high salaries for some officials (a common perception about problems in local and regional budgets), it is not desirable for the competition authority to become involved in reviewing the propriety of local budget expenditures.

Neither delay in the allocation of land nor uncertain land records are in the larger interests of promotion of competitive markets for land or the elimination of the general entry barrier posed by problems with land and premises. If simple capacity to perform by municipalities is a real concern, the cause of competition would be better promoted by advocacy of a different rule that would allow land allocation to move forward as quickly as possible. One option would be a rule placing responsibility for submission of most or all documents on petitioners, who could then purchase services as necessary,²⁰ and limiting the municipality to justified responses within a limited time frame. Another would be to provide for a means for municipalities to cover their costs, perhaps through a legally defined fee. Concerns being expressed over adequacy of budgets and of budgetary other competence of the new bodies of local self government currently being formed might provide support for the idea that financing for basic tasks in land allocation should come from petitioners or a fee outside their general budgeting process, at least during a transition period. The rule could be changed at a later date if appropriate.

Per Se Violations and Proof Standards

All of the cases in the sample involve either the direct specification of a firm from which a necessary service must be purchased or the contractual creation of conditions requiring that petitioners pay a specific firm to perform tasks assigned to the municipality. The direct specification of a firm from which goods or services must be purchased is so clearly competition restricting (or competition preventing) that there is almost no need to require that an economic analysis be performed to prove that effect. Indeed, this is tacitly acknowledged by both the respondents and the courts in the case in the sample group. Neither appears to have seriously questioned the idea that direct specification of a firm (or the creation of a special relationship between the municipality and the firm having the same effect) restricts competition. Given the certainty of the competition restriction involved, and the need to draw some lines between types of violation by state bodies discussed in Section II, it may be appropriate to consider the explicit treatment of this type of violation in the new competition law as a *per se* violation of the law.

The fact that all of the cases involve “documented” preferences – reflected in a rule or regulation or evidenced by a contract – raises some questions about instances in which the “preference” to a particular firm is provided by other means. A state or municipal body that wishes to benefit a specific firm may do so by suggestions to petitioners for land plots or by obstruction of the acceptance of the work of others, without ever creating a legal rule or contract. It may be reasonable to expect that as

²⁰ Access to existing records and other necessary conditions would need to be provided. Petitioners for land allocation may in any case have a better understanding than local bodies of what the proposed boundaries of a land plot should be – at least until cadastral mapping is completed. They will have more information about their use of the property than municipal employees, particularly in relation to allocation of land under existing structures that are already in use. Even after cadastral mapping and registration of plots is completed, petitioners seeking to undertake a larger or more complex development project requiring more than a simple sale of already-defined cadastral lots may have a better sense of what boundaries would work than municipal authorities. Procedural rules that go too far in the direction of excluding purchasers from the process of definition of boundaries are likely to be inefficient and may result in unnecessary delays and disputes that might be avoided by creating the conditions for petitioners to make boundary proposals.

time goes on the impermissibility of the legislated or contractual form of preference will become clear, and municipal bodies that desire to direct work to a specific form may begin to use these less obvious methods. Such instances can be far less clear in their intent and effects, and the competition authority will have to develop different investigation and analysis techniques if it wishes to pursue such cases, including an ability to rely on witness testimony. A more reliable means to reduce the incidence of this kind of behavior might be to remove as far as possible the incentives for municipalities to engage in it – for example, by ensuring that hard-pressed municipalities cannot improve their budgetary positions by forming and then “encouraging” the use of municipal firms in competitive markets. Current discussion of provision to the newly forming municipalities of the ability to engage in business as a means to create budgets raises real concerns in this regard, and FAS may need to engage in some competition advocacy on that issue, which goes well beyond land and real estate.

IV. Discrimination in Allocation of Land or Premises to Advantage Particular Firms

Nature of the Cases

A small number of the cases in the sample materials concerned actions by state or local bodies that reflected a priority in allocations of land or premises to benefit a particular firm. Perhaps the most egregious was a case in which city authorities invested in a company conducting retail gasoline sales and intended to provide the company with lease rights to land for the development of gas stations as a part of its investment. For that purpose the city withdrew land plots already allocated or in the allocation process for the development of gas stations by other companies in order to reallocate the same plots for the same use to its “own” company, effectively becoming itself a competitor of the other firms operating in that field. In a second case, the competitor was not the city itself, but the “regional” supplier of gas and oil products. In that case, another company that had successfully completed all of the preliminary stages required for the allocation of land for development of a gas station was refused at the last moment by officials who explained that the placement of gas stations was always considered in light of the interests of the regional supplier, “as is done in all regions.” In a third, the competition was for the lease of premises rather than land and came from planned expansion of the existing state enterprise that was a competitor of the much smaller firm seeking space. A firm attempting to lease space for use as retail pharmacies was refused in relation to several locations by municipal authorities, who explained their refusal by the fact that “a need had been identified for a state network of pharmacies to be created.” All of these cases were brought to attention of the competition authority by complaints of the firms unable to obtain land or premises. Discussion at project meetings indicated a belief that similar discrimination was occurring in a variety of locations, but that the lack of open statements of the reasons for refusals or for the success of a specific firm made initiation of a case difficult.

Application of the Law, Treatment of Cases by the Courts

In each of the cases described, FAS found the actions of the body to be in violation of Article 7 of the Law on Competition. In so doing, the territorial offices characterized the actions of the body in question under two separate sub-points of Article 7 – finding them to be both actions that provided privileges to a particular competitor in the market, placing it in an advantaged position in relation to others in the same market, and also actions that groundlessly obstructed the economic activity of the firms unable to obtain land or premises. Consistent with common practice in Article 7 cases, the territorial offices handling each of the cases also analyzed the laws and legal acts regulating the allocation of land or rental of premises in the area and sought evidence that the action of the municipal body in question also violated provisions of those acts. Because in each of the cases the intent of the relevant body to benefit by its actions a specific competitor of the complaining firm was stated clearly (and in two of the three reflected in a document), evidence of violations of the applicable rules seemed to serve more as supporting evidence, showing that the body was willing to violate rules or procedures to achieve its goal rather than as sole evidence of a “groundless” action that obstructs the economic activity of particular firms.

Two of the defendants appealed the competition authority’s decision finding their actions to be a violation of the Law on Competition. (In the case concerning protection of the interests of the regional oil and gas supplier, the defendant body executed FAS’ order to provide an appropriate plot of land to the injured firm, although only after the territorial office had filed suit in court concerning its failure to do so.) Interestingly, the resulting opinions of the courts are diametrically opposed. In the case concerning the attempt of the city to use leases on land for gas stations as an investment, both the court of the first instance and the appeals court upheld FAS’ decision. The courts did not question the right of the city to use city assets to invest in a company conducting business in the city, nor its ability to lease land to such a company. However, they treated the city’s civil law rights as an investor and its function as the body leasing state property separately, requiring it to treat all companies petitioning for allocation of land equally and to observe the general procedures for allocation of land plots even when allocating to its “own” company. Moreover, the courts did not accept the argument that the city’s civil law investment relationships are outside the scope of the Law on Competition, citing the provisions of Article 10 of the Civil Code that forbid the abuse of civil law rights, including for the purposes of restricting competition.

By contrast, in the case concerning the denial of leases of premises for expansion of a retail pharmacy company, the first instance court found FAS’ decision to be invalid. Relying on a provision in the regulations allowing state property to be rented without competitive bid or auction in “specified” instances (a provision that was never concretized further), the court found that the fact that the state pharmacy company was responsible for filling free and discounted prescriptions under state social programs might fall within this language and would justify a preference for the state company in choosing among several simultaneous expressions of interest. It ignored evidence that the private firm had, in fact, submitted its applications earlier than any for the state firm. Moreover, the court concluded that in any case Article 7 of the Law on Competition was not applicable, because it applies only to the actions of state and local bodies that are taken in exercise of a state function and that create an administrative-law relationship with the relevant firms. The leasing of property, the court reasoned, is an activity that

gives rise to civil law relationships and is therefore governed by the provisions of the civil law, including those that specify that state bodies are to participate in civil law relationships on the same bases as other parties. This decision was upheld in both the appellate and cassational instances. This suggests that state bodies are free to discriminate in civil law relationships for the express purpose of benefiting a particular firm, provided this is in a civil law (voluntary, contractual relationships) rather than an administrative law (imperative, mandatory rules) context. The cassational court did note in passing that FAS alleged that the state body had committed violations that are in a section of the Law on Competition concerning “monopolistic activity” and went on to state that since the body in question did not have a monopoly on the lease of non-residential premises, it could not be found to have conducted monopolistic activity and the private firm could seek premises from private companies. While it is possible that this statement indicates that the court would have been willing to consider the actions a violation if FAS had shown the state to be dominant in the market for leased premises, the court did not expand upon the matter. No evidence was presented concerning the percentage of the market for suitable premises accounted for by state property.

Issues to be Addressed, Options for Consideration

Structural Issues

The underlying structural cause of the problems illustrated by the cases in this group is the dominance of state and municipal ownership of land and premises and the consequent power of the bodies assigned to administer that property to control or influence competition by denying some firms the space to do business or favoring others. If land and premises for business development are available to those seeking them from multiple sources, a discriminatory policy by the bodies administering state and municipal property will have far less impact upon competition. Thus, as with other problems illustrated by FAS’ case load in this sphere, one of the most important things that FAS can do is to undertake competition advocacy in support of land reform policies that will reduce state and municipal dominance and to advocate policy design that favors development of dispersed property ownership and the development of robust markets for land and premises. It has been suggested that direct advocacy of a policy with the specific goal of moving property out of state and municipal ownership may present political or legal difficulties stemming in part from the constitutional provision concerning the equality of all forms of ownership. In this respect it may be important to distinguish a position that state and municipal ownership should be disfavored in general and on political/ideological grounds from a position advocating that a monopoly or strong dominance situation be eliminated through active promotion of multiple forms of ownership.²¹

A different means to address the issue might be to reduce the participation of state and municipal enterprises in activities that are competitive or potentially

²¹ In relation to the lease of premises, the problems associated with dominance in these markets of municipal bodies might be reduced by reducing the concentration of power to administer state property in the hands of a single body. While this might raise some efficiency concerns, it might perhaps promote some competition among lessors for revenues from the lease of space. The potential competition that developed between entities providing services in drafting boundaries for land plots in second example case discussed in Section III, above, was not between a municipal enterprise and a private entity, but rather between a municipal enterprise and a state enterprise providing the same services.

competitive, thereby reducing the incentives for state and local bodies – including those administering real property – to skew their decisions to benefit state and municipal firms against competitors. As the cases suggest, however, dominance by state and local bodies in the allotment of land and premises can be used not only to the benefit of state and municipal enterprises, but also to the benefit of private entities – such as in the consideration of the “interests” of a firm that is important to the region. As with advocacy for reduction of state and municipal ownership in land, however, a competition authority position advocating divestiture of state and municipal ownership of firms might be perceived to conflict with constitutional provisions or other policies advocating equality of ownership forms.

Statutory Provisions and Interpretation Issues

One explanation for the differing court decisions, is the clear monopoly of the municipality in the allocation of lots for construction of gas stations and the lack of such a clear situation in the case concerning rental premises for pharmacies. In the case of the allocation of lots for gas stations, the monopoly of the city was clear on its face. And while the court did not expressly address the issue in its opinion, it tacitly recognized the power of the city in the market concerned when it cited Article 10 of the Civil Code for the proposition that civil law rights may not be used to restrict competition. The court in the pharmacy rental case, although concentrating its opinion on other aspects of the case, stated that the city could not be considered a monopolist and that premises were available elsewhere. This raises squarely the question of whether and how the degree of dominance of a state or local body should affect the analysis of its conduct under the Law on Competition.

The currently effective law contains no direct discussion of how or if the Law on Competition is to apply to state and local bodies when they are participating in commercial activities in a market together with other competitors. Article 7 contains no requirement that the state bodies it covers have a certain amount of market power before its restrictions apply. Applying only the Law on Competition, it might be possible to conclude that state bodies may never take actions that discriminate among competitors under any circumstances whatever. Other legislation, however, might suggest a different approach. The Constitution of the Russian Federation guarantees equality of all forms of property and the Civil Code provides for equal treatment of state bodies with other parties in civil law relationships. If these principles are also applicable to competition law matters, it might be argued that state and local bodies are to be treated as other private parties, meaning that in civil transactions their behavior benefiting particular competitors would not be a violation unless it can be shown that they are dominant. Courts in some of the cases in the sample overall seem to establish a third variant, in which they determine only whether the transaction involved is defined as a civil transaction with terms voluntarily entered into by the parties, and if so make no further inquiry into the state’s dominance or the propriety of its behavior under the Law on Competition. This may well result, however, from reliance in those cases by FAS on the absolute prohibition in Article 7 and its failure to present the question of the monopoly or dominance of the relevant body to the court.

As noted above, the currently effective law does contain a requirement that the action of a state or municipal body that is challenged under Article 7 result in a restriction of competition, or have the capacity to do so. It would certainly be possible to interpret Article 7 as prohibiting state bodies from restricting competition, even in

their civil law relationships. If this requirement were to be treated more substantively by the competition authority, with the presentation of information on the market affected by the state action and analysis showing the restriction (or potential restriction) of competition alleged, it is quite possible that courts might be more inclined to see the harm and to support FAS' decisions.

While the current competition law is in effect, it would be helpful for FAS to clarify its position on the question of how the Law on Competition applies to civil law transactions of state bodies – through the provisions of Article 7 or through the treatment of state bodies in those cases as economic subjects equally with others. Clear argument on this issue and guidance to the territorial offices on enforcement practice might reduce the number of conflicting court decisions and make sure that differing branches of the FAS are not submitting conflicting legal arguments to the court system. As work proceeds on the new competition law, however, it would be appropriate to consider what standard in this respect is desirable and to reflect that more clearly in the new law.

There is no single answer to the question of which standard for state behavior is appropriate. It is matter of policy on which systems differ widely. One might argue that state bodies, regardless of any market power, should be held to a strict standard of neutrality between competitors – as a role model, due to concerns about corruption of political processes, or due to concerns about efficiency and return on state assets. This position might have special merit where state ownership still plays a large role in many markets and there is concern about the potential for a general, interlocking support of state owned firms by state and local bodies to disadvantage private firms and discourage entry and growth. A strict rule may, however, cause difficulties in situations when a state or local body wishes to give preference to a non-profit entity that participates in some markets but also provides cultural or social value or to discount rents to local start-ups to encourage economic growth. Should this be impossible, even when the state or local body has no significant market share? And should the competition authority waste resources on complaints by a firm unhappy with the terms of a lease or sale on a specific property if many alternatives were available?

A different approach would be to judge civil transactions of state bodies under a standard that takes market power and the restriction of competition into account. This approach may be attractive in that it concentrates enforcement resources on matters that cause the most serious competition problems. But how much market power in the hands of a state or local body is enough to allow it to restrict competition, given the other resources and levers that such bodies have at their disposal? If they are treated equally with private parties, dominance would be required to limit the ability to discriminate among competitors. The standard for dominance under the Law on Competition has not always been clear, however, and the competition authority has in some cases had difficulty in convincing the courts that even regulated utilities are dominant in their markets. Standards for the definition of dominance that take qualitative factors into account rather than relying on market share alone have yet to be developed. Apparent difficulties with economic analysis as the basis for proof of competition restriction have already been discussed. In these circumstances, a test relying solely proof of both dominance and a competition restriction may provide too little control over the behavior of state bodies, at least while the proportion of state ownership in many markets (including land) remains high.

Another issue that may account for the difference in the treatment of the two cases is the difference in the views of the courts regarding what constitutes a state function. The courts in the case concerning gas station plots appear to have been able to distinguish two aspects of the city's behavior. One was its investment in a specific company governed primarily by civil law rules, while a second was the function of allocation of state land for use, seen as a state function governed by, *inter alia*, Article 7 of the Law on Competition. The court in the case on pharmacy premises, however, did not divide the behavior of the city property committee into two aspects, although such an argument could be made. As with the allocation of land plots, one aspect of the behavior would be the specific leases on specific property which would be governed as between the parties by civil law rules, and the second the allocation of state premises for use, governed by rules concerning state functions. Because the court saw only one function – the participation of the city in the lease agreement, it applied only the rules for that function. Under the currently effective competition law, it may be useful for FAS, in applying Article 7 to state actions that are related to civil law transactions, to make the distinction between the civil transactions themselves and the acts of administration of state property that lead to them.

Finally, as with the cases concerning monopolization of services, all of the cases in this group concern instances in which the state bodies involved made the mistake of admitting the reasons for their actions. Notably, in both of the cases heard in court, the reason was recorded in a document. It is to be expected that this kind of behavior will stop as bodies become more familiar with the requirements of the Law on Competition. Consideration should be given to how FAS would handle a case in which no such admission was made.

VI. Manipulation of Allocation Processes

Nature of the Cases

Another small grouping of four cases in the sample set concerned complaints about manipulation by municipal authorities of the procedures for the allocation of land plots. All three came to the competition authority by complaint of firms that felt aggrieved by the procedures used. It is interesting to note that the cases are somewhat opposed in the nature of the complaint – in one case involving complaint over a failure to conduct an auction or tender, and in the others complaining of the conduct of an auction or tender.

In the case concerning the failure to conduct an auction or tender, city bodies were accused of manipulating the early stages of the processes for allocation of a land plot in order to give a particular firm the right to develop a land plot. In particular, the city property committee had received a proposal for commercial development from a firm. The city department of investment had been asked to issue a conclusion and had recommended to the firm that it seek a means to conduct the preliminary work that would be required for the allocation. For that purpose, the firm concluded a short term lease (for one year) during which the preliminary work was to be completed. A number of other firms submitted proposals for the development of the same land, but these firms received no similar treatment and no information on the session of the property

committee that would decide the matter of the lease to the company that received it. A firm that had made a similar proposal for the use of the land complained to the competition authority, which concluded that the failure to conduct a tender or auction for the right to the lease of the land for the preliminary work was a restriction of competition on the market for construction and related services. The lease itself did not legally provide to the lessee any priority rights to conclude a later contract for the long term lease or purchase of the land for construction. FAS, however, argued that the lease of the land to that company provided it with an advantage against others in the long term allocation process that would be conducted later. Therefore, FAS concluded, the city should have conducted a tender for the short term lease rights. The city and the firm that received the lease appealed FAS' decision and were supported by the courts.

In the other cases, the pattern of behavior is reversed. In both cases, a municipal authority had issued a decision making a preliminary assignment of a land plot to a firm or individual entrepreneur, in accordance with the legislative rules on allocation of land plots with a preliminary agreement concerning the location. The petitioners for the land plots completed the necessary documentation and expended the funds required for the marking of boundaries of the land plot and creation of a cadastral map of the plot, but were then refused the final allocation of the land plot and it was put up for auction. The municipal authorities stated that the reason for the refusal was that multiple proposals had been received and therefore the land was subject to auction. The complaining parties, however, offered different explanations.

In two of the cases, the complaining parties alleged that the refusal of the final allocation and placement of the land plot for auction occurred only after they had refused an illegal request by the municipal authorities that they conclude a contract with the municipality envisioning payment for the preliminary agreement on the plots and their later allocation. Thus, they viewed the decision to put the land up for auction as a form of punishment for petitioners' refusal to make a payment that was not legally required. In the third case, a petition from a competing firm with a significant presence in the market had been received, although later than that of the complaining firm (a new entrant into that market). The final allocation of the land plot was denied and the land put up for auction. In all three cases, FAS found the denial of the land to those who had begun the directed allocation process and the placement of the land for auction to be a restriction of competition.

Application of the Law, Treatment of the Cases by the Courts

In the case concerning the failure of the city authorities to hold an auction for the right to lease land for preliminary work, FAS argued that competition between the various construction firms in the city was, in essence, expressed in competition for the right to construct projects on available land plots in the city. Therefore, behavior of the city that restricted competition in relation to the single land plot in the case in question constituted a restriction of competition on that market. FAS does not appear to have addressed the question of what part of the available land for construction in the city was accounted for by the plot at issue in the complaint. Nor did it attempt to quantify or describe the effect of the alleged restriction of competition on the market in question as a whole. In essence, its argument in the case is that the failure of the city to use a more competition-promoting procedure *in this specific instance* was itself a restriction of competition, because it resulted in an advantage to one firm in the further bidding in

respect to this specific land plot. This is a very attenuated argument for a restriction of competition on the construction market as a whole. Without some analysis showing why the result of this specific transaction would somehow restrict competition between construction firms overall in the relevant market, this argument is problematic.

FAS' initial presentation of the evidence also seemed to suggest special treatment of a single firm and perhaps to hint at improper motives (although it did not make such a claim directly). FAS pointed out that a response by the city department of investment was made to only one of the interested firms advising it to seek a lease for preliminary work and emphasized the failure to inform any of the eleven others interested in the plot about the consideration of the lease at the relevant session of the body in question. The court of first instance, however, pointed out that the city department for investment that responded with the recommendation was approached for a conclusion on the project only by that single firm, and that no other firm made a request to conclude a lease for the conduct of preliminary work.

FAS also pointed out that applicable rules issued by the city itself require an auction among potential investors for the right to a short term lease for preliminary work. Thus, it argued, the failure to conduct such an auction in this instance was a violation of that law by the relevant body. Again the court disagreed. If another firm had made a request for the lease, the court stated, only then would the applicable rules have required that an auction for the lease right be held. The same court refused to find any significant advantage to the firm given the lease, stating that this did not provide any legally granted priority in the later conclusion of a long term lease or purchase agreement with the city. A discussion by FAS in its filings of the factual relationship of the city departments to one another and the means by which proposals for the land plot and requests for a short term lease are handled might have helped prove some form of manipulation of the process, although that alone would not qualify as an Article 7 violation. And more discussion of the specifics of the advantage that the firm allegedly received, and perhaps some general investigation into the practice of granting short-term leases to developers and whether the lessee tends to win in bidding on the long-term rights to the land, might have provided the specific information needed to convince the court that a practical advantage was granted even if no legal priority ensued. Such information, if it confirmed a general advantage to firms using short-term leases in later auctions, might also have allowed FAS to challenge the legal acts authorizing short term leases for this purpose as generally restricting competition. No such discussion, however, appears in FAS' filings in the case, which is based in the specific instance and relies on an assumption of a benefit.

Finally, FAS presented a general argument that under the applicable law (citing primarily the Land Code), auction or competitive bid must be considered the usual means by which land is to be allocated. Directed allocation, according to FAS, is permissible only in special circumstances or for special purposes that are specifically envisioned by law. Thus, the failure to use a competitive method in allocating the plot in question was a violation of this general legal principle, even if not of the specific legal rules on auction of a lease right that were passed by the city. Neither the court of first instance nor the cassational court accepted this argument. The cassational court upheld the decision of the first instance court, focusing on the technical legal question of whether an auction for the right to conclude the lease was required by federal law or

by other legislation. Having found that it was not, the court concluded that no violation of Article 7 had occurred. Review at the highest level of the court system was denied.

In the case concerning the demand for payment for the preliminary allocation of land and the auction of the plot as a result of refusal, FAS made precisely the opposite general argument. According to the filings in that case, the law (citing primarily the federal land and planning codes) gives a list of the circumstances in which an auction or competitive bid are to be used to allocate land, and in regard to leases only a transferable right to lease the land may be auctioned, and not a simple land lease itself. These circumstances listed in the law, FAS argued, are an exhaustive list of instances in which an auction may be held. All other allocations of land must therefore be made by the general means for land allocation – which is through the conclusion of a preliminary agreement on the placement of the object to be constructed and selection of a land plot, and the following procedures described by the law and not involving auction or bid. Therefore, the withdrawal of the land and its placement for auction was illegal.

As in the case described above, the motives of the state body were called into question as well. In these cases, the motive alleged for the action was punishment of the firms in question for refusing to make payments that were not legally required. The illegal and/or improper nature of the action then served as the basis for FAS' argument on restriction of competition. According to FAS' filings, any causation of cost to an economic subject by an improper or illegal action of a state body is a restriction of competition in any market in which that economic subject competes. FAS did not define those markets with any specificity or present any further evidence concerning the actual or potential restriction of competition based on economic analysis.

Neither the court of first instance nor the appeals court agreed with FAS. They described the conduct of an auction as a competition-promoting procedure and, oddly, characterized the request that a compensated contract be concluded for some stages of the allocation of a plot as only a “proposal” that had no effect on the process. The sample materials contain FAS' further cassational appeal filed in the case, but no information on the outcome of consideration at that level.

Issues to be Addressed, Options for Consideration

Structural Issues and Legislation in Other Areas

The cases in this subgroup strongly suggest a need for simplification in the processes by which land is allocated for construction. The need for many preliminary steps, project reviews and preliminary approvals not only increases the cost and delay involved, but also multiplies the opportunities in the process for abuse or manipulation. Some of the kinds of situations described in these cases could be avoided by minimizing, to the extent possible, the steps and approvals involved. In particular, it is not clear that any positive purpose is served by the use of an exclusive, short-term lease on land to a single potential investor while developing a project proposal. To the extent that the necessary activities may be conducted without significant change in the condition of the land, there would seem to be little reason not to allow any interested investor access to the land for planning and proposal purposes. To the extent that the lease allows the potential investor to undertake more substantial testing that may disturb the property, such as examination of the soil and subsoil conditions and evaluation of

the suitability of the property for particular types of construction, this function can be accomplished by a variety of other means as well. The municipality or other seller of the land could be required to undertake the necessary tests to determine the quality of the land offered and provide the results to interested parties for a fee that covers overall costs for that activity, for example. Moreover, if the practice of leasing the land for this purpose does, in fact, provide information to the lessee that is not available to other potential investors in making construction proposals at the stage of purchase or long term lease, then FAS' argument that the lease provides an advantage to its holder in obtaining the land for a longer term seems quite plausible. If information on the frequency with which a short-term lessee is the recipient of the land for construction were available from records in those areas in which it is used, a limited analysis might provide FAS with the statistical evidence that would support either a challenge to the rule itself under Article 7, or advocacy for a change in the law preventing use of short term leases in this manner.

In addition to simplification of the processes, there would appear from the cases to be a need as well for additional clarity concerning such matters as whether a process of allocation of land to a particular firm, once it has begun, may be interrupted and on what grounds this may occur. Rules on this would limit the ability of the relevant bodies to "hold up" petitioners for land in the middle of the process by threatening to re-start it or citing a later expression of interest as grounds for auctioning land that is already in the allocation process. The amount of publicity that must be given to availability of land, the amount of time that a municipality must wait to receive expressions of interest, and similar matters might also be further clarified, making it clearer whether aggrieved investors in the lease case or those in the case of the sudden decisions to auction land have a legitimate grievance (whatever body addresses it).

One of the suggestions made during project discussions was that the rules that were put in place by the December 2004 amendments to the Land Code for land to be used for housing construction be extended to all land allocation, or at least to all land allocation for new construction. This would be one means to achieve greater clarity, as those rules are considerably more specific at the federal level than the rules concerning other types of land allocation. Business use of land, however, may require the authorities to address such matters as mitigation of differing types of negative effects or the consequences of differing proposed business uses for the broader plan for development and assumptions about traffic, roads and other issues. Especially in the current "interim" period, while municipal authorities are being formed, cadastral records created and plans for growth created, a more flexible approach than is promoted by a simple auction model requiring sale to the highest bidder may be required.²² Even without unifying the rules for all land allocated for construction, difficulties of the type seen in this group of cases could be reduced by provision of additional detail on the procedural rules to be used, including the grounds and time frames for interruption of the allocation process by authorities, and the specific consequences of violation by the relevant bodies of these rules.

²² Housing construction, of course, also raises questions of population density, the need for services such as schools, road traffic levels and other similar issues. In the presence of a serious deficit of affordable housing, however, the Russian government has chosen to promote construction of housing by clarifying and simplifying the rules relating to land for housing construction. Those rules may be amended at a later time when the pressure of housing deficits is not so intense and both a greater need and capacity for planning review are felt to exist.

Finally, the repeating theme of payments to municipal authorities should be noted here as well. The provision of an exclusive, short-term lease to a potential investor for the purposes of planning and work on the definition of the plot to be allocated serves little practical purpose other than securing income to the municipality from that land even before the development process begins. Demands for payments for completion of parts of the directed allocation procedure were the subject of Section IV, and are also a means for municipalities to find additional income for budgets and/or a means to finance tasks for which they are responsible. Particularly during the period in which new municipal authorities are forming and budgetary income from the reorganized system for real property tax has not stabilized, it may be appropriate for mandatory rules concerning the land allocation process to be as clear as possible about what fees may and may not be charged and what parts of the process must be performed by the municipality at its own expense.

Development of the Law and FAS Litigation Strategy

The first thing that must be stated is that it is not desirable for FAS to be presenting diametrically opposed arguments to the courts about what constitutes a restriction of competition in any sphere, including in the allocation of land. This kind of contradiction can only support the view, expressed by some judges in prior activities related to competition law issues, that the competition authority has too strong a tendency to interfere outside its sphere of authority and to interpret the law in the way that supports intervention in the particular case. While it may be appropriate to allow some differing interpretations to be submitted to the courts on specific or narrow issues, the number of these should be limited. Review and comparison of diametrically opposed arguments in similar cases, which is very likely at the cassational level if not at lower levels of the court system, will damage FAS' image and persuasive authority in those courts in general. This makes FAS' job in defending any of its decisions more difficult.

Nor is the general damage to FAS' authority the only concern. The courts are far from comfortable with the operation of markets, the definition of competition, and the identification of what restricts it enough to cause concern and give rise to law enforcement actions. Judges that must resolve appeals of FAS' decisions have a general legal knowledge and a case load that is heavily weighted toward disputes in other areas (such as contract disputes, tax cases and bankruptcies). Even those with experience in the analysis of administrative law relationships and an interest in the subject matter will not be experts and will not have time to consider the broader effects of one or another interpretation on other competition cases. FAS cannot rely on the courts to resolve internal disputes about the interpretation and application of the law. It must be FAS – the expert agency in charge of competition issues – that educates the courts on competition in its presentations and provides to them a coherent and consistent legal position on competition issues. FAS should strongly consider taking organizational steps to prevent opposing arguments on the interpretation of the law from being presented as FAS' position.²³

²³ Competition authorities use a variety of methods to ensure that regional offices or differing teams of staff members handling differing cases take legal positions that are consistent with one another and also with the competition authority's overall policies and its enforcement strategy. While some of these are resource intensive and may involve more legal staff than FAS currently has, FAS might consider starting

Interpretation of the Law on Competition

These cases are good illustrations of some of the unresolved issues in the interpretation and application of the Law on Competition that are discussed above in Section II. The real question at issue in each of the cases appears to be that the act or action of the body was procedurally unfair to some firms (the short term lease) or improperly motivated (the auction of the land plots). But neither of these, by itself, is grounds for action by the competition authority under the currently effective law. A substantial effort is made in each case to show that the actions in question were also in themselves illegal. Although illegality is not required to show a violation of Article 7, and legality alone is not a defense, proof that the action was illegal appears to be considered as one means to show that the action was “without grounds” as is required to show a violation by discriminatory treatment or by generally obstructing economic activity. Proof of illegality also appears to serve as a sort of balance against weak proof of any competition effects, as one might arguably be willing to allow far less of an effect to justify a FAS decision concerning state or municipal action that is itself in any case illegal. (And available records of cases under Article 7 of the law suggest that this has, to at least some extent, been the case with courts reviewing the competition authority’s actions.) Because the cases really concern a single action of a state body in a particular instance, however, available arguments concerning the restriction of competition on the relevant market as a whole are weak. Such arguments are made in the cases in order to meet the requirements of Article 7, but in a form that seriously distorts the meaning of the term.

One means to deal with these kinds of cases would be for the competition authority simply to refuse them on the grounds that they do not concern a restriction on competition and to direct the complaining parties and any relevant materials to the procuracy, the courts, or other appropriate bodies.²⁴ The cases concerning the demand for compensation of the allocation process, in particular, might be simple corruption or a genuine dispute about the rules concerning allocation and auction, but the files do not present any evidence that the effects of the actions or their effects go beyond the individual complaining parties involved. Likewise, in the case concerning the short term lease of land to one developer, the cause of the actions might be deliberate favoritism, error, or a very formal application of rules not well drafted to promote competition, but a single plot of land is not a market and no evidence is presented of a

with a requirement for the review of the appeals or answers to be filed at the cassational stage for consistency.

²⁴ There is some indication that the courts and the procuracy are both handling matters similar to those described in this report. A recent project reviewing court cases on land matters reviewed 136 cases concerning the allocation of land for construction. In all of the cases reviewed that concerned allocation without preliminary agreement, the courts found the acts of state or municipal bodies to be without effect due to violation of the required procedures. The same report found that 60% of the reviewed cases concerning allocation through the preliminary agreement procedures were complaints about failure of the state or municipal bodies to act, and that courts generally took decisions in those cases obligating the bodies to fulfill their obligations. Procuracy statistics for 2002-2004 list tens of thousands of land matters addressed each year. See A. Mytsykov and A. Kazarina, “Effectivnost’ nadzora za ispolneniem zakona” (mnimaia i real’naia),” *Zakonnost_*’ 2005, No. 6(848), pp. 2-5 (citing statistics for 2002-2004 in major areas of procuracy supervision). Materials on procuracy supervision in land-related matters list several of the types of violations covered by the cases reviewed here as problems that procurators resolve. See, for example, I. Viktorov and T. Ashitkova, “Nadzor za ispolneniem zakonodatel_’stva o zemlepol_’zovanii,” *Zakonnost_*’, 2004, No. 2(832), pp. 27-30.

generalized restriction of competition. While one may have sympathy for any business or entrepreneur injured by an improper action of a state body or official, FAS cannot address every such instance – effectively become an adjudicatory body for any dispute between the state and a firm – without severely compromising its functions as the body responsible for competition issues. The fact that other available remedies may be less efficient or effective does not change this conclusion. If the inability of businesses to resolve problems with the actions of state bodies and officials is a serious deterrent to entry overall or affects competition in a more indirect manner, it may be appropriate for FAS to advocate for a more effective system to be put in place, but not for FAS to attempt to become that system.

While sending individual plaintiffs to other dispute resolution bodies, FAS might reasonably make note of the kinds of complaints being received and undertake investigations when there are repeated indications of behavior that would, in fact, restrict competition if repetitive or directed toward particular markets. Repetitive complaints by firms and entrepreneurs in a specific area of activity (gas stations, for example) that they are unable to obtain land or premises to enter the market or to expand in a particular municipality might warrant an inquiry into the state of competition in that market and whether the municipality is protecting a municipal enterprise or an incumbent firm. This would require more investigative effort than the cases currently being conducted under Article 7, including some economic analysis of the market in question. It might also require some investigative tools that FAS does not have or does not make use of, such as the ability to contact private parties and firms involved in similar dealings with the municipality and to use information gained from them as evidence to support its decisions. But action taken in a case in which competitors are systematically being excluded from a particular market will have far greater effect in promoting competition and will be far more powerful in its legal arguments than those brought to challenge a procedural irregularity or other violation in relation to a single firm. FAS is, in any case, likely to be forced to move toward this kind of investigation as municipal bodies learn to discriminate more subtly and not to make statements or issue documents that openly confirm an illegal purpose for their actions. It would be best to do it with planning and forethought, including during work on the new law.

A Special Role During Market Transition in Land?

There may be limited exceptions in which FAS should participate in ensuring that state bodies and officials act appropriately in most or all cases in a particular area of activity. This would apply especially to transitional activities that are key to the structure of markets that are being created and to the degree of competition that will be possible. It would be generally agreed, for example, that the sale of enterprises in a sector previously monopolized by the state is such an area, and that a competition authority would properly take an interest in the way that such a privatization is conducted and the market structure that would result. The competition authority's interest might well extend to the question of whether the agreed upon processes were being abused in a manner that discouraged competition or led to excessive concentration.

Privatization of land is not directly equivalent to enterprise privatization in this sense, since the example assumes that the enterprises are specialized in a particular activity and form the bulk of supply in a specific market while land may be used for a

wide variety of purposes. Nonetheless, high concentration in the ownership of land and real estate in particular markets may discourage growth and entry and facilitate abuse, and illegal or anticompetitive actions on the part of the bodies administering land privatization may frustrate state policies intended to make land ownership widely available and to ensure the competitive and open nature of the land privatization process. If FAS believes that illegal or improper actions by state bodies during the land transfer process – while not in any single instance necessarily resulting in a restriction of competition on a specific market – may cumulatively result in these kinds of effects, it may be appropriate to propose the formation of bodies that will consider most or all objections by firms and entrepreneurs to the acts and actions of state bodies in this area. FAS representatives could participate on such bodies together with representatives of other bodies or groups with appropriate authority and expertise.

If such a strategy is pursued, the procedures used by these bodies should be designed for efficiency and consideration should be given to a rule requiring that a dispute about land allocation issues be submitted to this body for resolution before being filed in court. Such bodies could provide a necessary check on abuses by municipal bodies that may prefer to maintain their control over land or may attempt to leverage their monopoly on its allocation to fill holes in their budgets, as well as informed dispute resolution on other land-related matters. If they were no longer needed after a period of transition to broadly based land ownership and the formation of well functioning land markets, the bodies could be abolished or laws amended to allow parties to go directly to courts with land disputes. Solutions of this kind would have the advantage of acknowledging the real concerns about land privatization as a foundation for development of business and competitive markets and allow response to violations in the process to be made on that basis, avoiding the temptation to do so on the basis of a fictive effect on competition in a specific market and the accompanying damage to concepts of competition. Such bodies, as a focus point for problems being encountered in practice, could also provide a valuable channel for feedback to the organizers of the reform process and a source of specific information concerning the kinds of amendments in legislation or additions to procedural rules and practices that might help to address common difficulties as they arise.

Greater Focus in New Competition Legislation

In continuing its work on the new competition law, FAS should give consideration to the clarification or elimination of language in Article 7 that contributes to confusion about what constitutes a violation or that has been used in an overbroad manner. This applies in particular to subpoint 2 of part 1 of Article 7, which forbids the relevant state and municipal bodies from “obstructing without grounds the activities of economic subjects in any sphere whatever.” It is this subpoint that most often provides the basis for decisions of FAS bodies that find an action of a state or municipal body in relation to a single firm in a single instance to be a violation of the Law on Competition. If the requirement that state action involve a restriction of competition were more narrowly interpreted and strictly applied, the breadth of this subpoint might be less problematic. Where that requirement has little or no meaning, however, it is an invitation for firms and entrepreneurs to demand that FAS respond to any negative interaction with a state body on the grounds that the outcome is a “groundless obstruction” of their activity.

Options for alternative language might include a formulation that would apply to “a pattern of obstruction” that leads to a restriction of competition. This might preserve the ability to enforce against serious attempts to restrict competition but eliminate demands that FAS address every difficulty or dispute. It might also be appropriate to consider language that would make it clear that the reasons offered by state bodies for their behavior could be challenged by FAS if there are clear effects on competition, even when those reasons are facially legal. This might be something similar to the civil law rules concerning “sham transactions” – that is, facially legal transactions that are undertaken to cover an illegal one. Such a rule would focus on the real concern (a pattern of decision or acts that restricts competition) and could help to move FAS bodies away from attempting to show that actions were illegal in other ways in order to show that they were “without grounds.” This, in turn, would have the beneficial effect of focusing court consideration in appeals on the competition issue and the real reasons for a state body’s actions, rather than on a technical legal argument concerning why a specific action violated a legal rule or principle, reducing the number of cases in which the legality issue is what decides the outcome.

VII. Differentiation in Land Rents

Nature of the Cases

Cases concerning differentiation in land rents were somewhat more numerous than those in the three groups discussed above. All of the cases concerned acts of bodies of local self government setting land rent rates for land in state or municipal ownership. Rates were calculated by the application of various coefficients to the base tax rate for land – which is imposed on the basis of land area in use. Thus, the rent rates were also calculated as a rate per square meter of land rented. All of the cases concerned the ways in which such local bodies differentiated among users of land in setting the coefficients. The specific type of differentiation, however, varied somewhat among the cases.

In at least one case, the local authorities set differing coefficients – different land rent rates – for enterprises based upon whether they were owned by the municipality or by other owners. For example, in provision of consumer services, municipal enterprises paid a rate equal to the land tax, while for private enterprises engaged in the same activity the rent was five times the land tax rate. This pattern repeated for other kinds of uses, although the degree of difference between the coefficients varied. Land leased for the construction of housing by municipal authorities, for example, was subject to a lower rent than that leased for the same purpose by others, and so forth. The municipality in question also set a special, higher coefficient for users of land that were not registered in the city.

In several other cases, the differentiation involved the type of structure for which land rent was being paid. In these cases, smaller and less permanent structures were often subject to a substantially higher coefficient applied to base rates than larger and more permanent structures. Kiosks engaged in retail trading, in particular, paid land rent calculated using a higher coefficient than for other types of retail trading spaces. Other distinctions were also made on the basis of the characteristics of the structures on the land. Land rents for areas occupied by markets, for example, were differentiated

based upon whether they were open air markets or “covered” – that is, having stalls inside a building or under a roof system.

Yet a third form of differentiation that appears in the cases is based on the type of product with which the business renting the land is concerned. Businesses selling particular food products (such as milk products or fruits and vegetables) were subject to lower rents, or those trading alcohol products to higher rents. Construction materials yards were treated differently from other wholesale supply operations. Gasoline stations were, in one case, subject to very high land rent for the area used for gasoline sales, although a lower land rent for other areas they might use.

Application of the Law - General Issues

The legal and economic analysis of competition cases concerning land rents is complicated by several factors. First, legal regulation lacks specificity and sometimes appears internally contradictory. Second, it is not entirely consistent with factual circumstances, in some parts reflecting the dominance of state ownership and of municipal bodies in administering it and in others presuming the existence of a market and treating land matters as freely negotiated. Third, the competition law’s provisions on state actions are not well designed to address situations in which state or local bodies may be participating in a market together with private actors.

The Land Code of the RF (Article 22, parts 2 and 4) treats lease of land as a contractual matter, with price to be defined by contract and the relevant relationships regulated by civil legislation together with the Land Code. This would suggest that standard civil law principles requiring a state body to be governed by the same rules as private parties in civil commerce and upholding such principles as freedom of contract would apply. These rules are based upon the general assumption that parties are equal and that their contracts and agreements are not forced and are the product of the voluntary expression of their wills. The Land Code does specifically permit the Government of the Russian Federation to establish the general bases upon which the amounts of land rent for state and locally owned land will be calculated, and the Law “On Payment for Land” (in force until January 1, 2006) states that the “corresponding body of the executive power” may establish base amounts of land rent by type of use and category of user (Article 21).

In practice, most land is still in the ownership of the Russian Federation, its constituent regions or localities and controlled by state or local bodies. And although some parts of the relevant legislation treat land lease as a freely negotiated contractual arrangement, land rents have up to the present more closely resembled a form of tax. They are in most cases a mandatory payment imposed by law upon entities and persons who possess rights in the buildings located on the land, and many of which/whom possessed such rights prior to the imposition of the land rent in its current form. For these persons and entities, avoidance of the payment by movement to another location would involve significant costs. In many locations, a general shortage of available premises and the large share of those that are on land owned or administered by the same local bodies and subject to the same type of land rent payments may mean that this is not currently an option even for those willing to incur the costs.

The competition cases concerning land rent are clearly based on this factual pattern. All of the cases are addressed under the provision of Article 7 that prohibits state bodies and officials from discriminating among those competing in a single market in a way that advantages or disadvantages some of them. Land rent is treated by the competition authority as a mandatory payment imposed by state and/or local bodies rather than a contract price voluntarily agreed to by two parties operating in a market environment. Thus, although the cases concern the rates charged by municipalities for land rent, they do not concern the effects of that differentiation on the markets for land leases. The subject of analysis is rather the effect of differentiation in land rents on competition among those who pay them. A different way to express this would be to state that the monopoly (or at least dominant) position of the municipality is presumed. In fact, however, no real presumption seems to be made. None of the initial FAS decisions that are at issue in these cases make any statement that the state body in question is acting as a monopoly or dominant lessor of land to justify their conclusion that the differentiation in rents violates Article 7 of the law. As noted in Sections II and V, above, the norms of Article 7 do not make the legality of state actions dependent upon the dominant or monopoly position of the state body, and indeed do not in any way address the possibility that state bodies might be operating as one of many participants in a market. The prohibition on discriminatory treatment of some competitors, as it is expressed in Article 7, is absolute and the FAS decisions in this group treat it in that fashion.

Another similarity in the cases is that few of the initial decisions in this group of cases make any mention at all of the purposes that are allegedly served by the differentiation in rents that is found to be illegal. As was also discussed above, the prohibition as stated in the Law is not a “least restrictive means” test. There is no provision that would allow some restriction of competition provided that it is the least amount possible to achieve a legitimate purpose that is within the responsibility of the state or local body in question. In this specific group of cases, this creates two concerns. First, it leaves very little room for state bodies and bodies of local self government to use differentiation of land rents, or equally of property tax rates or other land use fees, for legitimate purposes. Differentiation of taxes, rents or fees is, however, a tool that is widely used in other systems to allow localities to recoup the differing costs associated with differing uses of property, to control and manage the levels of public expenditure associated with various uses (traffic control, trash removal and so forth), and to preserve the value and aesthetic qualities of all property within the municipality. While it may be possible for some of the same purposes to be achieved using zoning restrictions or other tools, such tools are more likely to be restrictive of development and may also be equally subject to challenge as discriminatory.

Second, it may be difficult or impossible to apply such an absolute prohibition to the calculation of land rents, particularly during a transition period and in the absence of any reference value for the land produced by market forces. Acts that establish significantly different rents for the same amounts and types of land use by competing firms are subject to challenge as providing an undue advantage to those enjoying lower rates. The discriminatory effect of such an act, however, depends entirely upon the land plots in question being of equal value. It cannot reasonably be considered discriminatory to charge firms different prices for land plots that have different values, even if the firms in question are competitors. An act that established equal rents for land plots with very different values – for equal amounts of very poor and very

productive agricultural land, for example, or perhaps for a kiosk space on a busy corner near main public transport stops and for kiosk space on a quiet side street outside the center – could be equally subject to challenge as disadvantaging those receiving much more valuable land at the same price.²⁵ In the absence of a market for land, and therefore of an ability to assess the true market value of specific land plots or land use rights, almost any system of land rents could be challenged as discriminatory.

Finally, it should be noted that in none of the cases in this group did the competition authority present any economic analysis of the degree of restriction of competition that might result from the differentiation of land rent being addressed. Although the specific, per meter difference and the approximate difference in overall land rent payment for the alleged competitors was sometimes discussed, it was always assumed that a difference between competitors is, by definition, a restriction of competition. The amount of the difference was never compared to the cost of goods sold or profitability of the differentiated groups, either on average or with respect to specific payers. Nor is there any discussion of changes in demand for particular types of premises or other effects that may have been caused by advantageous land rent terms, nor any evidence of movement of market share to those in the privileged categories. Thus, it is impossible from the case materials to determine when the actual difference in land rent payments was at all significant for the actual groups involved. Was the discrimination threatening to drive some competitors out of business, was it the functional equivalent of paying differentiated parking fines, or did it fall somewhere in between? This absence of information on the real effects of the practice is consistent with the absence of economic analysis of the markets in question in the entire sample group overall. Here, as in the other groups of cases, it significantly weakens the competition authority's arguments, particularly in the face of what appears to be a direct legislative grant of authority to differentiate in the Law on Payment for Land.

Application of the Law – Specific Cases

Discrimination on the Basis of Ownership or Place of Registration

Examination of the types of land rent cases addressed by the competition authority provides some further illustration of the complications encountered in applying the law in this area and the questions that may remain to be addressed by legal acts and by development of practice. Perhaps the simplest example is the case concerning differentiation of land rents solely on the basis of the place of registration of the entity or individual entrepreneur paying the rent. Those registered in the municipality paid lower rents, while those from outside it paid considerably higher ones. There appears to be little or no justification for this form of differentiation except to advantage local enterprises over those based in other areas, and it would seem appropriate for such a rule to be found to be a violation without the need for significant proof of actual restriction of competition in specific markets. Indeed, discrimination of

²⁵ Article 2 of the Law “On Payment for Land” specifically lists “equalization of the socio-economic conditions for the conduct of economic activities on land of differing quality” as one of the purposes of the payment for land. In one of the cases concerning differentiated rent rates for land under kiosks and land under pavilions discussed in this section, the municipality argued that its lease rates for land had the intent and effect of equalizing conditions for economic activity between those leasing space for kiosks and those leasing space for the larger pavilions. This argument was not successful.

this type might easily be seen as a violation of the constitutional guarantees of a single economic space and of free movement of goods, services and capital within the Russian Federation. If the specification of *per se* violations by state and local bodies is considered as the new law develops, this type of discrimination would be a good candidate for inclusion in the list of *per se* violations.

The cases involving land rents set at lower rates for municipal enterprises and higher rates for other enterprises also appear at first glance to be relatively simple. Where this provision is broad and applies to enterprises engaged in competitive or potentially competitive activities, there may be little or no economic justification for this form of differentiation except to advantage municipal enterprises against competitors or potential competitors. In addition, like discrimination on the basis of place of registration, rules that favor state and municipal enterprises over privately owned firms competing in the same areas of activity would appear to violate constitutional guarantees of the equality of all forms of property. Moreover, the promotion of competitive provision of services in areas currently dominated by municipal service providers (particularly in the sphere of communal services and housing maintenance) in order to improve efficiency and moderate pricing may be an especially important policy goal, since there are widely acknowledged problems with monopolized services of this type. For these reasons, it may seem appropriate to place discrimination in favor of municipal enterprises in the same category as discrimination in favor of companies registered locally. A second glance at this category, however, suggests some complications.

For activities that are legally restricted to state or municipal providers, the analysis is not as clear. Where land is rented for the construction of housing for municipal distribution to those in need or where it is otherwise being used by the municipality for state functions or the provision of social services in which others do not compete, the establishment of advantageous rental rates should have little or no effect on competition.²⁶ While the economics of the situation might be clearer if such properties were simply not subject to rental payments at all – since that may only involve the transfer of money only from one line item of the municipal budget to another – there may be a variety of reasons (including budgeting rules and procedures and the promotion of efficient use of space by municipal departments and institutions) for a “rent” to be charged for their use by municipal bodies. And it is not at all clear that this would insulate the rules from challenge under the Law on Competition.

Similarly, situations in which the provision of a service to the public, when taken as a whole, is a loss-making endeavor and a municipal enterprise providing the service receives a subsidy are more complicated. In those instances, a blind support for the “creation of competition” by allowing private providers to enter markets at will may mean that private firms “cherry pick” the profitable services or clients, leaving the public budget to provide the loss-making parts of the service without that offset in costs. Current application of competition law rules that prohibit state and local bodies from obstructing the conduct of economic activities by firms and entrepreneurs or interfering

²⁶ As a broader policy matter, it might increase the amount of available space for rental and purchase and reduce barriers to entry if municipalities are encouraged to release even this property into the market as much as possible. This would, however, be a matter for general competition advocacy on land reform policies rather than the application of the Law on Competition in individual cases.

with their independence, however, may have precisely this effect.²⁷ Where municipal entities are providing necessary services to low-income citizens or where there is a significant social service element to their activities, a more careful approach to any special treatment may be required. Even in such situations, however, the provision of lower rental rates to municipal enterprises is a poor way to resolve the problem and may mask opportunities for competition. Alternatives may include allowing municipalities to put defined packages of services up for bid or to create some form of universal service requirement for private providers within their territories, avoiding the cherry picking problem. The complexity of the questions underscores the need for good economic analysis and a careful, rather than mechanical, approach to the issues involved.

Differentiation by Type of Structure

A second category of case involved differentiation of land rent on the basis of the type of structure placed upon it. In the sample cases, this occurred most often as a division of land rental rates for land under retail trading structures into sub-categories based on the type of structure in which the retail trade takes place. Very high rates for kiosks were typical, with significantly lower rates for retail stores in permanent buildings and perhaps a separate, middle rate for larger, semi-permanent structures. These differentiations were challenged by the competition authority on the grounds that the higher rate per square meter for kiosks disadvantages traders using them as compared to those selling the same goods in other kinds of structures, and therefore violates the prohibition in Article 7 of the Law on Competition on state actions that have discriminatory effect on some competitors in a market.

This common fact pattern raises a number of questions. One of these is the reason for the higher rates imposed upon kiosks. In defending their actions, the local government bodies in question did not identify the purpose of the distinction, relying in most cases upon general references to the legal authority specifically provided to them to differentiate rents for state and municipal property under Article 21 of the Law “On Payment for Land.” Discussion with representatives of the competition authority as well as with other persons, however, suggested a number of explanations. One of the most common was a general distaste for kiosks and a perception that they degrade the aesthetic qualities of public areas. Stated reasons for such distaste include the perception that kiosks are intrinsically unattractive or “cheap looking,” that their small interior space results in the piling of packing materials and trash in public spaces surrounding them, that the absence of running water for clean-up or sanitary facilities for staff promotes unsanitary conditions, and other similar concerns. Thus, the higher land rental for land used for kiosks could be interpreted as an attempt to discourage the use of kiosks in general or to compensate the municipality for the lowered aesthetic quality or increased costs that they impose.

In many systems, the structuring of rules (including differentiation of fees or taxes) to protect aesthetic values and discourage uses that impose costs on the municipality would be considered a legitimate task of the municipal authorities and within their powers, even if some effect on the competitive positions of various traders

²⁷ Examples include decisions requiring municipalities to allow all desiring to do so to compete on public transportation routes, and other similar occurrences.

ensued. The sphere of authority of municipal bodies is defined quite broadly (if somewhat vaguely) in Russian legislation, and municipal planning and architectural control fit easily within it. However, because the Russian competition law contains an absolute prohibition rather than a “least restrictive means” test, any restriction of competition is treated as sufficient to justify a challenge. It should be noted that this may lead to perverse results in the broader sense. A municipal rule preventing the use of kiosks entirely might well avoid the problem of differential treatment of various traders, but would certainly create a greater barrier to entry than a rule imposing higher land rents for kiosks.

A second explanation offered was that kiosks are perceived to be extremely profitable and able to pay a higher rent per square meter than the larger forms of retail structure. Under this explanation, the treatment of kiosks and other more permanent forms of retail trading space as different uses of land allows a municipality to capture more of those kiosk profits – by charging a higher rent per square meter for that small amount of space – than would be possible if the same rent per square meter must also be affordable to retail traders in much larger retail pavilions and stores. If kiosks are, in general, more profitable than other forms of trading, such a scheme might be viewed as a rough attempt to make the rental payment dependent upon the profitability of the lessee. The Law “On Payment for Land” specifically forbid this in relation to land taxes (Article 3). It is not clear, however, whether this forbids only the differentiation of land tax on the basis of profitability of individual payers, or any differentiation of land tax on the basis of the profitability of the use of the land, and the provision does not address land rents. However, if kiosks indeed generate significantly more income per square meter than do pavilions or permanent retail stores, a “kiosk space” and a “pavilion space,” defined as whole parcels, almost certainly have differing values per square meter and the setting of differing lease rates per square meter might be seen as a means to more accurately reflect the value of the leased property.

Differentiation by Product

Another form of differentiation of land rent encountered by the competition authority is differentiation on the basis of the type of product handled by a lessee of the property. Examples included differing rates for food markets and markets where other goods are sold, differentiation among sellers of various types of foods (milk products, fruits and vegetables), and special rates for sellers of specific products (construction materials, gasoline, others). The underlying reason for such differentiation was not stated in any of the cases, but appears very likely to be a perception of the ability of the various lessees to pay and/or a desire to encourage particular kinds of trade. Unlike differentiation on the basis of the type of structure that already exists or will be permitted on the land, differentiation on the basis of types of product sold seems less likely to reflect a difference in the physical characteristics or value of the land parcel itself or in the value of the real estate (land and structures) as a whole. However, because most of the distinctions of this type treat competitors dealing in a single product similarly, they can less clearly be challenged on the basis of discriminatory effects that distort competition among them, although it might conceivably alter entry/exit decisions across markets by changing the return on investment in particular sectors. And if the population of the municipality is perceived to be in need of greater provision of specific types of products that have low profitability, the provision of a benefit to all providers of such products raises again the need to define the legitimate tasks of a municipal authority and the tools available to it to achieve them.

Treatment of the Cases by the Courts

The decisions and orders of the competition authority in cases concerning differentiated land rents are routinely appealed by the municipal bodies appearing as the defendants. In all of the cases in the sample group the initial agency decision was appealed at least once, and in many the case was heard by three instances. The decisions issued by the courts in these cases varied considerably and relatively similar decisions of the competition authority concerning restriction of competition by differentiated land rents were treated quite differently by different courts. Among the cases in the sample group, there are more cassational decrees ruling against FAS than in its favor.²⁸

Given the vagueness of the law in this area and its failure to reflect the factual circumstances on the ground, it is not surprising to see some inconsistency in the application of the laws by the courts. Nor is it surprising to find that the overall balance of opinions in this area does not favor FAS. The general principles established by the Land Code (Article 22) clearly treat land leases as civil contracts with terms to be freely defined by the parties. Where the courts rely on this definition, the agreement of the lessee to pay the amount stated is viewed as voluntary and any interference in the terms as an infringement on principles of freedom of contract defined by the Civil Code and related legislation. The Civil Code is one of the most fundamental reference points for the work of the arbitrazh courts (which reviewed all but one of the relevant decisions of FAS) and its principles have a special force and familiarity for them. In order to overcome this, the competition authority must prove to the court that the contract terms are not a result of the voluntary expression of the free will of the lessees and that the differentiation constitutes a restriction of competition – a concept with which the courts are far less familiar. In other areas in which civil law concepts of freedom of contract and the restrictions placed on behavior by the Law on Competition have appeared to the courts to be in conflict or their relationship has been confusing – in particular, cases concerning abuse of dominance – the competition authority has also had to work particularly hard to overcome the reluctance of the courts to interfere in contractual terms on competition law grounds. Courts ruling against FAS in land rent cases regularly cited Article 22 of the Land Code and the principle of freedom of contract.

Courts that were willing to go beyond the general principles on freedom of contract and the right of the parties to establish lease terms and examine the overall rate structure had to address the fact that the Law “On Payment for Land” (Article 21) directly authorized state and municipal bodies to establish base rents for land depending upon the types of use and categories of user. As in the cases concerning proper land allocation procedures, territorial bodies of FAS made attempts to characterize the actions of the state bodies as nonetheless illegal in themselves. Some of them attempted to show that the municipality in question was legally required, if it was to differentiate land rents at all, to use other categories that appear in state standards or other documents, and the use of any other categories to differentiate rents was inconsistent with the law and outside the authority of the body in question. The argument that the choice made or action taken by the municipality was wrong as a matter of law does not address the issue of whether it restricted competition. But as was discussed above, the

²⁸ The case files reviewed do not show any applications for discretionary review through supervisory proceedings in the Higher Arbitrazh Court

tactic is a common one in Article 7 cases and a showing that the specific state act or action was in violation of other law is usually an attempt to convince the court that it was “groundless” and to make them more willing to support a FAS decision requiring a change, even without significant evidence of a restriction of competition. Arguments based on the illegality of the action and the mandatory use of state standards, however, appear not to have been particularly powerful with the courts in differentiated rent cases. This may be because the standards in question were clearly not designed for that purpose and could be used to support a variety of distinctions. Indeed, some municipalities also referred to different distinctions made in the same state standards to justify the categories they used.²⁹

Other territorial offices argued more simply that the state body in question, while it was authorized to distinguish rental rates based on types of use and categories of user, must observe the requirements of other federal laws, including the Law on Competition, in doing so. Therefore, it must avoid restrictions of competition or discriminatory treatment of some competitors in a market, even when otherwise exercising its powers legally. This statement of the legal principle involved, which focuses on the issue of competition rather than on an analysis of the overall legality and propriety of the state action, was referred to by several courts in decisions supporting FAS actions in this area.

Courts ruling against FAS, in addition to citation to the provisions of the Land Code and the Law “On Payment for Land,” also regularly stated that the competition authority had “failed to prove a restriction of competition.” All of such statements are general, rarely discussing the evidence the competition authority actually offered in the case and why it was not sufficient, and never indicating what the court would have found to be sufficient to prove a restriction. It can be noted, however, that in all of the differentiated rent rate cases, the legal act of the state or municipal body establishing the different rent rates for the differing categories of users was treated by FAS as a violation of the Law on Competition on its face. In its own decisions and in the arguments presented to the courts, the fact that individuals and entities falling within several of the categories of land use compete (or may compete) in a single market was clearly stated, but treated as an obvious matter not requiring statistical or other proof. The differential rent rates per square meter of land for those differing categories of renter were then cited as a clear violation of the prohibition on state acts creating discriminatory conditions of competition for some competitors in a market. In no case does any factual evidence appear to have been offered confirming the effects of the alleged discrimination (such as lower pricing by advantaged firms or movement of market share to them after the passage of the act).

Issues to be Addressed, Options for Consideration

Pending Changes in the Factual and Regulatory Situation

Laws that are now being implemented require a number of changes in the treatment of land that may have a significant effect on this category of cases. Among

²⁹ The fact that the arguments of different territorial bodies of FAS on the standards issue were not all consistent is also unlikely to have been helpful on these cases. Arguments made in Section VI about the potential problems caused by this practice will not be repeated here.

other provisions, they require that the legal status of land under many structures be regularized by the owners of the structures – either by their acquisition of the land into ownership or by their choice to conclude a lease on the land instead. Taxation will move toward the use of the value of the real estate as a whole, rather than a separate charge of tax or rent for land. The elimination of the mandatory aspect of land rent and of the artificial, per-area nature of tax payments on which land rent is currently based, as well the development of a broader market for land and premises could all help to eliminate the underlying causes of these cases. Thus, the importance of this specific type of violation in the competition law case load related to land may diminish as this process takes place.

On the other hand, there are also some reasons to doubt that this will occur immediately. The time frame legally provided for accomplishing these changes is extremely short and seems likely to prove unrealistic as a deadline for all of the necessary actions, and there are some indications that municipal bodies may be actively discouraging the purchase of land and attempting to maximize the amount that remains in lease arrangements. If the portion of land remaining in lease is significant and municipalities remain very dominant in land ownership, concerns about the competition effects of differentiated land rents may continue to arise for some time.

The anticipated changes will also significantly affect the legal analysis of any land rent cases that arise in the future. The requirement that land under existing structures be acquired either into ownership or be leased through a contract with the relevant state body will mean that the amount of land rent to be paid will have been formalized through an individual contractual agreement, strengthening the force of legal arguments that treat the terms of such contracts as voluntary expressions of the will of both parties. In addition, the law “On Payment for Land” – so often cited by courts in affirming the right of state bodies to differentiate rental rates for land on the basis of type of use and of user – will lose legal force as of January 1, 2006. This may have several effects. To the extent that the rate calculation for land rent is no longer expressed as a table of coefficients for particular types of use or user that are applied to the tax rate for the land, the ability of the competition authority to point to differentiation in those coefficients as discrimination on its face will likewise disappear. And even if a municipality continues to use the tax rate as a starting point for calculation of land rent, tax rates are scheduled to begin to move toward expression of the value of the real estate as a whole. It is not at all clear how this will affect the valuation of land rents for parcels on which the building is owned separately from the land, or the calculation of land rent for kiosks, pavilions and other temporary and semi-permanent structures placed on public land. Questions of competition distortion may still arise, but they will in general require considerably more investigation into leasing patterns and the bases for pricing, and considerably greater amounts of economic analysis than the current cases, which are brought on the basis of the coefficient list and a claim that the differentiation restricts competition on its face.

Interpretation and Enforcement of the Law on Competition

This group of cases is interesting in that it concerns a type of act by municipal bodies that they appear to have been quite directly authorized to issue by the Land Code. Despite this, some of the territorial bodies spent a significant portion of their efforts while defending their decisions before the courts attempting to use tenuous grounds to argue that the acts were themselves illegal. This was a losing strategy in

these cases and they illustrate the major problem with the habit that has developed of using alleged illegality of an action as the basis for application of the law: It keeps FAS from developing its arguments concerning the restriction of competition that occurred in the case and also tends to focus the courts away from that issue (which they find difficult) and toward the technical legality of the action in question. If FAS loses on the legality issue, it is likely to lose the case overall.

The focus on illegality of actions will also limit the ability to enforce against any type of act or action that is within the legal authority of the body taking it or issuing it. The majority of the actions of state bodies and bodies of local self government are, in fact, within their competence as generally defined. Making the technical legality of actions the focus keeps FAS' attention at the margins of their activities. FAS' must turn its focus in these cases to analysis of the competition effects of actions and its persuasive abilities in court to demonstrating those effects. In the cases in this group in which FAS most clearly presented the alleged restriction of competition – where the per-square-meter difference in rents was quantified for the court (or the difference in coefficients was very stark) and the municipality's arguments on the reason for the differentiation were directly refuted, FAS was most successful.

With respect to development of the new law, these cases raise some of the same issues already seen in the other groups. The application of the law to state and municipal bodies in situations when they participate in a market with other parties (although may remain dominant) will have to be clarified, or changes in land holding together with the clear treatment of land leases as voluntary civil law relationships by the Land Code may insulate most behavior related to transactions with land from challenge. And the question of balance of the purpose served by state action with the degree of competition restriction will also need to be addressed, to avoid pushing state and local bodies toward more restrictive policies than are required.

VIII. Demands for Payments Related to Infrastructure

Nature of the Cases

Cases in this group were quite similar in the nature of their facts, but varied somewhat in the treatment of the situation by FAS. In all of the cases, a demand was made in connection with the issuance of construction permits for a payment that was characterized as being related to infrastructure. In some cases the payment was described in a somewhat vague manner as for the construction of general infrastructure, while in most the specific infrastructure involved was specified. The cases include demands made both in instances of new construction and also instances of additions to or renovations of existing structures.

In most of the cases in this sample group, the demand for the payment or denial of a permit until the payment issue was resolved was characterized as an action of the municipality itself and the case was considered and decided by FAS on the basis of Article 7. In several of these cases, the focus of the case was a specific act issued by the municipality requiring a contract for participation in the infrastructure projects with the relevant municipal body or a written release noting payment into an infrastructure fund as a condition of the issuance of the final construction permit. Although the language of

the provisions cited was often less than clear, the case explanations suggest that the amount demanded was usually calculated as a percentage of the overall cost of the construction project, without reference to any specific use by the new structures of municipal infrastructure or additional infrastructure needs that a new development might create. In some cases, however, the municipality was unable to explain how the specific amount demanded had been calculated.

In at least one case in the sample group, the complaint focused not on the action of the municipality as such but rather on the action of the municipal water company in demanding the payment for development of infrastructure as a condition of connection to the municipal water system. That case was considered under the provisions of Article 5 concerning abuse of dominance. It should be noted that this is not an unusual type of claim under Article 5. Cases concerning similar kinds of demands made by enterprises providing electricity, gas and heat, as well as water and sewer services, have been quite common in the competition authority's Article 5 caseload for many years. Those cases have documented demands for contributions to infrastructure made in a wide variety of circumstances ranging from new construction to the conclusion of simple supply contracts.

Application of the Law, Treatment of the Cases by the Courts

Territorial offices of FAS took differing approaches and made a variety of differing arguments in their analysis of the cases. In one case a municipal act required those undertaking any kind of construction project to apply to a municipal fund to obtain a statement of their obligations and to conclude a contract with the fund in relation to "participation in the construction of general-use objects in the city." Such participation amounted in practice to an obligation to contribute 10% of the estimated cost of the work to the fund. The city included this requirement in contracts related to the construction projects and instructed that final approvals and permits were to be withheld unless evidence of execution of the contract with the fund was present. In its decision on the case, the FAS territorial body cited municipal legislation requiring that firms be allowed to choose voluntarily one of several means of contributing to general city infrastructure, including performance of related work using the firm's resources and other means, as well as contract with the fund to pay for work. FAS' attention to this other legal rule was not coincidental; that rule had recently been amended to provide for the voluntary nature of the type of participation on the basis of a prior case opened by FAS. FAS issued a decision finding the contracting rules and actions forcing the conclusion of the contract a violation of the provisions of Article 7 that prohibit interference with the independence of economic subjects. The restriction of competition that was alleged to have resulted from this act was the fact that the individual firm, being denied the ability to complete the construction project, was unable to enter the market on which it had planned to conduct activities.

When the city appealed this decision, FAS' filing focused not only on the violation of Article 7 and the municipality's own act, but also at some length on allegations that the act violated other laws. FAS argued that the act violated Article 421 of the Civil Code of the RF, which guarantees freedom of contract. It even went so far as to argue that the act placed a restriction on the rights of the firms forced to conclude a contract with the municipal fund in violation of Article 55 of the Constitution, which allows restriction of constitutional rights only for the purpose and to the extent that this

is necessary to achieve specifically listed goals. The court of first instance, in a very short opinion, upheld FAS, specifically citing the violation of Article 421 of the Civil Code as being of concern.

In other cases the territorial body of FAS characterized the violation committed by the municipality in demanding payment as “groundless obstruction of the activities” of the complaining parties, focusing again on the legality of the demands themselves rather than on the competition effects. For example, in two cases concerning reconstruction and addition of a floor to existing buildings, FAS presented in court filings a well written analysis of the legislation on the basis of which the municipality claimed the right to demand payment. It pointed out that the provisions of the Planning Code provided for participation in infrastructure projects “by agreement” and that no other legislation provided for mandatory contracts for such purposes. It went on to argue that civil legislation does not permit the forced conclusion of contracts except in instances specifically provided for by law, and that the refusal of the city to issue construction permits without an infrastructure agreement was therefore illegal, and must be considered a groundless obstruction of the activities of the firms seeking the permits. The city argued that Article 7, and indeed the entire Law on Competition, were not applicable to the situation, since the refusal of the construction permits did not have any effect on competition. FAS responded that any cost or other problem caused to a firm by the improper action of a state body affects its ability to compete, and therefore restricts competition on the market in which the injured firm competes. The first instance courts in both cases upheld FAS’ decisions. The case files in the sample materials indicate that both cases were appealed further, but do not contain the court decisions on those appeals.

A third approach was the treatment of infrastructure charges differentiated by type of construction and by identity of payer as discrimination providing advantages to some competitors over others. In this instance, a statute issued by the municipality defined the amount of contribution to infrastructure as a percentage of the cost of the work, imposing a lower percentage on housing construction than on other types. In addition, municipal organizations were released entirely from payment for infrastructure, as were a number of other types of organizations providing particular services. The territorial body of FAS also argued that the infrastructure charge was itself illegal, as it constituted a tax or fee and was not one of the specific taxes and fees that federal law defines as permissible for use by local self government. No analysis of the actual restriction of competition was made, nor any significant argument on that issue other than the notation of the differing treatment of various payers. Both the court of first instance and the cassational court agreed with FAS, both focusing heavily on the illegality of the charge overall as a violation of the legislation on taxes and fees and giving little or no attention to the question of restriction of competition.

Issues to be Addressed, Options for Consideration

Definition of Infrastructure

The discussion of charges covering the creation and maintenance of infrastructure is complicated first of all by the lack of either a definition or a consistent factual situation in municipalities that would make it clear exactly what is being discussed. The word in common usage appears to have meaning as broad and varied in

Russian as does the English term, being used in the more direct sense to refer to items physically supporting a particular function as well as by analogy in a much broader sense to indicate any kind of a supporting network (e.g. a discussion of the “infrastructure” of organized crime). Legal acts at various levels refer in some cases simply to “infrastructure” and in others to engineering infrastructure, transportation infrastructure, and other forms of infrastructure. The payments demanded in several of the cases in this group were said to be intended to finance “general use infrastructure” (‘общегородская инфраструктура’), but no distinction was made between what would qualify as “general use” and what would not, nor was the financing mechanism for any other kind of infrastructure mentioned. And while the broad term used in some of the cases might suggest such items as parks, roads and other city facilities broadly used by the public, in many cases the municipalities justified the charges in court not by reference to those items but rather to the “additional burden” that construction projects would place on specific utilities infrastructure.

Like the phrasing used in the documents, the apparent destination of infrastructure payments also varied. In some instances, “infrastructure charges” were to be paid into a fund or to a city body that appeared to have a very general profile. These funds or bodies, judging from the limited information provided, would seem to be capable of financing or undertaking directly a very wide variety of projects. The construction of housing or other municipal structures was suggested by the name of one fund, while others gave no indication as to purpose. In some, however, the collector of the payment was more clearly specialized, and in one case in the sample (although many more in the overall caseload of the authority) the demand for money for infrastructure development was made directly by the city water enterprise for support specifically of infrastructure related to its operations.

In seeking appropriate ways for “infrastructure charges” to be dealt with, it is quite important for the actual nature of the charges and the destination of the funds to be understood. “Municipal infrastructure” may be understood very broadly – perhaps to include housing, municipal buildings, and other items – and the funds from “infrastructure charges” may go to a general purpose entity or into the general municipal budget. In this case, “infrastructure charges” are effectively a general source of budgetary income to the municipality. If “infrastructure” is understood quite narrowly and the funds from infrastructure charges go directly to an entity providing utility services, then the charges may need to be evaluated as additional payments made to an entity that is subject to a regulatory regime. The incentives of the municipality and of other participants in these relationships, as well as the analysis of any competition issues, depend on a these factors. For this reason, it would certainly be appropriate for FAS and other bodies to advocate greater clarity in legislation and regulations related to the sources for infrastructure funding, the nature of infrastructure to be funded, and the proper use of the funds.

Infrastructure Charges and Regulation of Monopoly Utility Services

A second source of complexity is the close relationship of the “infrastructure payments” issue to problems with regulated monopoly utility providers that have plagued both their customers and the Russian competition authority for years. Municipalities in some locations own and operate not only systems for provision of localized utility services, such as water and sewer or heat, but also general transmission networks for electricity and gas provision to city residents and to business users. Clarity

and appropriate rules for the treatment of both types of “infrastructure” are vital to making broader reform plans work.

While prices for monopolized utility services to end-use purchasers are, in general, regulated, the Law “On Natural Monopolies” is quite narrow in its reach and allows regulation of pricing and some investment issues by a tariff setting body, but does not cover issues such as universal service obligations and quality of service, nor the specifics of contract terms to be used with customers. As a result, the competition authority has been responsible under Article 5’s provisions on abuse of dominance for responding to complaints about sharp practices by utilities providers, including punitive sanctions for late payments or usage over estimates and other similar matters. A subgroup of such cases have concerned various attempts by dominant or monopoly utilities to impose separate charges on customers in relation to the building, maintenance or repair of infrastructure. The separation of the tariff setting body from the body resolving questions about imposition of infrastructure costs, as well as the limited mandate of the tariff setting body, have resulted in some disagreements and lack of clarity about precisely which costs of utility providers should be (and in some cases which have actually been) included in tariff rate calculations. In the absence of clear pricing models, it is difficult to determine when demands for separate payments for infrastructure related to construction concern costs not addressed by the tariff regulator and when they represent “double dipping” by the utility provider – in these cases the municipality or a municipal enterprise.

In addition to questions of proper tariff regulation, the competition authority has regularly encountered problems with the relationship between two parties involved in utility provision – monopoly transmission networks for utilities and the dominant or monopoly suppliers of the utility product or service transmitted. In effect, a process of the multiplication of utility monopolies has been taking place for some time. This refers not only to the separation of transmission functions from the provision of the gas, electricity, heat or other good itself, but also to the separation of regional or municipal transmission networks (or those serving even smaller areas) from the main transmission networks. These local networks are in many cases defined either directly as municipal property or as the property of a separate municipal enterprise.

An example of some of the potential problems produced by this separation is a case that was reviewed by the competition authority under the rules concerning merger control. A local energy generation company was fined for failure to obtain preliminary approval for a transaction by which it acquired the city transmission network from the municipal authorities. In addition to the imposition of the fine, the territorial office of the competition authority ordered that the transaction be voided and the property returned to the municipality. The energy generator appealed the decision on the grounds that it was not covered by the relevant provisions of the Law on Competition, but lost in all instances. It nonetheless failed to return the network and the competition authority sought a court order forcing it to do so. Again the energy company appealed the order, this time primarily on procedural grounds, but again lost in all instances. The case materials indicate that the municipal enterprise which previously operated the transmission network was indebted to the generator for purchased electricity for considerably more than the entire estimated value of the network. The network was alleged to be in dire need of maintenance that had not been performed due to the financial condition of the municipal enterprise and of the city itself. It was certainly

correct for the competition authority to find that the possession of the network by the dominant generation company would strengthen its dominance and might well allow it to prevent competition for energy generation. On the other hand, it was not at all clear from the case materials what the prospects for such competition were, and there does not appear to have been any inquiry into what the practical result of the return of the network into the city's ownership and management would be in terms of the city's ability to maintain electrical service and to meet its financial obligations to the generation company.

In most countries that have undertaken regulatory reform in the energy sphere, this has taken place through the separation of generation and transmission functions and the deregulation of generation, allowing competition to supply power to customers through a regulated network or "grid." In the majority of cases, the first market to be deregulated has been the wholesale market – in which competition to supply large customers is reasonably easy to develop as long as the required transmission capacity exists. Even in many of the countries that have moved furthest along this reform path, the supply of energy to individual consumers for home use and to smaller commercial end-users is not yet completely deregulated. Creation of competition to supply smaller scale energy users is more complicated and smaller customers are far less able to manage the disruptions in pricing or supply that may result from a poorly managed transition. Russia has adopted a plan of privatization and deregulation in the energy sphere that is similar in its outline. That plan has only recently been put into place, and significant steps remain to be completed at the national level. Nonetheless, as the example case illustrates, the *de facto* separation of transmission networks and pipelines from production of the product transmitted through them is already occurring at local levels. This may create a situation in which the supply of the good to local end users requires the services of not one but two monopolists, who must agree either with one another or both with the customer.

The competition authority has seen many cases, usually under Article 5's provisions on abuse of dominance rather than under the provisions on state actions, in which disputes between the two dominant entities have effectively resulted in abuse of end users. For example, both entities may insist upon being the billing entity to end users for the utility services, or refusal of the transmission network to add new subscribers or subdivide service on a line may lead to the utility provider being unable to supply a customer under a direct contract. In a number of these cases, the underlying problem can be traced to budgetary problems on the part of the municipality or municipal enterprise running the network, and the consequent presence of back debts, settlement disputes and deferred maintenance issues. From the point of view of deregulation of the electricity market, the best answer might be for the municipal networks to be properly regulated as natural monopolies and for the regulator to approve appropriate charges for transmission allowing the network to cover appropriate operating and maintenance costs. From the point of view of practicality, however, the regulatory system is not at all prepared to take on the task of regulating a multitude of separate entities running distribution networks in municipalities – each with its own cost structures. This is to say nothing of how quickly and by what formula such charges are to be imposed on local end-users, how they are to be collected and who will be responsible for reimbursement to the network operator of costs not covered.

Pending Changes and Opportunities

The changes in local self government that are currently under way seem certain to complicate these issues further. The new, much smaller municipal formations are intended to be responsible for the maintenance of infrastructure on their territories, and it appears that the parts of the networks that were previously the property of larger units of local self government will now become the property of the smaller municipalities,³⁰ creating many new “monopolists” operating small parts of the network. As small parts of the transmission network move out of the possession of entities engaged in the generation and/or transmission of power as their primary business activity, regulation becomes far more complex and may be hampered by claims of legal autonomy on the part of municipalities in controlling their budgets and activities. For a regulatory reform based on competition in generation and supply to work well, transmission of power (or fuel) purchased from a particular generator (supplier) must be smooth and well-regulated. The costs and complexities of dealing with a disaggregated system of network ownership and maintenance – in regulatory complexity, in the accompanying dispute resolution costs, in contracting costs among municipalities, and in the likelihood of regulatory avoidance and failure – may spell disaster at the later stages of reform in gas and electricity provision. And for services such as heat and water supply that are more local in nature, the division of the assets used to supply them may produce analogous problems. In the absence of sensible regulation of the relationships involved, FAS may be faced with a substantial expansion of complaints about “abuse of monopoly position” by financially challenged municipalities and municipal enterprises.

Concerns about these kinds of potential problems, among others, led to the recent passage by the Duma on first reading of a draft law delaying the entry of the relevant law into force – currently scheduled for January 1, 2006 – for several years. While the Government has made its disagreement with the proposed delay clear, it has also indicated that it may not oppose some significant changes to the pattern of reform, including the enlargement of the municipalities and changes in their sources of budgetary income.³¹ Uncertainty concerning the final contours of the reform will make it more difficult to predict precisely how the powers and incentives of municipal bodies will change and may complicate FAS’ task in planning to address cases in this area. The reopening of the reform scheme for reconsideration and amendment, however, offers an excellent opportunity for FAS to advocate both for greater clarity in the rules concerning municipal behavior in relation to infrastructure and for the choice of structures that support, rather than suppress, entry and that support, rather than restrict, competition. FAS has some valuable information to contribute to the debate concerning the kinds of problems that the competition authority has encountered during years of reaction to complaints in the sphere of utilities provision and the kinds of problems that poor planning and a multiplication of monopolies may cause. It may be appropriate for

³⁰ The treatment of the physical elements that make up transmission networks as if they were land, buildings or any other property – to be assigned based on their location to the municipality in which they are located – is also problematic. If financially strapped municipalities are able to sell this property on to other owners, serious complications will result.

³¹ Discussions of sources of income for municipal budgets seem to have included the possibility that municipalities could become involved in commercial activities. While not the subject of this report, a change that permitted the new municipal formations to become directly involved in commercial activity in order to fund the general budget would certainly be cause for concern by the competition authority.

FAS to consider working with other relevant bodies to develop proposals that could garner broad support.

Application of the Law on Competition

Cases in this group, like those in Section VII, emphasize the need for a clear definition of the instances in which it is appropriate for FAS to intervene concerning improper behavior by state enterprises and the purposes for which it is intervening. In each of the cases in this group, the improper state behavior concerned a single enterprise and arguments concerning the restriction of competition by that behavior are problematic to say the least. In effect, FAS is not reacting in these cases to a restriction of competition by the act or action of the municipality, but rather is protecting individual enterprises from a municipality's use of its monopoly on construction permitting to enforce demands for contributions to infrastructure costs. If there is evidence that abuses are widespread and that this kind of behavior is having a major effect on entry or business development, it would be appropriate for FAS to present this evidence as the grounds for advocating better regulation and/or other solutions. The potential for cases of this kind to multiply and to cause confusion in the area of regulation of utility monopolies and, correspondingly, in FAS' Article 5 case load, would be another grounds for FAS to seek solutions in this area. It is preferable, however, for FAS to openly state these reasons for seeking solutions to these kinds of problems, as the arguments for a restriction of competition in the specific case are likely to cause the problems discussed in Section II, above.

The characterization of these cases as abuse of a monopoly on permitting suggests that clarification of the application of Article 5 to state and local bodies might also be helpful in addressing this type of case. Where a state or local body is serving in the place of a utility provider, it may be appropriate for at least some of the restrictions placed on the behavior of other dominant utility providers to apply to its actions. This may be a part of a larger clarification of how the Law on Competition is to apply to state bodies in relation to actions that are not intrinsically related to the functions of state or municipal government, the need for which has been discussed above.

The real problem encountered in these cases, however, appears not to be one of application of the Law on Competition, but rather of inadequate regulation on the issue of how various infrastructure costs are to be funded. Even if the application of the Law on Competition to some of the aspects of the cases were clarified, it will not be practical for the competition authority to resolve large numbers of disputes among municipalities or between municipalities and utility providers (and their customers) concerning cost sharing, contracting and payments. Nor will it be desirable for the competition authority to sort through municipal budgeting and expenditure to determine when the municipality is serving as a dominant utility provider and what income and expenditures are related to that function. Clear legislative regulation concerning municipal activities in these areas would avoid much of the need for these, allowing the competition authority to concentrate on other matters.

IX. Effect of the Pending New Law on Competition

A new competition law is currently making its way through the legislative passage process, having been passed at the first reading stage by the State Duma in July.

At present, its provisions on the acts and actions of state and local bodies read as follows:

Article 10. Acts and Actions of the Central Bank of the Russian Federation, Federal Bodies of Executive Power, Bodies of State Power of Subjects of the Russian Federation, Bodies of Local Self Government and Other Bodies or Organizations Carrying Out the functions of the Stated Bodies of Power or Bodies of Local Self Government ³²

1. The Central Bank of the Russian Federation (with the exception of instances envisioned by federal laws), federal bodies of executive power, bodies of state power of the subjects of the Russian Federation, bodies of local self government, and other bodies carrying out the functions of the stated bodies of power or bodies of local self government shall be forbidden to adopt acts and/or to commit actions (omissions) that have or may have as their result the prevention, restriction or elimination of competition. In particular, the following shall be prohibited:

- imposition of restrictions on the creation of new economic subjects in any sphere of activity, as well as establishment of prohibitions on the conduct of specific types of activity or production of specific types of goods, with the exception of instances envisioned by federal laws;
- groundless obstruction of the conduct of activities by economic subjects in any sphere whatever;
- establishment of prohibitions on the free movement of goods from one region of the Russian Federation (republic, territory, region, raion, city, raion within a city) into another;
- restriction by other means of the rights of economic subjects to sell (acquire, purchase, exchange) goods, with the exception of instances established by federal law;
- issuance of instructions to economic subjects concerning the priority supply of goods (performance of work, provision of services) to a specific group of purchasers (customers) or on the priority conclusion of contracts, with the exception of instances envisioned by federal laws;
- establishment of restrictions for purchasers of goods (work, services) in the selection of economic subjects that produce (perform, provide) them, with the exception of instances established by the legislation on the placement of orders.

2. It shall be prohibited to delegate the authorities of bodies of state power of the subjects of the Russian Federation, bodies of local self government, the exercise of which has or may have as its result the prevention, restriction or elimination of competition, with the exception of circumstances established by federal law.

It shall be prohibited to combine the functions of federal bodies of executive power, bodies of executive power of the subjects of the Russian Federation,

³² Draft as published on the website of the Federal Antimonopoly Service.

bodies of local self government or other bodies delegated the functions or rights of the stated bodies with the functions of economic subjects, as well as to delegate to economic subjects the functions and rights of the stated bodies or organizations, including the functions and rights of the bodies of state supervision and oversight, with the exception of instances established by federal laws, edicts of the President of the Russian Federation and decrees of the Government of the Russian Federation.

This draft text is very similar to the text of Article 7 of the Law on Competition currently in effect. There are, however, a few differences that deserve comment in light of the cases discussed above.

In the first paragraph of Article 10 of the draft law, reference to infringement on the interests of economic subjects has been eliminated. Now, in order to qualify as a violation of the law, the acts or actions of state or local bodies must prevent, restrict or eliminate competition. This could prove to be a very important change if it had the effect of moving enforcement practice away from provision of remedies to specific firms against improper actions of state bodies and toward a concentration on the effects of state and local actions on competition as whole in the relevant market. The results of the 2002 amendment to the Law on Competition, however, suggest caution in evaluating the likely effect of this change in the language of the law. Since that amendment came into effect, it has in theory been necessary for the competition authority to find that an act or action of a state or local body prevents, restricts or eliminates competition in order for it to enforce the law against it. This does not appear to have significantly reduced the tendency to react to the complaints of individual firms. Indeed, as discussed above, it appears to have instead led to distortions of the definition of what constitutes a restriction of competition. The complete removal of reference to infringement on the rights or interests of economic subjects is certainly a stronger change than that previously made. But it will have little effect on the case load and practices of the competition authority unless the broad definition of a restriction of competition discussed above is rejected and significant effort is put into improving economic analysis in this type of case.

Another change in the text of the draft article is the elimination of the general reference in the first paragraph to the “creation of discriminatory conditions for the economic activity of specific economic subjects” and also of the sub point that specifically prohibits state and local bodies from providing advantages to one or several economic subjects, without grounds, that places them in a privileged position in relation to others working on the same market. This is interesting, since a number of the cases reviewed for this report cited discriminatory effect and/or that sub point in particular as the basis for finding the act or action in question to be a violation, and it appears to account for a not insignificant proportion of the overall Article 7 case load. The explanatory notes to the draft law do not specifically discuss the removal of the reference in the first paragraph or the sub point, but do note that the requirement in the currently effective law that acts providing privileges or advantages to particular economic subjects be agreed with the competition authority was eliminated. This is explained by the decision to address these issues under new rules concerning “state aids,” and it is likely that the same reasoning accounts for the elimination of the other references as well.

It may be noted that traditional notions of “state aids” would cover subsidies and advantages in taxes and fees, but may not include all of the kinds of discrimination that have been addressed using the language of the existing law. Several of the cases concerning requirements that petitioners for land use a specific enterprise to obtain certain services were decided under that provision, as well as the case concerning the provision of an exclusive short-term lease to one of many bidders for land for construction. Most of these cases will arguably fall under other sub points in the draft (and some could have been considered under other sub points of the existing law). A requirement that firms purchase services from a specific firm, for example, would violate the draft law’s prohibition on interference with the rights of economic subjects to purchase and sell goods and services. Rules that provide a procedural advantage, however, may not fall within the new language of the draft. It may be appropriate to give some consideration, on the basis of a broader selection of cases under Article 7, to whether significant competition problems fall in that category and may be outside the reach of the new law.

Finally, there is one way in which the draft language remains the same as currently effective law that also deserves comment. The draft law still contains a reference to “groundless obstruction of the activities of economic subjects in any sphere whatever” as a specific act or action of state or local bodies that is prohibited. This is an extremely broad formulation that has in the past provided the rationale for many of the cases in which the competition authority addresses what amount to specific disputes between an economic subject and a state or local body. While the likelihood of a restriction of competition as a result of the behavior described in each of the other sub points of the draft law is clear, the “groundless obstruction” language seems to focus more on general bad behavior that may or may not have any competition effect. There is, of course, the requirement in the first paragraph of the draft provision that the act or action prevent, restrict or eliminate competition. This requirement exists in the currently effective legislation as well, however, and it has not prevented the competition authority from relying on the “groundless obstruction” language to issue decisions about a late response by local authorities to the petition of a single firm or other matters that do not at all appear to implicate competition in the relevant market as a whole. Consideration should be given to elimination of this sub point or its replacement with language more clearly indicating the competition problem that is meant to be avoided.

The inclusion of this sub point in the draft might be interpreted as indicating a desire to have the competition authority continue to take action against acts and actions of state and local bodies that clearly affect one or more specific competitors, but do not necessarily have any significant effect on competition overall in the relevant market. Examples of such acts and actions are refusal to issue a decision on a petition for allocation of land within the legally prescribed time or a denial to a specific petitioner, imposition on a specific enterprise of an inappropriate or unjustified fee, and other similar actions that appear repeatedly in the case records under Article 7 of the currently effective Law on Competition. A decision on whether this kind of enforcement activity should continue is key to the design of the new law.

Each of the individual acts or actions previously addressed under the “groundless obstruction” provisions of the law may prevent a particular competitor from competing or raise its costs, but absent other circumstances is unlikely to have an effect on competition in the relevant market. This does not mean that such behavior has no

larger effect on the economy. Some studies and polls indicate that problems with this kind of generally obstructive behavior by state and local bodies and officials – sometimes connected with corruption but also with biases or capacity problems – is a serious concern for business overall and may be preventing or delaying entry into various markets and thereby retarding economic growth and slowing the development of robust competition. But this broad effect is not the kind of “prevention, restriction or elimination of competition” that the Law on Competition is currently designed to address. The competition authority cannot be responsible for remedying a general absence of necessary regulation, of capacity or of legality in the behavior of state and local bodies by the use of case-by-case enforcement. Most of these broader problems should be addressed, if they are addressed at all by the competition authority, by competition advocacy activities and active cooperation with other state bodies to identify and remedy the causes.

If the competition authority is, nonetheless, going to attempt to address some of these problems, one means to do so in a more directed manner might be to create an ability to react not to single instances of infringement on the interests of a specific economic subject, but rather to patterns or practices of such infringements by state or local bodies or officials that may have a more significant effect on competition in the relevant market. This would require that the competition authority be able to investigate, on the basis of complaints or information from firms and entrepreneurs and the records of the bodies involved, whether a pattern of behavior by those bodies had the effect of protecting incumbent and/or local firms, or otherwise restricting competition. Single instances of bad behavior that affected only a single firm would, however, be sent on to other bodies (the procuracy, the courts, business advocacy groups) for resolution. This would require a separate article in the new law, defining the kinds of effects that would justify intervention by the competition authority, but leaving the list of bad behavior that gave rise to the effects more open. Other options might include the creation of a multi-body panel or tribunal that would address claims by businesses about the “groundless obstruction” of their activities by a state or local body, as discussed in Section VI for land allocation issues.