

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 20-F/A

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
for the fiscal year ended December 31, 2001

Commission file number 1-14748

OPEN JOINT STOCK COMPANY OF  
LONG DISTANCE AND INTERNATIONAL  
TELECOMMUNICATIONS ROSTELECOM  
Doing Business as Rostelecom

*(Exact name of Registrant as specified in its charter)*

THE RUSSIAN FEDERATION

*(Jurisdiction of incorporation or organization)*

14 1<sup>ST</sup> TVERSKAYA-YAMSKAYA STR.  
125047 MOSCOW, RUSSIA

*(Address of principal executive offices)*

Securities registered or to be registered pursuant to Section 12(b) of the Act.

<u>Title of each class of securities</u>	<u>Name of each exchange on which registered</u>
Ordinary shares, nominal value 0.0025 rubles per share, represented by American Depositary Shares, each of which represents six ordinary shares of Rostelecom	The New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act:  
None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:  
None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

Ordinary shares issued and outstanding: 728,696,320 ordinary shares, nominal value 0.0025 Russian rubles per share

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

This Amendment ("Amendment") to the Annual Report on Form 20-F for the year ended December 31, 2001 (the "2001 Form 20-F") of Open Joint Stock Company of Long Distance and International Telecommunications Rostelecom ("Rostelecom") amends the 2001 Form 20-F filed by Rostelecom with the U.S. Securities and Exchange Commission (the "SEC") on July 1, 2002. This Amendment is being filed by Rostelecom with the SEC in accordance with, and reliance upon, the SEC's Release No. 34-45589 dated March 18, 2002 (*Temporary Final Rule and Final Rule: Requirements for Arthur Andersen LLP Auditing Clients*) ("Release No. 34-45589") and contains the consolidated financial statements of Rostelecom for the year ended December 31, 2001 audited by Ernst & Young (CIS) Limited and the consolidated financial statements of Rostelecom for the years ended December 31, 2000 and 1999, audited by ZAO PricewaterhouseCoopers Audit. The information (financial and other) and the audited consolidated financial statements of Rostelecom contained in this Amendment supercede and replace the information (financial and other) contained in (1) the 2001 Form 20-F filed with the SEC by Rostelecom on July 1, 2002 (other than with respect to the exhibits contained in that filing) and (2) the unaudited consolidated financial statements for the year ended December 31, 2001 of Rostelecom contained in Rostelecom's Form 6-K dated May 15, 2002.

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## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this document are "forward-looking statements" within the meaning of the U.S. federal securities laws and are intended to be covered by the safe harbors created thereby.

Those forward-looking statements include, but are not limited to:

- the Company's expectations as to the decrease in its indebtedness under credits and loans;
- the Company's anticipated capital expenditures;
- the Company's plans to construct and modernize its network;
- the Company's plans relating to the expansion of the range of its services;
- the Company's plans concerning the restructuring of its branch network;
- the Company's expectations as to pricing of its services;
- the Company's expectations as to its position in the telecommunications market;
- the Company's expectations as to the future of the telecommunications industry and the regulation of the telecommunications industry; and
- other statements regarding matters that are not historical facts.

These forward-looking statements are subject to risks, uncertainties and other factors, which could cause actual results to differ materially from those expressed or implied by these forward-looking statements. These risks, uncertainties and other factors include:

- risks relating to changes in political, economic and social conditions in Russia;
- risks relating to Russian legislation, regulation and taxation, including laws, regulations, decrees and decisions governing the Russian telecommunications industry and currency and exchange controls relating to Russian entities and their official interpretation by regulatory bodies;
- risks relating to the Company, including demand for and market acceptance of, its services and competitive pressure; and
- other risks and uncertainties.

Many of these factors are beyond the Company's ability to control or predict. Given these and other uncertainties, readers are cautioned not to place undue reliance on any of the forward-looking statements contained herein or otherwise. The Company does not undertake any obligation to release publicly any revisions to these forward-looking statements (which speak only as of the date hereof) to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, except as maybe required under applicable securities laws.

## PART I

### **Item 1. Identity of Directors, Senior Management and Advisers**

Not applicable

### **Item 2. Offer Statistics and Expected Timetable**

Not applicable

### **Item 3. Key Information**

Open Joint Stock Company of Long Distance and International Telecommunications Rostelecom is incorporated as an open joint stock corporation organized under the laws of the Russian Federation. As used in this Annual Report, "OAO Rostelecom", "Rostelecom" or the "Company" refers to Open Joint Stock Company of Long Distance and International Telecommunications Rostelecom and "the Group" refers to the Company and its subsidiary, OAO RTC-Leasing ("RTC-Leasing").

Rostelecom publishes its financial statements in Russian rubles. In this Annual Report, references to "RUR", "Rbl" and "rubles" are to Russian rubles and references to "U.S.\$", "\$" and "U.S. dollars" are to United States dollars. All RUR figures, unless otherwise indicated, have been restated into real ruble purchasing power as of December 31, 2001. In addition, for convenience only (except where noted otherwise), certain RUR figures have been translated into U.S. dollars at the rate of RUR 30.14 = \$1.00, converted at the Date of Exchange Rate (published by the Central Bank of the Russian Federation, referred to in this Annual Report as the "Central Bank") effective on December 31, 2001. These translations should not be construed as a representation that the RUR amounts actually represent such U.S. dollar amounts or could be converted into U.S. dollars at the rate indicated. The ruble is not a convertible currency outside the territory of the Russian Federation. See Item 10.D.— "Exchange Controls."

#### **3.A. Selected Financial Data**

The selected financial data as of and for the years ended December 31, 2001, 2000, 1999, 1998 and 1997 presented below have been derived from, and are qualified by reference to, the consolidated financial statements including the notes thereto, of Rostelecom and its subsidiary (the "Group") included elsewhere in this Form 20-F. The Group's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The information below should be read in conjunction with Item 5.- "Operating and Financial Review and Prospects" and the consolidated financial statements and the notes thereto appearing elsewhere herein.

In accordance with IAS 29, the financial information as of December 2001, 2000, 1999, 1998 and 1997 has been restated in constant Russian rubles as of December 31, 2001 to take into account the effects of Russian inflation as determined by movements in the General Price Index. See Note 4 to the Consolidated Financial Statements for the year ended December 31, 2001 for more information on the methodology of such restatement.

IFRS differs in certain significant respects from accounting principles generally accepted in the United States ("US GAAP"). For a discussion of the principal differences between IFRS and US GAAP as they relate to Rostelecom, see Note 32 to the Consolidated Financial Statements. In addition, the valuation of certain property, plant and equipment described in Note 5 to the Consolidated Financial Statements for the year ended December 31, 2001 represent a departure from US GAAP that has not been quantified in the reconciliation to US GAAP or reflected in the US GAAP amounts shown below because, prior to January 1, 1994, the Company's

predecessor did not maintain sufficiently detailed historical cost records to enable the original historical costs of the assets now employed by the Company to be determined with sufficient accuracy.

The following selected financial data are expressed in millions of constant rubles as of December 31, 2001 purchasing power, except per share amounts and revenue per employee which are expressed in constant rubles.

**STATEMENT OF OPERATIONS FOR THE YEARS 1997-2001 ENDED DECEMBER 31**

	For the Years Ended December 31				
	<u>2001</u> <u>(restated)<sup>(1)</sup></u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
<b>Revenue from local operators</b>					
Telephone – international	4,659	3,549	3,316	2,063	1,429
Telephone – national	4,357	4,059	4,118	8,069	8,884
Other income from local operators	2,569	3,038	2,510	3,751	2,777
	<u>11,585</u>	<u>10,646</u>	<u>9,944</u>	<u>13,883</u>	<u>13,090</u>
<b>Revenue from subscribers</b>					
Telephone – international	4,301	5,488	6,465	3,799	4,437
Telephone – national	3,211	3,509	3,331	6,751	7,555
	<u>7,512</u>	<u>8,997</u>	<u>9,796</u>	<u>10,550</u>	<u>11,992</u>
<b>Revenue from foreign operators</b>					
Telephone	5,227	7,060	9,932	9,460	7,638
Telex, telegraph and other	725	1,505	2,073	1,346	1,347
	<u>5,952</u>	<u>8,565</u>	<u>12,005</u>	<u>10,806</u>	<u>8,985</u>
<b>Other revenue</b>	<u>1,244</u>	<u>1,399</u>	<u>1,009</u>	<u>276</u>	<u>263</u>
<b>Total Revenue</b>	<b><u>26,293</u></b>	<b><u>29,607</u></b>	<b><u>32,754</u></b>	<b><u>35,515</u></b>	<b><u>34,330</u></b>
Wages, salaries, other benefits and payroll taxes	3,368	3,657	2,898	3,995	4,771
Depreciation	6,946	6,625	5,744	6,090	6,162
Impairment of property, plant and equipment	-	-	-	8,046	-
Charges by network operators – international	6,461	7,944	10,217	8,674	7,296
Charges by network operators – national	1,902	1,975	2,083	3,137	2,593
Other operating expenses	5,339	6,497	6,391	8,229	7,683
<b>Total operating expenses</b>	<b><u>24,016</u></b>	<b><u>26,698</u></b>	<b><u>27,333</u></b>	<b><u>38,171</u></b>	<b><u>28,505</u></b>
Operating profit	2,277	2,909	5,421	(2,656)	5,825
<b>(Loss) /Gain from associates (excluding related tax)</b>	<u>(30)</u>	<u>551</u>	<u>333</u>	<u>164</u>	<u>573</u>
<b>Net interest and other non-operating items, including gain/loss on monetary position</b>	1,271	(144)	(1,214)	(15,217)	314
<b>Income before tax and minority interest</b>	<b>3,518</b>	<b>3,316</b>	<b>4,540</b>	<b>(17,709)</b>	<b>6,712</b>
<b>Income tax benefit /(expense)</b>	<u>765</u>	<u>(4,420)</u>	<u>(306)</u>	<u>(7,347)</u>	<u>(5,380)</u>
<b>Income /(loss) after taxation</b>	<b>4,283</b>	<b>(1,104)</b>	<b>4,234</b>	<b>(25,056)</b>	<b>1,332</b>
<b>Minority interest</b>	<u>(281)</u>	<u>(1,033)</u>	<u>(295)</u>	-	-

	For the Years Ended December 31				
	<u>2001</u> <u>(restated)<sup>(1)</sup></u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
<b>Net income /(loss)</b>	<u>4,002</u>	<u>(2,137)</u>	<u>3,939</u>	<u>(25,056)</u>	<u>1,332</u>
Earnings /(loss) per share – basic and diluted (rubles)	<u>5.34</u>	<u>(3.34)</u>	<u>5.05</u>	<u>(34.75)</u>	<u>1.24</u>
Earnings /(loss) per ADS – basic and diluted (rubles) <sup>(2)</sup>	<u>32.04</u>	<u>(20.03)</u>	<u>30.30</u>	<u>(208.53)</u>	<u>7.41</u>
Per share dividend on preferred share (rubles) <sup>(3)</sup>	<u>0.45</u>	<u>0.96</u>	=	=	<u>1.71</u>
Per share dividend on ordinary share (rubles) <sup>(3)</sup>	<u>0.17</u>	<u>0.19</u>	=	=	<u>0.25</u>
<b>Amounts in accordance with US GAAP</b>					
Total revenues	26,293	29,607	32,754	35,515	34,330
Operating income	1,779	2,886	4,938	4,534	5,933
Net income /(loss)	3,873	(2,731)	3,310	(19,351)	1,397
Earnings /(loss) per share – basic and diluted (rubles)	5.17	(4.21)	3.67	(28.33)	1.37
Earnings /(loss) per ADS – basic and diluted (rubles) <sup>(2)</sup>	31.02	(25.24)	22.03	(169.96)	8.20
<b>BALANCE SHEET DATA</b>					
<b>Amounts in accordance with IFRS</b>					
Non-current assets	56,106	62,245	63,469	64,177	70,463
Current assets	12,732	10,796	13,603	12,393	14,062
Total assets	<u>68,838</u>	<u>73,041</u>	<u>77,072</u>	<u>76,570</u>	<u>84,525</u>
Total shareholders' equity and minority interest	44,025	39,908	41,372	37,140	61,837
Current liabilities	13,765	14,493	16,540	13,071	8,972
Non-current liabilities	1,277	5,369	8,186	13,990	7,214
Deferred tax liability	9,771	13,271	10,974	12,369	6,502
Total shareholders' equity, minority interest and liabilities	<u>68,838</u>	<u>73,041</u>	<u>77,072</u>	<u>76,570</u>	<u>84,525</u>
<b>BALANCE SHEET DATA</b>					
<b>Amounts in accordance with US GAAP</b>					
Total assets	74,585	79,271	83,871	84,126	84,525
Long-term liabilities	11,705	19,707	20,208	27,681	13,715
Total shareholders' equity and minority interest	49,159	45,129	47,117	43,303	62,382
<b>STATEMENT OF CASH FLOWS</b>					
Cash flows provided by operating activities	5,630	6,936	8,320	8,172	9,406
Cash flows used in investing activities	(1,986)	(4,159)	(4,851)	(6,234)	(11,026)
Cash flows (used in) /provided by financing activities	(2,827)	(3,698)	(3,695)	(2,600)	2,830

	For the Years Ended December 31				
	<u>2001</u> <u>(restated)<sup>(1)</sup></u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
Effect of exchange rate changes and inflation on cash and cash equivalents	(255)	(129)	(327)	(259)	(19)
Net increase /(decrease) in cash and cash equivalents	<b>562</b>	<b>(1,050)</b>	<b>(553)</b>	<b>(921)</b>	<b>1,191</b>
<b>SELECTED INDUSTRY STATISTICAL DATA</b>					
International telephone minutes (million)					
Incoming	869	897	929	1,025	1,034
Outgoing	1,082	944	928	439	312
Local operators	683	522	483	248	148
Subscribers	399	422	445	191	164
Domestic long distance minutes (million)					
Local operators	5,020	3,905	3,035	2,787	2,587
Subscribers	1,159	1,055	880	1,013	965
Average employees	35,410	36,595	37,038	39,162	40,917
<b>Revenue per employee (rubles)</b>	<b><u>742,530</u></b>	<b><u>809,061</u></b>	<b><u>884,333</u></b>	<b><u>906,882</u></b>	<b><u>837,493</u></b>

(1) Refer to Note 31 to the Consolidated Financial Statements for the year ended December 31, 2001 for details of restatement of the financial statements for the year ended December 31, 2001. See also Item 5.A. – "Operating Results – Restatement of Previously Issued Financial Statements."

(2) Each ADS represents six shares.

(3) Per share data is stated in constant rubles as of December 31, 2001.

### Exchange Rates

Since 1991, the Russian ruble has experienced a substantial devaluation. The two tables below set forth, for the periods and dates indicated, high, low, average and period-end rates of the Central Bank of Russia for the purchase of U.S. dollars, expressed in Russian rubles per one U.S. dollar. The rates have not been restated in constant currency units. All amounts are stated in rubles. No representation is made that the Russian ruble or U.S. dollar amounts referred to herein could have been or could be converted into U.S. dollars or Russian rubles, as the case may be, at any particular rate. The Russian ruble is not a convertible currency outside the territory of Russia and is subject to significant restrictions on trading within the territory of Russia. On January 1, 1998, the ruble was re-denominated such that one thousand rubles existing at December 31, 1997 became equivalent to one re-denominated ruble. See also Item 10.D. – "Exchange Controls".

<u>Year ended</u> <u>December 31</u>	<u>High</u>	<u>Low</u>	<u>Average<sup>(1)</sup></u>	<u>Period-end</u>
1997	5,960.00	5,560.00	5,785.44	5,960.00
1998 <sup>(2)</sup>	20.99	5.96	9.71	20.65

<u>Year ended December 31</u>	<u>High</u>	<u>Low</u>	<u>Average<sup>(1)</sup></u>	<u>Period-end</u>
1999	27.00	20.65	24.61	27.00
2000	28.87	26.90	28.13	28.16
2001	30.30	28.16	29.15	30.14

<sup>(1)</sup> Average of month-end rates

<sup>(2)</sup> 1998 through 2001 numbers reflect the re-denomination of the ruble on January 1, 1998

<u>Year 2001 –2002</u>	<u>High</u>	<u>Low</u>	<u>Average</u>	<u>Period-end</u>
December 2001	30.30	29.90	30.08	30.14
January 2002	30.69	30.14	30.42	30.69
February 2002	30.93	30.68	30.81	30.93
March 2002	31.15	30.94	31.06	31.12
April 2002	31.20	31.12	31.16	31.20
May 2002	31.31	31.20	31.24	31.31
June 2002	31.48	31.31	31.40	31.45
July 2002	31.56	31.44	31.52	31.44
August 2002 (through August 27, 2002)	31.58	31.46	31.55	31.58

### **3.B. Capitalization and Indebtedness**

Not applicable

### **3.C. Reasons for the Offer and Use of Proceeds**

Not applicable

### **3.D. Risk Factors**

*The risks described below, and any other risks set forth in this Annual Report, are not the only risks facing the Company. Additional risks not presently known to the Company or that it currently deems immaterial may also impair its business operations.*

*In general, issuers with substantial operations in countries such as Russia encounter a higher degree of risk than issuers with substantial operations in the United States or similar jurisdictions. The Company's business, financial condition or results of operations could be materially adversely affected by such risks, and the trading price of its shares and American Depositary Shares could decline because of such risks, resulting in the loss of part or all of the value of its securities.*

#### **Risks Relating to the Russian Federation**

##### ***Political and Social Risks***

In recent years, Russia has been undergoing a substantial political transformation from a centrally controlled command economy under communist rule to a pluralist market-oriented democracy. There can be no assurance that the political and economic reforms necessary to complete such a transformation will continue. In its current relatively nascent stage, the Russian political system is vulnerable to the population's dissatisfaction with reforms,



social and ethnic unrest and changes in governmental policies, any of which could have a material adverse effect on the Group.

During this transformation, legislation has been enacted to protect private property against expropriation and nationalization. However, due to the lack of experience in enforcing these provisions in the short time they have been in effect and due to potential political changes in the future, there can be no assurance that such provisions would be enforced in the event of an attempted expropriation or nationalization. Expropriation or nationalization of any substantial assets of the Group, potentially without adequate compensation, would have a material adverse effect on the Group.

The Russian Government has been highly unstable, having experienced four changes in prime minister since March 1998, as well as the resignation of former President Yeltsin on December 31, 1999 and the subsequent election of President Putin on March 26, 2000. The various government institutions and the relations between them, as well as the Russian Government's policies and the political leaders who formulate and implement them, are subject to rapid change. Any major changes in, or rejection of, current policies favoring political and economic reform by the Russian Government may have a material adverse effect on the Group.

Russia is a federation of republics, regions, areas, cities of federal importance, autonomous districts and one autonomous region. The delineation of authority among the constituent entities of the Russian Federation and federal government authorities is often uncertain and at times contested. Lack of consensus between local and regional authorities and the Russian Government often results in the enactment of conflicting legislation at various levels, and may result in political instability. This lack of consensus may have negative economic effects on the Group, which could have a material adverse effect on its business, financial condition and results of operations.

In addition, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict. Russian military and paramilitary forces have been engaged in Chechnya in the recent past and continue to maintain a presence there. The spread of violence, or its intensification, could have significant political consequences. These include the imposition of a state of emergency in some parts or throughout the Russian Federation. These events could have a material adverse effect on the investment environment in Russia.

The failure of many Russian companies to pay full salaries on a regular and timely basis, and the failure of salaries and benefits to keep pace with the increasing cost of living, could lead in the future to labor and social unrest. This may have political, social and economic consequences, such as increased support for a renewal of centralized authority, increased nationalism with restrictions on foreign involvement in the Russian economy and increased violence, any of which could have a material adverse effect on the Group.

### ***Economic Risks***

Simultaneously with the enactment of political reforms, the Russian Government has been attempting to implement policies of economic reform and stabilization. These policies have involved liberalizing prices, reducing defense expenditures and subsidies, privatizing state-owned enterprises, reforming the tax and bankruptcy systems, and introducing legal structures designed to facilitate private, market-based activities, foreign trade and investment.

Despite the implemented reform policies the Russian economy has been characterized by declining industrial production, significant inflation, an unstable but managed currency, rising unemployment and underemployment, high government debt relative to gross domestic product, high levels of corporate insolvency with little recourse to restructuring or liquidation in bankruptcy proceedings, a weak banking system providing limited liquidity to

Russian enterprises, widespread tax evasion, high levels of corruption and the penetration of organized crime into the economy, and the impoverishment of a large portion of the Russian population.

The Russian economy has been subject to abrupt downturns. The events and aftermath of August 17, 1998 - the Russian Government's default on its short-term ruble-denominated treasury bills and other ruble-denominated securities, the abandonment by the Central Bank of the ruble currency band and efforts to maintain the ruble/U.S. dollar rate within it and the temporary moratorium on certain hard-currency payments to foreign counterparties - led to a severe devaluation of the ruble, a sharp increase in the rate of inflation, the significant deterioration of the country's banking system, significant defaults on hard currency obligations, a dramatic decline in the prices of Russian debt and equity securities, and an inability to raise funds in international capital markets.

Although starting from 1999 economic conditions in Russia have been gradually improving, the prospect still exists of widespread, mass unemployment and the collapse of certain sectors of the Russian economy. Moreover, there is a lack of consensus as to the scope, content and pace of economic and political reform. No assurance can be given that reform policies will continue to be implemented and, if implemented, will be successful, that Russia will remain receptive to foreign trade and investment, or that the economy in Russia will improve. Any failure of the current policies of economic reform and stabilization could have a material adverse effect on the operations of the Group. In addition, the recoverability of the Group's assets and the ability of the Group to pay its debts as they mature significantly depend on the effectiveness of the fiscal measures and other governmental actions, which have been or will be undertaken to achieve economic recovery.

### ***Russia's Physical Infrastructure***

Russia's physical infrastructure largely dates back to Soviet times and has not been adequately funded and maintained over the past decades. Particularly affected are the power generation and transmission; communication systems; building stock and rail and road networks. The federal government is actively considering plans to reorganize the nation's electricity, rail and telephone systems. Any such reorganization may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems.

The deterioration of Russia's physical infrastructure harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business in Russia and can interrupt business operations, all of which could have a material adverse effect on the Group.

### ***Funding from International Organizations; Access to the International Capital Markets***

Russia in the past has received substantial financial assistance from several foreign governments and international organizations, including the International Monetary Fund. No assurance can be given that further financial assistance will be provided to Russia and without such financial assistance economic development in Russia may be adversely affected.

Moreover, due to previous defaults on certain obligations and other factors, the Russian Government may be unable to raise funds on international capital markets, which may lead to direct or indirect monetary financing of the budget deficit, putting further pressure on inflation and the value of the Russian ruble.

The considerable external debt of Russia, as well as the failure to obtain funding from foreign governments and international organizations, or increased rates of inflation or devaluation arising from the need to resort to monetary financing of the budget deficit in the absence of access to the international capital markets, could have a material adverse affect on the Russian economy.

### ***Lack of Liquidity***

Russian companies face significant liquidity problems due to a limited supply of domestic savings, few foreign sources of funds, high taxes, limited lending by the banking sector to the industrial sector and other factors. Many Russian companies cannot make timely payments for goods or services and owe large amounts of overdue federal and local taxes, as well as wages to employees. Many Russian companies have also resorted to paying their debts or accepting settlement of accounts receivable through barter arrangements or through the use of promissory notes.

These problems were aggravated by the 1995 Russian banking crisis and by the impact on the Russian banking system of the events of August 1998, which further impaired the ability of the banking sector to act as a consistent source of liquidity to Russian companies. An intensification of liquidity problems or a further deterioration of the Russian banking system could have a material adverse effect on the Group's business, financial condition and results of operations.

### ***Legal Risks***

Risks associated with the Russian legal system include, *inter alia*: (i) the untested nature of the independence of the judiciary and its immunity from economic, political or nationalistic influences; (ii) inconsistencies among laws, Presidential decrees, and Government and ministerial orders and resolutions; (iii) the lack of judicial or administrative guidance on interpreting the applicable laws; (iv) a high degree of discretion on the part of governmental authorities; (v) conflicting local, regional and federal laws and regulations; (vi) the relative inexperience of judges and courts in interpreting new legal norms; and (vii) the unpredictability of enforcement of foreign judgments and foreign arbitral awards.

The laws in Russia regulating ownership, control and corporate governance of Russian companies are relatively new and, by and large, have not yet been tested in the courts. Disclosure and reporting requirements do not guarantee that material information will always be available and antifraud and insider trading legislation is generally rudimentary. The concept of fiduciary duties on the part of the management or directors to their companies or the shareholders is not well developed.

In addition, substantive amendments to several fundamental Russian laws (including those relating to the tax regime, corporations and licensing) have only recently become effective. The recent nature of much of Russian legislation, the lack of consensus about the scope, content and pace of economic and political reform, and the rapid evolution of the Russian legal system in ways that may not always coincide with market developments may result in ambiguities, inconsistencies and anomalies, the enactment of laws and regulations without a clear constitutional or legislative basis, and ultimately in investment risks that do not exist in more developed legal systems. All of these weaknesses could affect the Company's ability to enforce its rights, or to defend itself against claims by others in respect of the Company or its Russian subsidiaries, and could affect enforcement in Russia of any rights of the holders of the ADSs against the Company. Further, no assurance can be given that the development or implementation or application of legislation (including Government resolutions or Presidential decrees) will not have a material adverse effect on foreign investors (or private investors generally).

These uncertainties also extend to property rights. During Russia's transformation from a centrally planned economy to a market economy, legislation has been enacted to protect private property against expropriation and nationalization. However, it is possible that due to the lack of experience in enforcing these provisions and due to potential political changes, these protections would not be enforced in the event of an attempted expropriation or nationalization. Some government entities have tried to renationalize privatized businesses. Expropriation or nationalization of any of the Company's assets, potentially without adequate compensation, would have a material adverse effect on the Company.

Many Russian laws are structured in a way that provides for significant administrative discretion in application and enforcement. Reliable texts of laws and regulations at the regional and local levels may not be available, and usually are not updated or catalogued. As a result, applicable law is often difficult to ascertain and apply, even after reasonable effort. In addition, the laws are subject to different and changing interpretations and administrative applications. As a result of these factors, even the best efforts to comply with the laws may not always result in full compliance.

Russian laws often provide general statements of principles rather than a specific guide to implementation, and Government officials may be delegated or exercise broad authority to determine matters of significance. Such authority may be exercised in an unpredictable way and effective appeal processes may not be available. In addition, breaches of Russian law, especially in the area of currency control, may involve severe penalties and consequences that could be considered as disproportionate to the violation committed.

The independence of the judicial system and its immunity from economic, political and nationalistic influences in Russia remains largely untested. Judges and courts are generally inexperienced in the areas of business and corporate law. Judicial precedents generally have no binding effect on subsequent decisions. Not all Russian legislation and court decisions are readily available to the public or organized in a manner that facilitates understanding. The Russian judicial system can be slow. All of these factors make judicial decisions in Russia difficult to predict and effective redress uncertain. Additionally, court claims are often used to further political aims. Additionally, court decisions are not always enforced or followed by law-enforcement agencies. There is no guarantee that the proposed judicial reform aimed at balancing the rights of private parties and governmental authorities in courts and reducing grounds for re-litigation of decided cases will be implemented and succeed in building a reliable and independent judicial system.

#### ***Foreign Court Judgments or Arbitral Awards***

The Russian Federation is not a party to any multilateral or bilateral treaties with most Western jurisdictions for the mutual enforcement of court judgments. Consequently, should a judgment be obtained from a court in any of such jurisdictions it is highly unlikely to be given direct effect in Russian courts. However, the Russian Federation (as successor to the Soviet Union) is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the Deposit Agreement contains a provision allowing for arbitration of disputes in London, England in accordance with Rules of London Court of International Arbitration. A foreign arbitral award obtained in a state which is a party to that Convention should be recognized and enforced by a Russian court (subject to the qualifications provided for in the Convention and compliance with Russian civil procedure regulations and other procedures and requirements established by Russian legislation). It is expected that Russian procedural legislation will be changed, *inter alia*, by way of introducing further grounds preventing foreign court judgments and arbitral awards from being recognized and enforced in Russia. In practice, reliance upon international treaties may meet with resistance or a lack of understanding on the part of Russian court or other officials, thereby introducing delay and unpredictability into the process of enforcing any foreign judgment or any foreign arbitral award in the Russian Federation.

#### ***Exchange Rates, Exchange Controls and Repatriation Restrictions***

In recent years, the ruble has experienced a significant depreciation relative to the U.S. Dollar, particularly following the financial crisis of August 1998. Before August 1998 the Central Bank had been trying to support the ruble within a certain band. However, after the significant August 1998 devaluation of the ruble, the band was cancelled. The ability of the Russian Government and the Central Bank to reduce the volatility of the ruble will depend on many political and economic factors, including their ability to control inflation and the availability of foreign currency.

The ruble is not convertible outside Russia. A market exists within Russia for the conversion of rubles into other currencies, but it is limited in size and is subject to rules limiting the purposes for which conversion may be effected. There can be no assurance that such a market will continue indefinitely. Currently, 50% of foreign currency revenues from export sales must be converted into rubles. The relative stability of the exchange rate of the ruble against the U.S. Dollar since 1999 has mitigated risks associated with forced conversion, but no assurance can be given that such stability will continue. Moreover, the banking system in Russia is not as developed as its Western counterparts, and considerable delays may occur in the transfer of funds within, and the remittance of funds out of, Russia.

While the current policy of the Russian Government is to allow the repatriation by foreign investors of profits earned in rubles, there are restrictions on such repatriation. Ruble proceeds from certain operations of foreign investors are required to be frozen for 365 days before they may be converted into hard currency.

Approximately 23% of the Group's revenues and 38% of the Group's costs (excluding depreciation and bad debt recovery) in 2001 were denominated in currencies other than Russian ruble. Revenues generated in foreign currency represent income received from international operators, and foreign currency denominated costs comprise primarily payments to international operators and payments of interest on the foreign currency loans. Accordingly, the relative movements of domestic inflation and ruble exchange rates could, in the future, have a material adverse affect on the Group's business, financial conditions and results of operations. The restrictions on conversion of its ruble revenues into foreign currencies, or on purchase of U.S. Dollars or other foreign currencies, could also have a material adverse effect on Group's business, financial condition and results of operations.

Some of the Group's liabilities, such as external borrowings, are denominated in foreign currencies. As a result, devaluation of the ruble against the U.S. dollar can adversely affect the Group's ability to repay or refinance its foreign-currency denominated indebtedness and increase the Group's costs in ruble terms. The devaluation of the ruble would also result in losses in the value of ruble-denominated assets.

### ***Lack of Official Data Reliability***

Official statistics and other data published by Russian federal, regional and local governments, and federal agencies are substantially less complete or reliable than those of Western countries, and there can be no assurance that the official sources from which certain information set forth herein has been drawn are reliable or complete. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia herein must therefore be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

### ***Privatization***

The Company was privatized in the beginning of 1990s. To the extent that privatization legislation has been vague, inconsistent and conflicting with other applicable legislation, and with conflicts even between federal and local privatization legislation, most, if not all, privatizations are arguably deficient and therefore are vulnerable to challenge, at least on formal grounds. Currently, there are no pending challenges to the privatization of the Company. In the event that the Company comes under attack as having been improperly privatized and it is unable to defeat such claims, the holders of the ADSs might face a risk of losing their ownership interests in the Company's shares underlying ADSs.

### ***Taxation***

Taxes payable by Russian companies include value added tax, profit tax, single social tax, turnover tax, property tax and other taxes. Until recently, the tax system of the Russian Federation was rather inefficient, which

was characterized by numerous, and often economically unjustified, taxes and far too many normative acts which regulated taxes in frequent controversy to each other.

However, there is a reform underway, aimed to improve and facilitate the Russian tax system and reduce the tax burden. The reform is a codification of the tax laws in the form of the Tax Code, the first part of which was enacted in 1999, and certain chapters of its second part came to force from 2001 to 2002. In particular, the Tax Code chapter on individual income tax providing for a flat income tax rate of 13% was introduced effective from January 1, 2001. On January 1, 2002, the Tax Code chapter on tax on profit of enterprises took effect, reducing the profit tax rate from 35% to 24%. The reform of principal taxes formatting Russian Federation tax system is expected to complete in 2004.

The tax reform of the Russian Federation is implemented through continuing amendments being introduced into the tax legislation. Frequently, these amendments are not well drafted and allow varied interpretation. The uncertainty of new tax regulations and lack of practice proving application thereof may lead to controversies in the views of the Company and tax authorities as to the application of such regulations, and cause sanctions to be imposed on the Company despite its best efforts to comply with the tax law.

In addition, the tax reform complicates the tax planning and decision making process in the Russian companies.

At the same time, the possible negative impact of the tax reform on taxpayers is mitigated by the legally established principle of prohibition on the retroactive effect of laws envisaging new taxes or otherwise adding extra burden on taxpayers.

In contrast to the US tax system, Russian companies being members of a group of companies do not consolidate their financial reports for taxation purposes. As a result, each company of the Company's consolidated group pays taxes independently and may not offset its profits and losses against profits and losses of another organization being a member of the Company's consolidated group.

Since January 1, 2002, a new system of dividend taxation has been in force, eliminating the multiple taxation on dividends payable within a group of companies. The new system provides for a possibility to offset taxes paid on dividends received, upon calculating the tax amount subject to payment on payable dividends. However, this rule covers only dividends payable to tax residents of the Russian Federations. The dividend tax is to be withheld by the payer of dividends. For further details, see Item 10.E. – "Taxation."

### ***Securities Market/Corporate Regulations***

The regulation and supervision of the securities market, financial intermediaries and issuers are considerably less developed in Russia than in the United States and Western Europe. Disclosure and reporting requirements, anti-fraud safeguards, insider trading restrictions and fiduciary duties are relatively new to Russia and are unfamiliar to many Russian companies and managers. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian companies in other areas result in delays in conducting securities offerings and in accessing capital markets. It is unclear whether certain regulations, decisions and letters issued by the various regulatory authorities apply to the Company and its Russian subsidiaries. As a result, they may be subject to sanctions despite best efforts at compliance, which could have a material adverse effect on Group's business, financial condition and results of operations. Additionally, inconsistencies among, and limited enforcement of, securities laws and regulations create uncertainty that may also discourage foreign investors from investing in the Group.

### ***Corporate Governance and Disclosure***

The corporate affairs of the Group are governed by Russian laws and by the charters of companies comprising the Group. The rights of shareholders and the responsibilities of members of the Board of Directors and the Management Board under Russian law are different from, and may be subject to certain requirements not generally applicable to, corporations organized in the United States, the United Kingdom, and other jurisdictions.

A principal objective of the securities laws of the United States and the United Kingdom and other countries is to promote full and fair disclosure of all material corporate information to the public. The Group is subject to Russian law requirements, which oblige it to publish, *inter alia*, annual financial statements and information on material events relating to the relevant company (such as major acquisitions and increase in charter capital). However, there is less publicly available or other information about the Group than the information regularly published by or about listed companies in the United States, the United Kingdom or certain other jurisdictions.

### ***Minority Shareholders' Rights***

Russian law provides some protection of rights of minority shareholders, although corporate governance standards for many Russian companies have proven to be inefficient. Minority shareholders in some of the Russian companies are known to have suffered losses due to abusive share dilutions, asset transfers and transfer-pricing practices within corporate structures. Where major shareholders effectively control 75% or more of the voting shares of a company, they are in a position to approve amendments to the charter of the company, which could be prejudicial to the interests of minority shareholders, and to veto all other decisions which are within the authority of the general shareholders meeting.

Russian Law No. 208-FZ "On Joint Stock Companies" dated December 26, 1995 (the "Joint Stock Companies Law") provides that shareholders owning not less than 1% of the company's ordinary shares may bring an action for damages against the management of the company on the grounds of breach of fiduciary duties. However, Russian courts are still inexperienced with respect to such cases. Accordingly, the practical ability of minority shareholders to pursue legal redress action against the Company's management may be limited.

### ***Maintenance of the Shares Registry***

Ownership of shares in Russian joint stock companies arises by entry in a share register and is evidenced by extract from such register. Currently there is no unified registration system in Russia. Maintenance of share registries is carried out by the companies themselves or, if the number of company's shareholders exceeds 50, by specialized licensed registrars (as it is the case with the Company). Regulations have been issued by the Federal Commission for Securities Market regarding the licensing of the registrars and the rules on performing the functions of a registrar. In practice, however, these rules have not been strictly enforced. Furthermore, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company's shares could be improperly or inaccurately recorded, and share registration entries could be lost through fraud, negligence or even mere oversight of a registrar.

### ***Liability for the Obligations of Subsidiaries***

The Civil Code and the Joint Stock Companies Law generally provide that the shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one company (the parent) is capable of determining decisions made by another company (the subsidiary). The parent company bears joint and several liability for transactions concluded by the subsidiary in carrying out these decisions if (i) this decision-making capability arises from prevailing participation in the charter capital of the subsidiary or it is provided in a contract between

the companies or arises due to certain other reasons, and (ii) the parent company gives obligatory directions to the subsidiary.

In addition, the parent company is secondarily liable for the debts of the subsidiary if the subsidiary becomes insolvent or bankrupt resulting from the action or inaction of the parent company. This is the case no matter how the parent company's capability to determine decision of the subsidiary arises. For example, this liability could arise by a contract. In these instances, other shareholders of the subsidiary may claim compensation for the subsidiary's losses from the parent company which caused the subsidiary to take action(s) or fail to take action(s) knowing that such action(s) or failure to take action(s) would result in losses.

### ***Debt Collection***

The Company bills local telephone operators ("LTOs") for domestic long distance and international traffic at either an agreed proportion of the receipts they collect from subscribers or an agreed rate based upon minutes of traffic for the use of the Company's network. The Company has in the past experienced, and continues to experience, significant delays in payment from certain LTOs, certain government funded entities and government ministries, and some international operators (in common with many other Russian companies). Delays in payments by LTOs, as well as any significant level of bad debt may have a material adverse effect on the Company's business, financial conditions and results of operations.

### ***Risks Relating to Russia's Accession to WTO***

Russia's accession to World Trade Organization ("WTO") will be conditional upon, among other factors, regulative and structural changes aimed primarily at demonopolization of the Russian telecommunications market.

Demonopolization and granting access to the Russian market to new participants may adversely affect the Company which is currently holding a position of a natural monopoly in the wholesale long-distance telecommunications market. In particular, strengthening of competition may lead to reduction of the Company's market share, as well as force the Company to reduce tariffs with respect to the long-distance communications.

In addition, upon Russia's accession to WTO, foreign operators' activities in the liberalized Russian telecommunications market may adversely affect the Company's business and financial position.

### **Risks Relating to the Company's Operations and Telecommunication Industry**

#### ***Regulation of Telecommunication Industry: General***

The Company's business operates in an uncertain regulatory environment. There is no comprehensive legal framework with respect to the provision of telecommunication services in Russia, although a number of laws, decrees and regulations apply to the telecommunications sector. The principal legal acts regulating telecommunications in Russia are the Federal Law on Communications, dated February 16, 1995, as amended (the "Communications Law"), and the Federal Law on Natural Monopolies, dated August 17, 1995, as amended (the "Natural Monopolies Law"). The current regulatory framework does not clearly establish the interaction between these two laws, which has resulted in a number of contradictory decrees and decisions. As the primary provider of long distance telecommunications in Russia, the Company has been, and continues to be, subject to regulation under these laws as well as other Russian legislation. Although the Company uses its best efforts to comply with laws, decrees and regulations, there is no guarantee that in the course of future inspections conducted by governmental authorities, the Company will not be found to have violated any laws, decrees and regulations and that the Company will be able to cure such violations within any grace periods permitted by such authorities, and that such findings will not result in the imposition of fines or penalties or more severe sanctions, including the



suspension or withdrawal of the Company's licenses and other permissions, any of which could increase the Company's costs and have a material adverse effect on the Company's business, financial conditions and results of operations.

The regulatory environment for telecommunications in Russia may be subject to political influence, resulting in negative regulatory decisions on other than legal grounds. In particular, the telecommunications system is regulated by the Ministry of Communications of the Russian Federation, largely through the issuance of licenses and instructions. As a result, officials of the Ministry of Communications have a high degree of discretion.

Currently, the Company is subject to regulations pertaining to licensing, competition, frequency allocation and other general operational matters related to providing telecommunications networks for public consumption. For example, the Communications Law provides for equal rights of individuals and legal entities to participate in telecommunications operations and does not currently contain any special restrictions with regard to participation by foreign persons. There can be no guarantee, however, that the Russian Government will not change this policy. Changes in the laws and regulations of the telecommunications industry, and other decisions by regulators regarding the Company's business and that of its competitors could have a significant material impact on the performance and continuity of its business.

#### ***Regulation of Telecommunication Industry: Anti-Monopoly Regulation***

The telecommunications industry is currently classified as a "natural monopoly". Russian laws vest the Government of the Russian Federation with certain authority over natural monopolies. Furthermore, the Company's activities are regulated by the Ministry of Anti-Monopoly Policy and Support of Entrepreneurship of the Russian Federation (the "Ministry for Anti-Monopoly Policy").

The Natural Monopolies Law provides a legal basis for federal regulation of telecommunications providers and provides for state control over setting tariffs and other activities. This law may have a significant impact on the Company's ability to set tariffs independently. The Natural Monopoly Law also controls the types of transactions into which a regulated entity, such as the Company, may enter. The Company may also be subject to continuous reporting requirements, which include the submission of plans for capital investments. In addition, as with all regulated entities, the Company may not refuse to conclude contracts with particular consumers if required by the Ministry for Anti-Monopoly Policy. Any failure to comply with such regulation could materially adversely affect the business of the Company. The Russian Government may exercise its authority and set tariffs or to require the Company to enter into specified contracts, either of which could have a material adverse effect on the financial condition of the Company.

#### ***Foreign Investments in the Telecommunication Industry***

Russian legislation on foreign investments does not prohibit or restrict such investments in the telecommunications industry. However, there is a lack of consensus over the methods and scope of government control over the telecommunications industry. The Law on Foreign Investments in the Russian Federation, dated July 9, 1999, does not provide any specific protections of the investors in the telecommunications. Since the telecommunications industry is widely viewed as strategically important to the Russian Federation, governmental control over the telecommunications industry might increase, and foreign investment in or control over the industry might be limited in the future. Any such increase in governmental control or limitation on foreign investment could impair the value of foreign investments in the Company and hinder the Company's access to additional capital in foreign equity markets.

### ***Dependence on Major Shareholder and Key Management***

The Group is effectively controlled by Svyazinvest which holds 50.67% of the voting shares of the Company. Further, the Government has a controlling interest in Svyazinvest. There can be no assurance that the Government will not further decrease its interest in Svyazinvest or that Svyazinvest will not decrease its interest in the Company thereby no longer maintaining its present degree of control over the Group. Any such change of control may have a material impact on the Group's business activities.

The Company is dependent on its senior management for the implementation of its strategy and operation of its day to day activities. In addition, the personal connections and relationships of members of senior management are important to the conduct of its business. No assurance can be given that management will continue to make their services available to the Company.

### ***Insurance Coverage***

The Group does not maintain a sufficient level of insurance on its existing asset base. Any significant damage to the Company's facilities and networks or any significant difficulties in operations through its facilities and networks, whether as a result of fire, flooding, earthquake or other causes, could have a material adverse effect on the financial condition, results of operations and cash flows of the Group. In addition, the Group does not maintain business interruption insurance.

### ***Failure of the Company's Network and Systems Equipment***

Though the Company has equipment providing back-up capacity in case of disruption of its operations, the Company's network is still subject to a number of risks, several of which are outside of its control, such as:

- the risk of damage to software and hardware resulting from fire,
- power loss,
- natural disasters, and
- general transmission failures.

Any failure to the Company's network or other systems or hardware that causes significant interruptions to its operations could have a material adverse effect on the Company's business, financial condition and result of operations. The Company's operations also are dependent on its ability to integrate successfully new and emerging technologies and equipment into the network, which could increase the risk of system failure and result in further strains upon the network. Prolonged or significant system failures, or difficulties for customers in accessing and maintaining connection with the Company's network, could seriously damage its reputation and result in customer attrition, reduced margins and financial losses.

### ***Availability of Equipment from Key Suppliers***

The operation of the Company's network depends upon its obtaining adequate supplies of switching and other network equipment on a timely basis. At present, the Company purchases component parts to switching and certain network equipment from Siemens, NEC, Alcatel, Fujitsu, Iskratel, Ericsson, Ericsson Nikola Tesla. The Company's business could be adversely affected if it is unable to obtain adequate component parts or equipment in a timely manner from its current suppliers or any alternative supplier, or if there were significant increases in the costs of such equipment.

### ***Capital Requirements***

The Company may require significant amounts of capital to sustain its growth, to develop and expand its network, and to stay competitive by expanding its sales and marketing efforts and its product and service offerings. If the Company's current plans or assumptions change or prove to be incorrect, the Company may need to seek other sources of financing, such as lines of credit with commercial banks or vendors or additional public financing. These additional financings may be significant. If the Company is unable to obtain financing from these sources, or is unable to obtain financing on a timely basis or on commercially reasonable terms, the Company may have to delay or abandon some of its development and expansion plans or seek additional financing earlier than anticipated.

### ***Competition***

The Company believes that the capital and time required to build a long distance network comparable to its own, especially in light of the size, dispersed population and extreme weather conditions of Russia, make such an undertaking by a competitor unlikely. However, there is a new group of companies such as strategic alliances of the Russian and foreign companies and foreign competitors offering international channels. Some of them are owned by large corporations using their own broad communications networks (RAO UES, Gazprom). The services the Company offers are technology-intensive. To maintain its market share and be competitive, the Company must continue to anticipate and adapt to rapid technological changes and introduce competitively priced services that meet the constantly changing industry standards.

The Group's success in keeping up with the technological innovations significantly depends on its ability to make substantial investments in new technologies, to obtain the necessary licenses. New technologies the Company chooses may not prove to be commercially successful, and the Company therefore might lose its customers or fail to attract new ones. The Group's ability to compete successfully in this environment, will also depend on its ability to generate high traffic volumes from its customers while keeping its cost of services low.

### ***Licensing; Governmental Permits***

All of the Group's activities in the telecommunication industry and almost all telecommunication equipment used by the Group are subject to licensing and certification requirements, respectively. Regulatory uncertainties affecting the maintenance and renewal of the Group's licenses and certification of the telecommunication equipment could result in the Group's difficulty or even inability to maintain and renew such licenses or to import and use such equipment.

### ***Risks Relating to the ADSs***

#### ***Beneficiary Ownership to the Underlying Shares; Exercise of Rights Arising out of the Underlying Shares***

The Federal Law No. 39-FZ "On the Securities Markets", dated April 22, 1996 (the "Securities Market Law"), provides that shares may be held by nominees entitled to receive dividends and to vote the shares on behalf of the beneficial owners upon the voting instructions. However, the regulations governing nominee holders, custodians and depositaries are not yet well developed in Russia. Russian law may treat the depositary as the beneficial owner of the shares underlying the ADSs, and, hence, may not recognize the holder of ADSs as such. This would be different from the way other jurisdictions, such as the states of the United States of America, treat ADSs. In those jurisdictions, although shares may be held in the depositary's name or to its order and the depositary is therefore a "legal" owner of the shares, the ADS holders are the "beneficial," or real owners. In those jurisdictions, no action against the depositary would result in the beneficial owners losing rights to underlying shares.

Russian law does not recognize the same distinction between legal and beneficial ownership. Thus, it may only recognize the rights of the depositary in whose name the shares are registered, but not the rights of ADS holders, to the underlying shares. Therefore, in proceedings brought against a depositary, whether or not related to shares underlying ADSs, Russian courts may treat those underlying shares as the assets of the depositary open to seizure or arrest. If this lawsuit is decided against the depositary bank involved, respective ADS holders would lose their rights to the underlying shares.

A depositary can only vote the shares underlying the ADSs as the beneficial owner of these shares, but not as a nominee. Russian law does not allow shareholders to vote in more than one way on any agenda item, and a depositary cannot vote the shares underlying ADSs other than as a block and may not grant a discretionary proxy to a person designated by the Company, if ADS holders do not give voting instructions. This may result in the inability of ADS holders to exercise their rights with respect to underlying shares, including voting. While the Russian Federal Commission for Securities Market indicated its intention to issue regulations allowing foreign depositary banks to vote on behalf of ADS holders in accordance with their respective instructions, until Russian legislation is changed accordingly, the shares underlying ADSs may not be voted other than as a block.

Attempts to view a depositary as nominee holder of the shares underlying ADSs might be interpreted as requiring such nominee to obtain a license from the Russian authorities to act in that capacity with respect to the underlying shares. However, it is unlikely the Russian law licensing provisions could be effectively applied to foreign nominee holders and depositaries. Further, nominees reported to have experienced difficulty in convincing registrars of their rights to represent beneficial holders. All these uncertainties of a depositary's activities regulation could result in difficulties or inability of ADS holders to exercise their rights arising out of the shares underlying ADSs.

#### ***Voting the Shares Underlying ADSs: Deposit Agreement Provisions***

Even if Russian legislation is amended in the future to allow the depositary to differentiate voting with shares underlying ADSs, such voting rights may be exercised only in accordance with the Deposit Agreement provisions. However, there are practical limitations upon the ADS holders ability to exercise voting rights due to the additional procedural steps involved in communicating with them. For example, the Joint Stock Companies Law and the Company's Charter require the Company to notify its shareholders of any general shareholders meeting at least 30 or, in certain cases, 50 days in advance of such meeting. The Company's shareholders will be notified directly by the Company, and will be able to exercise their voting rights by either attending the general shareholders meeting in person, through a representative, or by sending a filled-in voting ballot.

On the contrary, ADS holders will not receive notice of a general shareholders meeting directly from the Company. In accordance with the Deposit Agreement, the depositary will be notified by the Company of a general shareholders meeting. The depositary has undertaken in turn, as soon as practicable thereafter, to mail the notice of such meeting, voting instruction forms and a statement as to the manner in which instructions may be given, to ADS holders. To exercise their voting rights, ADS holders should instruct the depositary how to vote their shares. Due to this additional procedural step involving the depositary, the process for exercising voting rights may be longer for ADS holders than for shareholders. ADSs, for which the depositary does not receive voting instructions in time, will not be voted at any general shareholders meeting in accordance with such instructions.

#### ***Repatriation of Earnings from ADSs outside of the Territory of the Russian Federation***

The Federal Law on Foreign Investments in the Russian Federation specifically guarantees foreign investors the right to repatriate their earnings from Russian investments. However, the Russian exchange control regime may materially affect your ability to do so.

Russian currency control legislation allows ruble dividends to be paid to the depository or its nominee and converted into U.S. dollars or other foreign currency by the depository for distribution to the ADS holders without restriction.

The ability of the depository, as well as any other foreign person to convert rubles into U.S. dollars or other foreign currencies is subject to the availability of U.S. dollars or other foreign currency in the Russian foreign currency market. Although there is an existing market in Russia for conversion of rubles into U.S. dollars and other foreign currencies, including the interbank currency exchange and over-the-counter and currency futures trades, the way in which Russian foreign currency market will develop remains uncertain. Currently, the market for conversion of rubles into foreign currencies outside of Russia is not allowed to exist. Additionally, the conversion of rubles into foreign currencies and repatriation may be subject to costs and delays.

### ***Securities Market Risks***

Due, among other reasons, to the limited liquidity of the Russian corporate securities market and the lack of effective regulation thereof, prices of Russian corporate securities and respective ADSs may be significantly affected by a relatively small amount of buying and selling activity and favorable or unfavorable press commentaries. Since regulation of insider trading and market making is undeveloped, prices of Russian corporate securities and respective ADSs may be affected by practices that are not permitted in other markets.

Currently, the Company does not anticipate to offer equity securities in the near future. However, future offering, or the possibility of the offering, of substantial number of the Company's shares in the public market could have an adverse effect on the prices of the ADSs. Furthermore, such equity offerings may still dilute shareholding of the Company's current shareholders. Newly issued preferred shares may have rights, preferences or privileges senior to those of existing shares.

Financial turmoil in Russia and other emerging markets in 1997 and 1998 adversely affected the securities markets in developing economies worldwide. Continued or increased financial downturns in these countries could cause further decreases in prices for securities of the Company, even if the Russian economy remains relatively stable.

### ***Applicability of the United States – Russia Double Taxation Treaty***

The United States – Russia Tax Treaty may be not applicable to the U.S. holders of ADSs.

Russian tax rules applicable to the U.S. holders of ADSs are characterized by significant uncertainties and by an absence of interpretative guidance. Russian tax authorities have not provided any reasonable guidance regarding the treatment of ADS arrangements, and there can be no certainty as to how they will ultimately treat those arrangements. In particular, it is unclear whether Russian tax authorities will treat the U.S. holders as the beneficial owners of the underlying shares for the purposes of the Tax Treaty. If Russian tax authorities do not treat the U.S. holders as the beneficial owners of the underlying shares, then the U.S. holders would not be able to benefit from the provisions of the Tax Treaty. However, even if the U.S. holders are treated by the Russian tax authorities as the beneficial owners of the underlying shares, the U.S. holders still may be unable to benefit from the provisions of the Tax Treaty, or may experience significant expense and effort due to the complicated administrative procedures on the Russian side claiming these treaty benefits.

Further, capital gains from disposal of ADSs or ordinary shares in the Company (the "Ordinary Shares") may be subject to Russian withholding tax; dividends received by the holders of ADSs or Ordinary Shares are subject to Russian withholding tax.

A purchaser of ADSs or Ordinary Shares may be required to withhold 20% of the purchase price (or 24% of any gain if the cost basis can be confirmed as required by Russian law) if ADSs or Ordinary Shares are sold, exchanged or disposed of outside a stock exchange by a Non-resident entity holder. However, no mechanism for withholding and remittance of the tax to Russian tax authorities exists, where the transaction is made between two Non-residents with no tax registration in Russia.

Capital gains (or proceeds if costs can not be confirmed) realized by Non-resident individual holders from the sale of Ordinary Shares or ADSs are subject to 30% withholding tax if the securities are sold in Russia.

Relief from withholding tax may be available if full exemption or lower rate of withholding tax is provided for by an applicable double tax treaty, subject to the risk mentioned in Item 10.E. "Taxation – Russian Profits Tax and Withholding Tax Considerations." However, obtaining treaty benefits can be difficult due to the requirements imposed by the Russian tax legislation. If any such tax is assessed, the value of an ADS or a share of Ordinary Shares could be materially adversely affected.

Dividends on ADSs or Ordinary Shares paid to Non-resident Entities generally will be subject to Russian withholding tax deducted at source by the payer of such dividends at a rate of 15%. For Non-resident Individuals the rate of withholding may be 30% if the payer of income chooses the conservative approach.

The withholding tax rate can be reduced in accordance with the provisions of an applicable double tax treaty, subject to the risks outlined in Item 10.E. "Taxation – Russian Profits Tax and Withholding Tax Considerations." The Tax Treaty reduces the rate of withholding tax on dividends to 10% (and to 5% if a Non-resident holder is an entity treated as a body corporate for the US tax purposes that owns at least 10% of the voting stock).

Also, technically, there is a risk that trading in Russian securities will require registration (in the form of notification) with the Russian tax authorities.

## **Item 4. Information on the Company**

### **4.A. History and Development of the Company**

#### ***General***

Rostelecom is an open joint stock company organized under the laws of the Russian Federation on September 23, 1993. Its principal and executive offices are located at 14, 1<sup>st</sup> Tverskaya-Yamskaya Str., 125047 Moscow, Russia, and its telephone number is +7 095 787 2849, fax: +7 095 787 2850.

Prior to 1990, the Ministry of Communications of the Union of Soviet Socialist Republics (the "USSR" or "Soviet Union") (the "Soviet Ministry of Communications") was responsible for all telecommunications services within the Soviet Union. In June 1990, the Soviet Ministry of Communications established a state-controlled joint stock company, Sovtelecom, to which it delegated the right to operate the telecommunications network of the Soviet Union. On September 19, 1990, Sovtelecom was registered by the Moscow City Council in accordance with the Soviet Union Law "On Enterprises in the USSR." Following the dissolution of the Soviet Union in December 1991, the ownership structure of Sovtelecom changed. On February 24, 1992, a new corporate name, AOZT Intertelecom, was registered. Intertelecom became the owner of all telecommunications assets and operations within the Russian Federation.

On December 22, 1992, the Russian Government issued Resolution No. 1003 entitled "On Privatization of Communications Enterprises", which launched the privatization of the Russian telecommunications industry. The principal elements of privatization for Russian international and domestic long distance telecommunication providers were established by the Directive of the State Committee on the Management of State Property of

Russia (the "Property Committee") No. 1302-r, dated December 30, 1992 ("Directive No. 1302"). Pursuant to Directive No. 1302, Russian state long distance and international communications enterprises were merged into one state-owned enterprise, Rostelecom. Furthermore, Directive No. 1302 mandated the privatization of this enterprise into a joint stock company and provided that the telecommunications assets constituting the Russian Government's participation interest in the charter capital of Intertelecom were to be contributed to the charter capital of Rostelecom. In addition, Directive No. 1302 required that a controlling interest in Rostelecom be maintained by the Property Committee for three years. This three-year holding period was extended in September 1996 and expired in April 1997.

On September 23, 1993, Rostelecom was officially registered as a joint stock company of an open type in accordance with Directive of the Property Committee No. 1507-r, dated August 27, 1993 (the "Privatization Directive"). The Privatization Directive approved the privatization plan and evaluation of the assets of Rostelecom. Pursuant to the Privatization Directive, the Property Committee retained Ordinary Shares representing 38% of Rostelecom's charter capital (*i.e.*, the number of outstanding ordinary and preferred shares multiplied by their nominal value) and, as a consequence, retained approximately 51% of Rostelecom's voting control. Approximately 22.9% of the Company's charter capital, including its Class B preferred shares, converted into ordinary shares at the time of sale, was sold to the general public through voucher and cash auctions held in April and July of 1994, between July through September of 1995, and in January 1996.

During 1993 and 1994, an additional 14.1% of Rostelecom's charter capital was distributed to the Company's employees and management through a closed subscription procedure pursuant to the Regulation on Closed Subscription for Shares during Privatization of Rostelecom, which was approved by a meeting of Representatives of Labor Collectives of State-Owned Enterprise Rostelecom on September 20, 1993 (the "Subscription Regulation"). The terms of the distribution of shares among the Company's employees and management set forth in the Subscription Regulation followed the guidelines established by the then effective Russian privatization laws and regulations, including the State Program of Privatization of State and Municipal Enterprises in the Russian Federation in 1992 (the "1992 Program") and the Regulation on Closed Subscription for Shares during Privatization of State and Municipal Enterprises approved by Directive of the Property Committee No. 308-r, dated July 27, 1992 ("Regulation No. 308-r"). Subsection 1.1 of Regulation No. 308-r defines a closed subscription as an issuance of shares of a privatized enterprise on favorable terms to employees and other persons entitled by privatization laws to subscribe to such shares in accordance with the 1992 Program. The 1992 Program set forth three options for the issuance of shares to employees and management of a privatized company. The privatization of Rostelecom was effected pursuant to option one, which required (i) the distribution of non-convertible, non-voting Class A preferred shares representing 25% of the charter capital of Rostelecom to employees, management and other persons entitled by privatization laws to subscribe to shares (the "Other Parties") at no cost, (ii) the issuance of ordinary shares representing up to 10% of the charter capital to employees and Other Parties entitled by privatization laws to subscribe to shares at a 30% discount from nominal value, and (iii) the issuance of ordinary shares representing up to 5% of the charter capital to management at nominal value.

According to the Subscription Regulation, Other Parties entitled under the privatization laws to subscribe for the Company's shares included the following:

- 1) individuals who, as a matter of Russian law, had the right to return to their previous positions at Rostelecom (*e.g.*, women on maternity leave, employees on sick leave, employees in military service);
- 2) Rostelecom retirees;
- 3) former Rostelecom employees, who had worked at Rostelecom for more than 10 years (for males) and more than 7 years and 6 months (for females) and who had terminated their employment with Rostelecom at will, or through a transfer, or as a result of a labor force downsizing; and

- 4) individuals whose employment with Rostelecom was terminated after January 1, 1992 (for the issuance of Class A preferred shares—after January 1, 1993) as a result of a labor force downsizing and who, at the time of the privatization of Rostelecom, were legally registered as unemployed persons.

Pursuant to the Subscription Regulation, 9.986% of Rostelecom's charter capital was initially allocated for issuance to employees and other parties at a 30% discount from the nominal value of RUR 1,000 per share, 9.15% of which was requested by and issued to the employees and Other Parties in the form of ordinary shares through the subscription process. The remaining undistributed shares were transferred to the Russian Federal Property Fund.

Regulation No. 308-r and the Subscription Regulation provided that the maximum number of shares to be issued to one employee or each Other Party could not be more than 5% of the total amount of shares allocated for issuance to employees or Other Parties at a 30% discount from nominal value. Any application for shares with an aggregate nominal value of more than RUR 90,000 required a deposit of the full amount of the purchase price. The deposit requirement resulted in a very small number of Rostelecom employees applying for more than 90 ordinary shares and, therefore, each employee or Other Party was issued ordinary shares in the amount requested in his application.

Ordinary shares representing 4.94% of Rostelecom's charter capital were issued to the management at a nominal value of 1,000 nominal rubles per share.

An aggregate of 583,594 non-convertible, non-voting Class A preferred shares were issued to employees, management and Other Parties at no cost, and the number of shares issued to each employee was determined on the basis of the number of years actually employed in the telecommunications industry: employees who had worked for less than one year were issued one share, one to three years—ten shares, three to five years—twelve shares, five to ten years—fourteen shares, and over ten years—eighteen shares. Class A preferred shares were issued to Other Parties on the same basis as shares distributed among employees, although Other Parties received only 50% of the number of shares received by employees, provided that each Other Party received a minimum of one preferred share.

In connection with the voucher auction held in April 1994, the Russian Federal Property Fund declared an eighty to one stock split of Rostelecom's shares, as a result of which the nominal value of the shares decreased from 1,000 nominal rubles to 12.5 nominal rubles. A second stock split at a ratio of five shares to one was authorized by the Russian Federal Property Fund in connection with a specialized cash auction held during the period July through September 1995, as a result of which the nominal value of Rostelecom's shares decreased from 12.5 nominal rubles to 2.5 nominal rubles. Both the first and the second stock splits were approved by the shareholders of Rostelecom in January and November 1995, respectively. A new version of Rostelecom's charter was approved by the Company's shareholders on July 18, 1997 and registered by the Moscow Registration Chamber on August 26, 1997. On June 27, 1998, the new charter was amended to account for the redenomination of the Russian currency.

Rostelecom's charter capital is currently equal to 2,428,819.4725 nominal rubles and is comprised of 728,696,320 outstanding ordinary shares (the "Ordinary Shares"), nominal value RUR 0.0025 each, and 242,831,469 outstanding Class A preferred shares, nominal value RUR 0.0025 each (the "Class A Preferred Shares"). On November 27, 2000, the Annual Shareholders Meeting of Rostelecom approved a new version of the Company's charter (registered by the Moscow Registration Chamber on December 9, 2000), which authorize the issuance of additional 905,330,221 Ordinary Shares and 531 Class A Preferred Shares, nominal value RUR 0.0025 each. The Board of Directors of Rostelecom was authorized under the terms of such charter to issue additional ordinary shares up to the total of authorized, but not yet issued, shares without obtaining further shareholder approval.



On January 6, 1994, the Ministry of Communications of Russia, which was reorganized into the State Committee of Communications and Information of Russia in March of 1997, and reorganized back into the Ministry of Communications and Informatization of Russia (the "MOC") on November 12, 1999, granted Rostelecom a license, which authorized Rostelecom to provide long distance and international communications services throughout Russia. Such license, reissued as License No. 8777 on October 17, 1997, officially recognizes Rostelecom as an operator of domestic long distance and international communications systems and confers the Company the right to carry out settlements with foreign telecommunications companies and international organizations in accordance with the rules of international communications. License No. 8777 is valid through January 1, 2004.

In November 1994, the Russian Government approved the creation of a telecommunications holding company, Open Joint Stock Company Svyazinvest ("Svyazinvest"). The Government initially capitalized Svyazinvest with its 38% ownership interest in the total common and preferred equity of the 85 LTOs, which represents a 51% voting interest in these entities. In addition, pursuant to the Decree of the President of Russia No. 427, dated April 28, 1997, and the Resolution of the Russian Government No. 618, dated May 23, 1997, the Property Committee's 38% equity stake in Rostelecom was transferred to Svyazinvest. Simultaneously, in order to inject further capital and expertise into the Russian telecommunications industry, the Government announced plans to auction 49% of its equity ownership of Svyazinvest. The Government directed that the auction be carried out in two stages. The first stage resulted in the sale of 25% plus one share of the charter capital of Svyazinvest to Mustcom Limited, a newly formed investment consortium registered in Cyprus whose winning cash bid amounted to approximately 1.87 U.S.\$ billion in July 1997. The Mustcom Limited consortium included Uneximbank, Soros Capital, Morgan Stanley Asset Management and Deutsche Morgan Grenfell.

In June 1999, the general shareholders meeting of each of Rostelecom and OAO The Moscow Long Distance and International Telephone ("MMT") adopted decisions on the reorganization through merger of MMT with and into Rostelecom. Under Russian law, the merger of two joint stock companies is a long and multi-step procedure. On August 28, 2000 MMT was deleted from the register of legal entities, its shares were converted into shares of Rostelecom. On November 18, 2000 an Extraordinary General Shareholders Meeting of Rostelecom completed the merger of MMT into Rostelecom. Amendments which were introduced into the Company's charter due to the adoption of its restated version on November 27, 2000 have reflected the reorganization and confirmed the Company's succession to all rights and obligations of MMT.

The Annual General Shareholders Meeting of the Company, which was held on June 1, 2002, adopted a new version of the Company's charter, which was required by Federal Law No. 120-FZ "On Introduction of Amendments and Supplements to the Federal Law "On Joint Stock Companies", dated August 7, 2001 and was necessary to bring the Company's charter in conformity with the new provisions of the Joint Stock Companies Law. See further details in Item 10.B. – "Articles of Association."

### ***Register of the Company's Shareholders***

The Register of Rostelecom shareholders has been kept since May of 1997 by the specialized registrar RTC-Registrar, a branch of ZAO Registrar-Svyaz.

During the time of its existence, the activities of RTC-Registrar have been made subject to several comprehensive audits conducted, for example, by Price Waterhouse in 1997, which then was Rostelecom's auditor. An audit in 1998, repeated in 1999, was performed by WBK International Limited to survey risk management procedures practiced by RTC-Registrar. The same auditor in 1998 examined the terms of risk sharing applied by the registrar in its relations with insurance broker Heath Lambert Limited, and in 1999 appraised the registrar's risk in selection of its underwriting rate and adjustment of reinsurance terms.

The above audits have proven that RTC-Registrar has acted in strict conformity with Russian laws and resolutions of the Federal Commission for Securities Market regulating specialized registrar activities.

During the term of its service for the Company, RTC-Registrar has never been a party in any legal proceeding which found it at fault as a registrar.

For maintaining the register, the registrar uses computer hardware manufactured by SUN Microsystems, Compaq, Hewlett Packard and licensed programs Solaris 2.6, Novell 4.1, and Windows 95 OSR2. For the same purpose, the registrar also uses certified software Alfa-Registrar (PARTAD License No. 16) operable under Database Management System Informix 7.23.

To ensure the proper maintaining of the shareholders register, RTC-Registrar conducts daily back-up of information (one copy is retained in the registrar office, one copy is transferred to Rostelecom, and one is deposited weekly in a bank safe).

Pursuant to paragraph 5.22 of Resolution No. 27 of the Federal Commission for Securities Market, all instructions of persons entered into the register are executed by several employees working in different departments. Additionally, all operations executed in the shareholders register are monitored and checked on a daily basis by different employees, which allows to minimization of the risk of fraud, negligence or omission.

### ***Corporate Governance Principles***

At its meeting held on April 11, 2002, the Board of Directors of Rostelecom approved the Declaration on Corporate Governance Principles addressed to the Company's shareholders, customers, personnel, investors and financial institutions, as well as to the other parties interested in the operations of the Company.

The Declaration on Corporate Governance Principles provides that, acknowledging the importance of high corporate governance standards for the successful operation of the Company's business and for reaching mutual understanding with the parties interested in the operations of the Company, Rostelecom plans to prepare and adopt, by the end of 2003, a Code of Corporate Conduct consistent with the basic principles of corporate governance accepted internationally, and in Russia.

The management of Rostelecom is clearly aware that the confidence of the shareholders, investors and partners of the Company in its economic stability and effective and practical corporate governance are essential for Rostelecom's further development.

In determining the direction of the Company's future development and in preparation of the Code of Corporate Conduct, Rostelecom management intends to abide by the following basic principles of corporate governance:

- observance and protection of shareholders' rights;
- equitable treatment of shareholders;
- prompt and precise disclosure of information on all material matters related to the Company;
- acknowledgment of the duly recognized rights of interested parties;
- encouragement of vigorous cooperation between the Company and interested parties to assure the Company's stability, development and creation of working positions;

- effective control by the Board of Directors over the Company's management; and
- accountability of the Management Board to the Board of Directors and the shareholders.

### ***Initiatives to Promote Investor and Shareholder Relations***

The Company accords great attention to the promotion of investor relations ("IR") and to the maintenance of high standards of disclosure. Rostelecom management is aware of the need to disclose information in conformity with the requirements of Russian law, the Russian Federal Commission for Securities Market and the United States Securities and Exchange Commission ("SEC"), and of the need to maintain an active dialogue with the investment community.

In connection to this, the Company began, in 2002, to draw up an integrated investor relations program. The Company's objective is to enhance the understanding of the Company's business, opportunities and prospects, among investors and analysts. Rostelecom emphasizes transparency, detailed and prompt disclosure and an ongoing dialogue with the target audience. Currently, Rostelecom has already launched a number of actions to increase the availability of information about the Company. They include:

- meetings and presentations for investors and analysts;
- road shows and individual meetings with investors;
- conference calls;
- distribution of press releases; and
- publications in the trade media.

### ***Capital Expenditures***

To achieve its strategic objectives, the Company constructs new telecommunications infrastructure facilities, develops its primary initial network and implements new technologies which enables the Company to expand the scope of services it provides to various customers. The Company's investment policy is to primarily utilize internal sources of funding.

In 1999, the Company's capital investments totaled 5,593 million rubles.

The most important investment projects put into operation in 1999 were:

- the following international Fiber-Optic Lines ("FOL"): Russia – Ukraine and Russia – Belarus; FOL Novorozhdestvenskaya – Stavropol – Makhachkala in North Caucasus; FOL Apastovo – M. Purga, DMLs Tyumen-Surgut and Samara-Orenburg;
- extended capacity of the Company's major FOL Moscow – Saint-Petersburg;
- completion of the construction of the initial stage of infrastructure development of Rostelecom's domestic long-distance transit digital network on the basis of digital automatic switching units; and
- the final extension of FOL Moscow – Khabarovsk.

In 2000, the Company proceeded with developing and upgrading its digital network. Rostelecom invested 4,580 million rubles.

The most important investment projects put into operation in 2000 were:

- FOL Novorozhdestvenskaya – Stavropol – Makhachkala;
- FOL Perm – Izhevsk;
- FOL Samara – Saratov – Volgograd; and
- FOL Aksay – Lugansk.

In addition, the Company completed the construction of the East Segment of the satellite communications network owned by the Company, the second launch facility of its public multimedia communications network, put into operation earth stations of the Rostelecom satellite communications network, as well as an international switching center in Lyuban with the capacity equal to 9,510 channels. In 2000, Rostelecom also completed the establishment of the digital domestic long-distance integrated network which connects to nearly all local switches.

### ***Capital Construction and Investments in 2001***

#### *Major Investment Projects Put into Operation in 2001*

In 2001, the Company invested 3,182 million rubles. The following facilities were put into operation: 1,686.8 kilometers of FOL, long-distance switches with 10,800 channels, international telephone exchanges with 1,320 channels, one satellite station and automated exchanges with 2,600 numbers.

The most important investment projects put into operation in 2001 were:

- FOL Kizlyar-Grozny;
- two sections of FOL Volgograd-Rostov-on-Don and the Volgograd-Elista-Budennovsk FOL;
- FOL Lyuban-Issad;
- FOL Issad-Petrozavodsk;
- expansion of the three AMTSS of Moscow and the FOL Moscow Ring; and
- launching of a telephone exchange in Murmansk.

See also Item 4.B. – "Business Overview – Capital Construction and Investment in 2001."

As a priority for 2002, the Company wants to construct and modernize the network to increase the volume of its existing and future services. See also Item 4.B. – "Business Overview – Main Directions of the Development in 2002."

## **Divestitures**

The following divestitures have been effected by the Company during 2001 and 2002:

### *ZAO Telmos*

In 2001, Rostelecom purchased additional 40% of share in ZAO Telmos, one of the principal jointly-owned entities in which the Company previously held 20% of its shares. On June 5, 2001, pursuant to the decision of Rostelecom Board of Directors, dated February 23, 2001, the Company's interest in ZAO Telmos increased up to 60% following the acquisition from AT & T Communicational Services International Inc. of a block of ZAO Telmos shares representing 40% of the company's charter capital. The above decision was made on the basis of the report on the performed legal investigation prepared by legal firm D.P.Halmond and Co., and also pursuant to the opinion given by specialists of Rostelecom and MMT on the technical condition and capabilities of the network owned by ZAO Telmos.

On September 5, 2001, the share of Rostelecom in ZAO Telmos decreased to 20% in connection with sale of 40% of the charter capital through alienation of ZAO Telmos shares under the Sale Purchase Agreement between the Company and OAO Aktsionernaya Finansovaya Kompania Sistema (OAO AFK Sistema) on the basis of the decision of Rostelecom's Board of Directors, dated August 10, 2001.

The other shareholders of ZAO Telmos are OAO Aktsionernaya Finansovaya Kompania Sistema (OAO AFK Sistema) (40%) and AO MGTS (40%). The core business of ZAO Telmos is the provision of international, long-distance and local communication services to corporate customers in Moscow and Moscow Region.

### *OAO Giprosvyaz*

On March 13, 2002, the Board of Directors of Rostelecom decided to terminate its participation in OAO Giprosvyaz through the sale of its 65,326 ordinary registered shares of OAO Giprosvyaz constituting 22% of the charter capital of OAO Giprosvyaz, under the Sale-Purchase Agreement between the Company and the Non-Profit Partnership Center for Telecommunications Problems Research.

Therefore, on March 26, 2002 Rostelecom transferred 65,326 shares of OAO Giprosvyaz pursuant to Sale-Purchase Agreement No. 4-TsB, having terminated its participation in the company.

### *EDN Sovintel*

On March 29, 2002, Rostelecom's Board of Directors decided to terminate the Company's participation in Limited Liability Company (OOO) EDN Sovintel ("Sovintel" or "EDN Sovintel") by selling the Company's stake in Sovintel's charter capital under a sale and purchase agreement between the Company and corporation SFMT-CIS, Inc. and OOO Teleross, which is a subdivision of Golden Telecom. As a result of the transaction, Rostelecom expects to exchange its 50% stake in Sovintel's charter capital for 15% of Golden Telecom's shares and U.S. \$10 million in cash and \$46 million in notes payable in 90 days after transfer of shares. The Company's management believes that the sale of shares of Sovintel, whose business is not a core business for Rostelecom, will enable the Company to repay a portion of its external debt. Additionally, the purchase of shares of Golden Telecom, a leading provider of voice communications, data transmission and Internet services, is attractive for Rostelecom from the point of managing an internationally listed company.

## ***Borrowings***

In 2001 and 2002, the Company made diligent efforts to decrease its debt obligations, *inter alia*, through negotiations on restructuring the indebtedness of the Company to some Russian creditors, which were conducted successfully.

On April 30, 2002, Standard & Poor's (S&P), the rating agency, increased the long-term credit rating of Rostelecom from CCC to B-, with a stable outlook.

S&P's report says that the new ratings show that Rostelecom maintains a dominant position in the Russian long distance communications market, a steady growth in demand for telecommunication services, a successful restructuring of debt obligations, and an improvement in the financial conditions of the Company.

In March 2002, the indebtedness to Sberbank, a Russian bank, in the amount of RUR 200 million (U.S.\$ 6.5 million) was restructured.

Rostelecom expects that, as a result of its ongoing campaign to restructure its indebtedness, credits and loans will decrease to approximately U.S.\$ 150 million at the end of 2002 compared with U.S.\$ 224.8 million at the end of 2001.

### *U.S. dollars Denominated Loans of the Group*

A credit agreement between Rostelecom and Telecom Italia entered into force in May 1994 with the outstanding principal amount of U.S.\$ 10.2 million as of December 31, 2001. The expected proceeds from specialized international traffic were used as security for this credit. The escrow account was opened in the relevant currency, which was then supplemented by installments to ensure the payments. Repayment was made in 14 semiannual installments in June and December of each year, and the last installment was required to be made no later than December 2002. The interest rate was LIBOR+3%. The purpose of the financing was to construct an underwater cable between Italy-Turkey-Ukraine-Russia. In January 2002, the credit was fully repaid by the Company.

A credit agreement between Rostelecom and Vneshtorgbank entered into force in July 1995 with the outstanding principal amount of U.S.\$ 1.3 million as of December 31, 2001. The respective equipment and cash balances deposited in a designated escrow account were used to secure the loan. The credit was to be repaid quarterly in 20 equal installments in the amount of U.S.\$ 0.1 million, and in 20 equal quarterly installments in the amount of U.S.\$ 0.8 million, commencing no later than March 1997, with the last payment being made no later than June 2002. The interest rate was LIBOR+3.16%. The purpose of the financing was to construct the FOL Moscow-Saint-Petersburg. This credit was fully repaid on June 17, 2002, in accordance with the repayment schedule.

A credit agreement between Rostelecom and Sumitomo Corporation entered into force in March 1997 with the outstanding principal amount of U.S.\$ 24.2 million as of December 31, 2001. The loan is secured by the related equipment and by cash balances deposited in designated escrow accounts, and repayable in quarterly installments with the final payment due no later than July 2005. The interest rate is LIBOR+3.2%. The purpose of the financing is to construct the FOL Novosibirsk-Khabarovsk. As of August 27, 2002, the amount of outstanding principal was U.S.\$ 18 million.

A credit agreement between Rostelecom and Merrill Lynch entered into force in February 2000 with the outstanding principal amount of U.S.\$ 17.7 million as of December 31, 2001. The credit was not secured and was to be repaid by quarterly payments of 1/16 of the value of the credit, commencing August 2000, with the last

payment being made no later than May 2004. The interest rate was LIBOR+6%. The purpose of the credit was to provide working capital to Rostelecom. In May 2002 the credit was fully repaid by the Company.

A credit agreement between RTC-Leasing and ING Bank (Eurasia) entered into force in January 2001 with the outstanding principal amount of U.S.\$ 2.9 million as of December 31, 2001. The credit was secured by telecommunications equipment leased to Rostelecom and by a guarantee from Rostelecom. The last payment is to be made no later than October 2003. The interest rate is LIBOR+6%. The credit was incurred for the purpose of the purchasing telecommunications equipment. As of August 27, 2002, the amount of outstanding principal was U.S.\$ 1.8 million.

A credit agreement between RTC-Leasing and ING Bank (Eurasia) entered into force in May 2001 with the outstanding principal amount of U.S.\$ 3.2 million as of December 31, 2001. The credit is guaranteed by Rostelecom. The last payment is required to be made no later than March 2003. The interest rate is 12% per annum. The credit was incurred for the purpose of purchasing telecommunications equipment. Since drawdowns were made in January and May 2002 under the credit line opened in accordance with this agreement, the amount of outstanding principal was U.S.\$ 4 million, as of August 27, 2002.

A credit agreement between RTC-Leasing and Vneshtorgbank entered into force in July 2001 with the outstanding principal amount of U.S.\$ 3.3 million as of December 31, 2001. The credit is guaranteed by OAO Moscow City Telephone Network ("MGTS"). The last payment is to be made no later than August 2004. The interest rate is LIBOR+8%. The credit was incurred for the purpose of purchasing telecommunications equipment. Since the drawdown was made in March 2002 under the credit line opened in accordance with this agreement, the amount of outstanding principal was U.S.\$ 3.6 million, as of August 27, 2002.

A U.S.\$ 15 million credit agreement between RTC-Leasing and Joint-Stock Commercial Bank "Trust Investment Bank" (DIB) entered into force on April 23, 2002. The loan is secured by the proceeds from the placement of a bond issue at the Moscow Interbank Currency Exchange. The credit was incurred for the purpose of providing working capital. The last payment is to be made no later than November 22, 2002. The interest rate is 14% per annum. As of August 27, 2002, the outstanding principal amount was U.S.\$ 15 million.

A U.S.\$ 1.96 million credit agreement between RTC-Leasing and Russian Commercial Bank entered into force on April 8, 2002. The loan was incurred to finance leasing agreements. The last payment is to be made no later than March 21, 2005. The interest rate is LIBOR/0.95 + 6.316%. As of August 27, 2002, the outstanding principal amount was U.S.\$ 1.96 million.

#### *German Marks Denominated Loans of the Group*

A credit agreement between Rostelecom and Vnesheconombank entered into force in June 1995 with the outstanding principal amount of DM 5.4 million as of December 31, 2001. Repayment is to be made by semiannual installments, each in the amount of DM 0.9 (€ 0.46) million, with the last payment due no later than August 2004. The loan was used for the purpose of purchasing automatic switching systems (EWSA). As of August 27, 2002, the amount of outstanding principal was DM 3.6 (€ 1.9) million.

A credit agreement between Rostelecom and Vnesheconombank entered into force in March 1996 with the outstanding principal amount of DM 1.9 million as of December 31, 2001. Repayment is to be made by semiannual installments, each in the amount of DM 0.6 (€ 0.3) million, with the last payment being no later than February 2003. The loan was used for the purpose of purchasing transmission systems, (IKM 1920x2). As of August 27, 2002, the amount of outstanding principal was DM 0.6 (€ 0.3) million.

### *Japanese Yen Denominated Loans of the Group*

A credit agreement between Rostelecom and Vnesheconombank entered into force in 1994 with the outstanding principal amount of JPY 11.837 billion as of December 31, 2001. It is repayable in equal annual installments of JPY 2,105 million, with a final payment due no later than October 2001. The loan was incurred for the purpose of constructing digital microwave Moscow – Khabarovsk. The Government decree provides for the possibility of a restructuring of Government's debts administered by Vnesheconombank over a 10-year period at an interest rate of 3% per annum. In accordance with the provisions of the decree, in 2001 the Group entered in negotiations with respect to restructuring this credit agreement on the above terms. See also Item 13 "Defaults, Dividend Arrearages and Delinquencies."

A credit agreement between RTC-Leasing and ING Bank (Eurasia) entered into force in August 2001 with the outstanding principal amount of JPY 150 million as of December 31, 2001. The credit is guaranteed by Rostelecom. Repayment is to be made in quarterly installments, with the last payment being made no later than August 2004. The interest rate is LIBOR+3.5%. The loan was incurred for the purpose of purchasing telecommunications equipment. As of August 27, 2002, the outstanding principal amount under this agreement was JPY 170.4 million.

A credit agreement between RTC-Leasing and ING Bank (Eurasia) entered into force in August 2001 with the principal amount of JPY 25 million as of December 31, 2001. The credit was guaranteed by Rostelecom. The credit was repaid by semiannual installments, with the last payment being scheduled for no later than August 2002. The interest rate was LIBOR+5%. The credit was incurred for the purpose of purchasing telecommunications equipment. In August 2002 the credit was fully repaid by RTC-Leasing.

### *Euro Denominated Loans of the Group*

A revolving credit agreement between Rostelecom and Siemens entered into force in September 1993 with the outstanding principal amount of € 33 million as of December 31, 2001. The credit is secured with the rights under the agreement between Rostelecom and Deutsche Telecom AG. The credit is to be repaid in quarterly installments in the amount of 90% of the monies deposited in Rostelecom's account with Ost-West Handelsbank. The interest rate is Euro Interbank Offered Rate+2%. This revolving credit was incurred to finance a number of projects for the construction of communication lines. As of August 27, 2002, the amount of outstanding principal was € 31.2 million.

A credit agreement between RTC-Leasing and ING Bank (Eurasia) entered into force on May 18, 2002 with the principal amount of € 2.9 million. The loan is granted for a period of 7 months and was used to finance leasing agreements. The loan is secured by the equipment and conditional assignment. The interest rate is Euro Interbank Offered Rate+5%. As of August 27, 2002, the principal amount outstanding was € 0.4 million.

### *Ruble Denominated Loans of the Group*

A credit agreement between Rostelecom and Sberbank entered into force in April 1999 with the outstanding principal amount of RUR 200 million as of December 31, 2001. The credit is secured by the equipment. The repayment of the principal amount was made in quarterly installments and repayment of the interest was made in monthly installments, with the last payment being scheduled for no later than April 2002. The interest rate was 20%. The loan was used for the purposes of purchasing telecommunications equipment. In March 2002, the debt for RUR 200 million was restructured to allow equal principal repayments of RUR 50 million through December 2003, beginning in July 2002. As of August 27, 2002, the outstanding principal amount was RUR 50 million since on August 20, 2002, the Company repaid RUR 100 million ahead of schedule.



A credit agreement between RTC-Leasing and Sberbank entered into force in August 1999 with the outstanding principal amount of RUR 350.2 million as of December 31, 2001. The credit was secured by the telecommunications equipment leased to Rostelecom and a guarantee by Rostelecom. The last payment is to be made no later than January 2003. The interest rate, as of January 1, 2002, was 20% per annum. The loan was used for the purpose of purchasing telecommunications equipment. As of August 27, 2002, the amount of outstanding principal was RUR 140 million.

A credit agreement between RTC-Leasing and Sberbank entered into force in April 2000 with the outstanding principal amount of RUR 492.8 million as of December 31, 2001. The credit was secured with the telecommunications equipment leased to Rostelecom and a guarantee by Rostelecom. The last payment must be made no later than February 2003. The interest rate, as of January 1, 2002, was 20% per annum. The loan was used for the purpose of purchasing telecommunications equipment. As of August 27, 2002, the amount of outstanding principal was RUR 197 million.

A credit agreement between RTC-Leasing and Sberbank entered into force in October 2001 with the outstanding principal amount of RUR 100 million as of December 31, 2001. The credit was secured with the equipment supplied pursuant to this credit agreement. The interest rate was 17% per annum. The loan was used for the purpose of purchasing telecommunications equipment. The credit was fully repaid in April 2002.

In April 2002, RTC-Leasing concluded a credit agreement with the Vernadskoye branch of Sberbank, in which a credit line was opened for the purposes of providing working capital for RTC-Leasing. The credit is secured with leased telecommunications equipment. The last payment is to be made no later than April 2003. The interest rate is 18% per annum. As of August 27, 2002, the amount of outstanding principal was RUR 152 million.

In addition, RTC-Leasing intends to enter into a credit agreement with Sberbank with a purpose to raise funding to finance telecommunication equipment supplies.

The purposes of the financings are the only restrictions stipulated in the credit and loan agreements described above.

## **The Russian Federation**

### ***Territory and Administrative Divisions***

The Russian Federation is the largest country in the world in terms of land area, with a land area of 6.6 million square miles. Spanning 11 time zones, it stretches across the continents of Europe and Asia and borders Poland, Belarus, Ukraine and the Baltic countries to the west, Finland and Norway to the north and Georgia, Azerbaijan, Kazakhstan, Mongolia, the People's Republic of China and North Korea to the south.

The Russian Federation is divided into 89 constituent entities, including 21 republics, six areas, 10 autonomous districts, 49 regions, one autonomous region and two cities of federal importance (Moscow and St. Petersburg).

### ***Government and Political Factors***

The Russian Federation was the dominant member of the former Soviet Union. Following the disintegration of the Soviet Union in 1991, the Russian Federation emerged as one of the 15 newly independent former Soviet republics, and is now a member of the Commonwealth of Independent States (CIS).

A new Russian Constitution was approved by referendum on December 12, 1993, creating a presidential republic with the President wielding extensive executive powers. Russia's legislature, the Federal Assembly, consists of a lower chamber, the State Duma, and an upper chamber, the Federation Council.

Boris Yeltsin was elected President of the Russian Federation in June 1991 and was re-elected in July 1996. After his resignation on December 31, 1999, Vladimir Putin assumed the position of acting president and was subsequently elected President in 2000. In his earliest statements, Putin advocated a "moderately liberal" economic policy, involving the strengthening of legal institutions, maintaining state regulation of certain portions of the economy, nonpreferential treatment of organizations, and caution in formulating policy. As Putin articulated his economic priorities, a few themes emerged: improving the business climate for both Russian and foreign companies, attracting foreign investment, reforming Russia's tax and customs system and land reform. These and other concepts were incorporated into a 10-year action plan adopted in the summer of 2000.

In 2001, Putin has cited a number of additional economic reform priorities. These include banking reform, currency liberalization, diminishing Russian bureaucracy and red tape, addressing property and shareholder rights and the reform of Russian natural monopolies (in particular, gas, electricity, and railways).

To secure the enforcement of the President's powers throughout the Russian Federation, in the year 2000 its territory was divided into seven "federal regions", each comprising several constituent entities. The President appoints to each of the "federal regions" his representative vested with significant powers in implementing the President's policy and overseeing the activities of local executive bodies.

### ***Economic Factors and the General Regulation of Business***

Russia has exceptionally rich natural resources, such as oil, diamonds, gold, copper, rare metals, manganese, bauxite, uranium, silver, graphite and platinum, all of which are a source of hard currency because of world-wide demand. In particular, about 10% of the world's proven oil reserves are located in Russia. The Russian Federation is a major producer of most types of minerals and, in many cases, it is the world's leading producer and exporter. It was reported that in 1995, the country accounted for 11% of world oil output, 30% of gas, and 10% of hard coal. Siberia and the Russian Far East are considered the resource backbone of the Russian economy.

According to Goskomstat, industrial production in the late 1990s was only 45% of the levels achieved in 1990; other sources suggest larger declines. Among those sectors hit the hardest by this severe decline were the military-industrial complex and light industry.

One of the effects of the August 1998 crisis described below was to facilitate, at least temporarily and only for some sectors, progress at stimulating local production and import substitution. Industrial output in 1999, and again in 2000, reflected this influence and other factors. Although output at medium and large Russian enterprises for the most part steadily declined throughout the 1990s, while small companies and joint ventures were largely responsible for increased output, the Russian financial crisis somewhat altered this dynamic, with some of the medium- and large-sized enterprises ramping up production and their market orientation towards stronger domestic competitiveness.

Russia's economic growth in 2000 was the highest achieved in the last three decades, but many analysts are reluctant to proclaim that this growth – or other isolated macroeconomics indicators showing improvement in 2000 – indicate real economic turnaround. Higher world prices for fuel and metals facilitated improvements, as did ongoing effects of the 1998 ruble devaluation, which rendered Russian products relatively less expensive compared to imports and contributed to increased domestic purchases and exports, as well as a decline in barter transactions.

At the end of 2000, economic growth slowed. In 2001, economic growth was 5.1%. Many initial estimates for 2002, including estimates by international organizations, have predicted continued, albeit slower, economic growth in the vicinity of 3.5% to 4%. Alternative estimates suggest the possibility of 0% economic growth.

### ***Privatization***

Russia has moved through four phases of privatization. The first phase began in October 1992, and involved the distribution of privatization vouchers among the population and holding voucher auctions. The second phase of privatization was initiated in July 1994, and involved the privatization of Russian companies for cash, including privatization of some of the largest Russian enterprises. The third phase, which began in the second half of 1995, involved the controversial "loan-for-shares" auctions in which the Russian Government borrowed long-term loans from major Russian banks against the controlling stakes in the largest Russian enterprises as collateral, together with voting and management rights. Lastly, since late 1995, Russia has been selling shares – primarily to domestic investors – in approximately 140 enterprises considered the "crown jewels" of the Russian industry.

In 1997, President Yeltsin signed a decree on plans to privatize Russia's natural monopolies, including power and gas enterprises, as well as Russian railroads; however, privatization of the natural monopolies continues to be a disputed issue. In late 2000, the State Duma halted privatization of the largest Russian companies until a new privatization law came into effect on April 26, 2001.

The new privatization law replaces the 1997 law on the same subject. The law introduces some new forms of privatization methods and discusses their specifics, including placement of shares through a stock exchange, sale of state property by public offer, sale of open joint stock companies' shares to a trust manager upon completion of the terms of a trust management agreement, and, subject to certain requirements, direct or indirect sale of state owned shares abroad. Further, it states that the initial price of the property that is subject to privatization should generally be based on an appraisal report prepared in accordance with the appraisal legislation of the Russian Federation.

By the mid 1990s, 75% of medium- and large-scale enterprises in Russia had been privatized. Since January 1996, the Russian Government has reported that at least 70% of Russian GDP is composed of goods and services accounted for by the private sector. In early 1997 Russian Government figures reported that the private sector accounted for 75% of manufacturing enterprises, 85% of manufacturing and more than 80% of the Russian workforce.

### ***Inflation and Hard Currency Rates***

The ruble exchange rate has declined dramatically since the onset of economic reforms. Monetary authorities concerned with the danger of frequent wide fluctuations have attempted to stabilize the ruble within a band. The fluctuation band in January 1997 was set at 5,500-6,100 rubles to U.S.\$1.00. On January 1, 1998, the Russian Federation redenominated the ruble, introducing new bills with three fewer zeros than pre-1998 rubles. At the same time, the Russian Federation reintroduced the kopeck, valued at 1/100 of a ruble.

In August 1998, the country's banking system was paralyzed by financial crisis. In 1998, the total annual inflation rate grew almost eight times (84.4%) in comparison with 1997 (11%). At the end of 1999 the ruble exchange rate to the U.S. Dollar was 27:1.

In 2000 and 2001, Russian inflation continued to decrease from the peak that followed Russia's 1998 financial crisis. The total annual rate of inflation for the year 2000 was equal to 20.2% and 18.8% for the year 2001. The average of month-end ruble exchange rates to the U.S. Dollar in 2000 was 28.13:1 and 29.15:1 in 2001. Although initial predictions estimated year-end inflation in 2002 to be around 12%, both Russia and international financial institutions adjusted estimates upward to 15% in early 2002.

## ***Labor***

The Russian Federation benefits from a large workforce and, as a result of, among other things, growing unemployment, there is now an increasing pool of available labor which includes individuals with Western business exposure, education and experience. Employment statistics from the Russian Federation are unreliable and official unemployment statistics are believed to be artificially low.

A new Russian Labor Code came into force on February 1, 2002. The new Labor Code is more market oriented than its predecessor, in which socialist values dominated, and, generally speaking, gives dominant position to employers in determining their relations with employees. The new Labor Code regulates issues related to the relationship between employers and employees, including salaries, terminations, the conclusion of labor contracts, and protection of employee rights.

## ***Foreign Investment***

Since 1991, the Government has undertaken a number of legal and economic measures designed to stimulate foreign investment. The first major step was the adoption of the Law on Foreign Investment in July 1991 (the "Old Foreign Investment Law"), which permits a wide range of foreign investment activities in Russia. The Old Foreign Investment Law is the primary body of legislation relating to foreign investment, although specific provisions in various other legislation including the basic corporate, tax, customs, accounting and other laws applicable to businesses operating in Russia often create practical difficulties for foreign investors. The Old Foreign Investment Law allows the repatriation of profits and prohibits nationalization without prompt, adequate and effective compensation. On July 14, 1999, the new Federal Law "On Foreign Investments in the Russian Federation" (the "New Foreign Investment Law") became effective.

The New Foreign Investment Law is less generous than the law it replaced, and its provisions leave much to be desired in terms of clarity and specifics. The New Foreign Investment Law guarantees foreign investors the same treatment as Russian companies, but also makes the foreign parent company liable for the actions of Russian subsidiary companies. The New Foreign Investment Law puts foreign and Russian investors on an equal taxation footing. Foreign investors lose tax preferences that were established by the Old Foreign Investment Law. In return, the law guarantees foreign investors protection against future unfavorable changes in the legislation regarding the payback period for investments. The New Foreign Investment Law also sets clear standards to determine when a foreign investor and its local investment vehicle (typically, a joint stock or limited liability company) may qualify for protection from adverse changes in Russian law, such protection being unavailable unless investors are willing either to maintain more than 25% of the total capital in local investment vehicles or to use such vehicles to implement priority investment projects.

## ***Securities Market***

The Russian securities market is governed principally by the Securities Market Law. The Securities Market Law regulates the activities of brokers, dealers, custodians and other "professional participants in the securities market" including stock exchanges, as well as the issuance and circulation of securities. The Securities Market Law also addresses various disclosure requirements (including those applicable to the Russian issuers) and the functions of the Federal Commission for the Securities Market. In addition to this overarching piece of legislation, the President, the Russian Federation Ministry of Finance, the Russian Federation State Property Committee, the Central Bank and the Federal Commission for Securities Market have issued detailed regulations and decrees applicable to the securities market.

Under the Securities Market Law, the issuers are required to register any issuance of securities and register a prospectus (i) if the shares are being placed to an unlimited group of potential shareholders or, if to a limited

group, the number of potential shareholders exceeds five hundred, or (ii) if the total value of the issuance exceeds fifty thousand times the then effective minimum monthly wage (currently, approximately U.S.\$161,290).

The Federal Commission for Securities Market has issued detailed procedures to be followed in connection with the registration and issue of shares of a joint stock company, thereby implementing the more general provisions of the Securities Market Law. These procedures require prior registration of the share issue (which may include registration of a prospectus) and, following the placement of the shares, require registration of a report on the results of the share issue approved by the board of directors and registration of amendments to the charter of the company reflecting the capital increase.

Shares are normally issued in non-documentary ("paperless") form and are always registered securities. Ownership of shares in Russian companies is established generally by reference in the company's shareholder register and is evidenced by extracts from the register. The extracts themselves are not securities, and, thus, the share register provides the only conclusive evidence of share ownership (unless a custodian is recorded in the registrar as a nominee holder, in which case the ownership is evidenced by an extract from a custody account maintained by the custodian for the securities owner). The shareholders register includes data on each registered person (*i.e.*, the owner, nominee holder, pledgee or trust manager), the number, categories and classes of shares recorded in the name of each such registered person, and certain other data.

Russian law currently requires that the share register of Russian companies with more than 50 holders of ordinary shares, such as Rostelecom, must be held by a specialized registrar. The Federal Commission for Securities Market regulations prohibit such specialized registrars from carrying out any other activities than maintenance of a share registrar, and require that the specialized registrar obtain a license from the Federal Commission for Securities Market.

Russian law currently contemplates the use of custodians who also act as nominee holders of securities. Custodians are entitled to receive dividends and vote the shares on behalf of the beneficial owner upon receipt of instructions from a beneficial owner of shares. Pursuant to the Securities Market Law, shares held by custodians do not form part of their assets and are not subject to distribution upon the nominee's liquidation or bankruptcy.

The Russian Government over the last few years has consistently moved in the direction of enhancing protection of investors, shareholders and depositors in the securities market and the banking system. On July 1, 1996, the President issued a decree approving the "Concept for the Development of the Securities Market in the Russian Federation" which focuses on the protection of shareholders. In addition, the new Criminal Code has criminalized securities fraud and conducting professional activities in the securities market without an appropriate license.

To provide more stringent protection of investors and prevent the possibility of infringement of minority shareholders' rights, the Law "On the Protection of the Rights and Legitimate Interests of Investors in the Securities Market" (the "Investors Protection Law") became effective on March 11, 1999. The law establishes additional requirements with regard to the placement of securities to an unlimited number of investors, introduces additional investor protection measures and the liability of issuers and other persons for violations of the investors' rights. Furthermore, the Investors Protection Law places additional requirements on professional participants of services to investors on the securities market.

On March 13, 2001, the Federal Commission for Securities Market issued a specific Regulation "On the Procedure for Issuing the Approvals for Circulation of Shares of Russian Issuers Abroad in the Form of Securities of Foreign Issuers Issued in Accordance with the Foreign Law and Certifying the Rights to the Issue Securities of the Russian Issuers" adopted by Resolution No. 3 of Federal Commission for Securities Market ("Regulation No.3"). Pursuant to the Regulation No. 3, the securities of Russian issuers may be circulated outside the Russian Federation in the form of depositary receipts only upon a preliminary approval of the Federal Commission for

Securities Market. Regulation No.3 establishes the procedure for obtaining such approval, the purposes of which, generally, are to (i) limit the amount of underlying Russian shares deposited pursuant to deposit agreement to 75% of the aggregate amount of shares of the same category of a Russian issuer, and (ii) prevent the possibility of exercising the voting rights conferred by the underlying shares other than in accordance with the instructions of their beneficial owners. Regulation No. 3 has no retroactive effect.

The long-awaited amendments to the Joint Stock Companies Law entered into force on January 1, 2002, except for certain provisions related to the competence of general shareholders meetings, which came into force on August 9, 2001.

The landmark provisions of the new amendments are mainly aimed at strengthening the rights of shareholders, to cover inadequacies of the existing law related to establishment, reorganization and liquidation of joint stock companies, charter capital increases, and the placement of shares and other securities. Pursuant to such provisions, the existing shareholders of a joint stock company enjoy preemptive right in both open and closed subscriptions for additional shares and certain other securities of such company. They also retain rights proportionate to their shareholding in a company in any new companies formed as a result of a corporate restructuring. Furthermore, as a result of the permission of the circulation of fractional shares minority shareholders will no longer face forced buy-outs in the process of shares consolidation.

### ***Taxation and Duties***

Currently, Russian tax system is subject to fundamental reform. The reform is intended to provide a solid basis for investment and trade, to reduce and to improve the stability, transparency and fairness of the Russian tax system. This is to be achieved by a mean of simplification of Russian tax system through gathering tax legislation in a single body of tax law (the tax code), significant cutting of the total number of taxes, and reduction of tax burden through reduction of tax rates.

As part of the reform on January 1, 1999, Part I of Russia's new tax code (the "Tax Code") came into effect. This part of the Tax Code establishes basic principles of imposing taxes, tax calculations, relations between tax authorities and taxpayers, etc. In particular, among other principles Part I of the Tax Code provides that (i) all doubts, contradictions and ambiguities of legislative acts relevant to taxes and fees shall be interpreted in favor of taxpayers, (ii) any taxpayer is presumed innocent until proven otherwise in a court of law and the burden of proof is carried by the tax authorities and (iii) the tax authorities maintain confidentiality of information.

Certain chapters of Part II of the Tax Code, which came into effect in 2001-2002, regulate major taxes (VAT, profits tax, personal income tax, unified social tax, etc.).

Rostelecom is registered with the Specialized State Tax Inspectorate No. 40 at the Ministry of Taxation and Charges, which was established to deal with the largest companies. Starting from January 1, 2000, Rostelecom has been keeping centralized records of taxes and payments.

## **4.B. Business Overview**

### **Overview**

Rostelecom is the primary provider of international and domestic long-distance telecommunications services in Russia. The Company renders international and domestic long-distance traffic throughput services to all 89 local operators (the "LTOs"). Additionally, Rostelecom provides long-distance traffic throughput services to operators of the overlay networks, as well as international and long-distance services to end-users in Moscow.

Rostelecom operates its own trunk network which transmits the majority of Russia's domestic and international traffic. The Company's trunk network is comprised of nearly 200,000 kilometers of digital and analog lines. Its digitalization level in terms of channel kilometers was 73% at the end of 2001.

The "backbones" of the Rostelecom network are its modern fiber optic lines: Moscow – Novorossiysk, Moscow – Khabarovsk, and Moscow – St. Petersburg. The Company has completed a major part of the construction of its domestic long-distance digital transit network based on eight Automatic Switching Nodes (UAKs). Today, 90% of the Automatic Trunk Exchanges (AMTS) are connected through two or more paths to the Company's UAKs.

Rostelecom has completed the construction of a fully connected international digital network based on 11 international switching centers (ISCs). As a result of the Rostelecom network, international telecommunication services are available in any geographic point of Russia. The Company has direct access to 74 countries and participates in 28 international cable systems. Rostelecom maintains extensive relationships with 295 international operators and network administrations. Russia is a member of the International Communications Union (ITU), a specialized intergovernmental organization under the UN which facilitates guidelines and agreements regulating telecommunications. ITU is designed to coordinate, standardize and internationally regulate the telecommunications industry on a worldwide scale. Notwithstanding that established international standards are sufficiently effective to regulate communication services and settle disputes, Rostelecom is seeking to strengthen its relations with all international operators to which it has direct channels, by executing relevant arrangements in writing.

Rostelecom's network interconnects all LTOs, which operate their own local telephone networks in the regions. As a result, Rostelecom does not bill most end-users directly, except certain enterprises, Russian governmental bodies and retail customers in Moscow, but instead collects payments from LTOs and other entities which independently charge their local customers for domestic and international outgoing calls.

In 2001, the Company's network throughput amounted to 8,129.9 million minutes of which 6,178.9 million minutes were long-distance calls and 1,951 million minutes were international calls (both outgoing and incoming).

Adjusted for inflation as required in IAS 29 "Financial Reporting in Hyperinflationary Economies" the Company's total revenues for the year ended December 31, 1999 amounted to RUR 32,754 million, for the year ended December 31, 2000 – to RUR 29,607 million and for the year ended December 31, 2001 – to RUR 26,293 million. Domestic long-distance and international services comprised 29% and 57% of all revenues in 2001, respectively (26% and 59% in 2000; 23% and 67% in 1999).

Rostelecom has implemented and is developing a variety of new services, largely complementing its existing domestic long-distance and international services. In particular, Rostelecom provides multimedia communications services, offers digital channels for lease, and distributes TV and radio programs through its network among broadcasting entities on the whole territory of Russia.

Rostelecom owns interest in certain companies specializing in the provision of modern communications services in Russia, including multimedia communications, access to the Internet and other value added services.

## **Services**

### ***International Traffic***

The Company is the primary provider of international telecommunications services in Russia. It provides the switching and transmission infrastructure that connects the Russian domestic telecommunications trunk network

with foreign networks and, in coordination with foreign telecommunications operators, facilitates the transmission of global telecommunications traffic. In 2001, revenues from international telecommunications services totaled RUR 14,912 million, or 57% of Rostelecom's total revenues. International telecommunications services amounted to RUR 17,602 million in 2000 (59% of total revenues) and RUR 21,786 million in 1999 (67% of total revenues).

In 2001, overall international traffic, including both incoming and outgoing traffic, amounted to 1,951 million minutes. Of this, incoming international calls totaled 869.3 million minutes, while outgoing international calls accounted for 1,081.7 million minutes. In 2001, outgoing international traffic increased by 15 % compared to 2000. While it proved impossible to effectively reverse the downward trend in incoming international traffic; it did prove possible to slow down its rate of reduction – to 3%.

Incoming traffic from the Baltic states amounted to 23 million minutes, from the Commonwealth of Independent States (CIS) countries amounted to 430 million minutes and from the rest of the world amounted to 416 million minutes. Outgoing traffic to the Baltic states totaled 48.1 million minutes, to CIS countries totaled 747 million minutes and to the rest of the world totaled 286.5 million minutes.

Prior to 1998, traffic between Russia and CIS countries was included in the overall volume of domestic long-distance traffic. Traffic with the CIS countries was reclassified as international in 1998; the reclassification was completed by January 1, 1999.

The charts below detail the data on Rostelecom's incoming and outgoing international traffic:

**International traffic with foreign countries, excluding traffic to and from the CIS and Baltic States  
(million minutes) for the years ended December 31**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Outgoing traffic	289	302	293	281	287
Outgoing traffic growth (% per annum)	23%	5%	-3%	-4%	2%
Incoming traffic	466	427	388	421	416
Incoming traffic growth (% per annum).	7%	-8%	-9%	8.5%	1%
Total traffic	755	729	681	702	703

**International traffic with the Baltic states (million minutes) for the years ended December 31**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Outgoing traffic	52	48	38	38	48,1
Outgoing traffic growth (% per annum)		-8%	-21%	0%	27%
Incoming traffic	43	43	29	28	23
Incoming traffic growth (% per annum).		0%	-33%	-3%	-18%
Total traffic	95	91	67	66	71



**International traffic with the CIS countries (million minutes) for the years ended December 31**

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Outgoing traffic	-	606	597	626	747
Outgoing traffic growth (% per annum)	-	-	-1%	5%	19%
Incoming traffic	525	555	512	448	430
Incoming traffic growth (% per annum).	6%	6%	-8%	-13%	-4%
Total traffic	525	1,161	1,109	1,074	1,177

Rostelecom's largest international traffic routes are between Russia and Germany, the United States of America, the United Kingdom, France, Italy and Finland. The chart below sets forth the total number of billed minutes of international incoming and outgoing calls for these countries.

**Minutes of international incoming and outgoing calls (million minutes)  
for the years ended December 31**

<u>Country</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Germany	132	126	93	110	113,5
United States of America	69	55	83	95	72
United Kingdom	48	48	43	46	29
France	35	35	26	29	25
Italy	38	34	23	29	31
Finland	37	30	24	17	21

In 2001, Moscow and St. Petersburg accounted, respectively, for approximately 37% and 9% of outgoing international traffic. Accordingly, the traffic volume and the tariffs level for outgoing international calls, as well as the rates level for incoming international calls in these two cities have a material impact on the Company's results of operations.

*Tariffs*

For outgoing international calls, the Company charges to end-users based on the destination of the call and the day and the time of the call. For each outgoing call, Rostelecom receives 50% of the total amount that the originating LTO receives from a subscriber initiating the call. For international calls made by Moscow subscribers, the Company keeps on average 88% of the tariff proceeds after settlement with the local operators. Also, Rostelecom must pay a pre-determined termination charge to a foreign operator receiving the outgoing call. For the incoming international calls Rostelecom charges foreign operators at a pre-determined termination rate.

In June 2001, the Company announced new tariffs on international communications that come in to force on July 1, 2001. The tariffs on international communications from Moscow to most European countries (Austria, Belgium, Great Britain, Germany, Greece, Denmark, Ireland, Spain, Italy, Cyprus, Liechtenstein, Luxembourg, Monaco, the Netherlands, Norway, Portugal, Finland, France, Switzerland and Sweden), and to the United States and Canada, from 8:00 p.m. to 8:00 a.m., were reduced by 23%. Tariffs for the Ukraine and Belorussia were increased from five to seven rubles. Tariffs for the Trans-Caucasian countries (Georgia, Armenia and Azerbaijan) remain 16 rubles, regardless of the time or day of the call. Tariffs were revised to eliminate traffic imbalances, assure cost-effective international telecommunications and improve customer service quality.

To optimize the tariffs for the provision of international telephone communications with the Trans-Caucasian countries, as of July 1, 2001, a unified 24-hours-a-day tariff was introduced for calls between Armenia, Azerbaijan and Georgia, and all of the Russian regions.

In response to requests from certain LTOs with large volumes of outgoing traffic to Kazakhstan, a special tariff area was established for this border region and reduced the tariffs for Kazakhstan. In order to maintain the revenue level of the LTOs and Rostelecom, the tariffs in the Ukrainian, Belorussian and Moldavian zones were increased.

Also, in light of requests from customers who live on the Russian/Ukrainian border areas, Rostelecom reduced the rate for calls to Ukraine from subscribers of OAO Belgorod Telecommunications by 15%.

The charts below illustrate the international tariffs used by the Company as of December 31, 2001.

**International Outgoing Tariffs for Foreign Countries, CIS Countries and Baltic States:**

Region	Per minute tariff (nominal rubles)						
	For Moscow, St. Petersburg, Moscow Oblast and Leningrad Oblast			For European Russia			
	<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>	
	8 a.m. through 8 p.m., local time	8 p.m. through 8 a.m., local time	00.00-24.00	8 a.m. through 8 p.m., local time	8 p.m. through 8 a.m., local time	00.00-24.00	
<b>CIS countries:</b>							
Belarus, Ukraine	10.50	7.00	5.25	10.50	7.00	5.25	
Moldova	12.00	8.00	6.00	12.00	8.00	6.00	
Azerbaijan, Armenia, Georgia	16.00	16.00	16.00	16.00	16.00	16.00	
Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan	12.00	8.00	6.00	12.00	8.00	6.00	
<b>Baltic States:</b>							
Latvia, Lithuania, Estonia	19.50	13.00	9.75	19.50	13.00	9.75	
<b>Foreign countries:</b>							
Europe	(tariff 1)	15.00	10.00	7.50	19.50	13.00	9.75
	(tariff 2)*	21.90	14.60	10.95	21.90	14.60	10.95
Asia and Middle East	(tariff 1)	29.40	19.60	14.70	29.40	19.60	14.70
	(tariff 2)**	44.85	29.90	22.43	44.85	29.90	22.43
Vietnam		44.85	29.90	22.43	44.85	29.90	22.43

Region		Per minute tariff (nominal rubles)					
		For Moscow, St. Petersburg, Moscow Oblast and Leningrad Oblast			For European Russia		
		<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>
Turkey		15.00	10.00	7.50	19.50	13.00	9.75
Americas	(tariff 1)	19.50	13.00	9.75	24.00	16.00	12.00
	(tariff 2)***	38.85	25.90	19.43	38.85	25.90	19.43
Australia, Oceania		35.40	23.60	17.70	35.40	23.60	17.70
Africa		42.30	28.20	21.15	42.30	28.20	21.15

Region		Per minute tariff (nominal rubles)					
		For Far East			For Siberia		
		<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>
		8 a.m. through 8 p.m., local time	8 p.m. through 8 a.m., local time	00.00-24.00	8 a.m. through 8 p.m., local time	8 p.m. through 8 a.m., local time	00.00-24.00
<b>CIS countries:</b>							
Belarus, Ukraine		18.00	12.00	9.00	15.00	10.00	7.50
Moldova		18.00	12.00	9.00	18.00	12.00	9.00
Azerbaijan, Armenia, Georgia		16.00	16.00	16.00	16.00	16.00	16.00
Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan		15.00	10.00	7.50	12.00	8.00	6.00
<b>Baltic States:</b>							
Latvia, Lithuania, Estonia		25.50	17.00	12.75	19.50	13.00	9.75
<b>Foreign countries:</b>							
Europe	(tariff 1)	25.50	17.00	12.75	19.50	13.00	9.75
	(tariff 2)*	29.40	19.60	14.70	21.90	14.60	10.95
Asia and Middle East	(tariff 1)	19.95	13.30	9.98	29.40	19.60	14.70
	(tariff 2)**	30.90	20.60	15.45	44.85	29.90	22.43

Region		Per minute tariff (nominal rubles)					
		For Far East			For Siberia		
		<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>
Vietnam		30.90	20.60	15.45	44.85	29.90	22.43
Turkey		25.50	17.00	12.75	19.50	13.00	9.75
Americas	(tariff 1)	18.00	12.00	9.00	24.00	16.00	12.00
	(tariff 2)***	18.00	12.00	9.00	38.85	25.90	19.43
Australia, Oceania		35.40	23.60	17.70	35.40	23.60	17.70
Africa		42.30	28.20	21.15	42.30	28.20	21.15

Region		Per minute tariff (nominal rubles)					
		For cities bordering on Kazakhstan			For Belgorod		
		<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>
		8 a.m. through 8 p.m., local time	8 p.m. through 8 a.m., local time	00.00-24.00	8 a.m. through 8 p.m., local time	8 p.m. through 8 a.m., local time	00.00-24.00
<b>CIS Countries:</b>							
Ukraine		15.00	10.00	7.50	9.00	6.00	4.50
Belarus		15.00	10.00	7.50	10.50	7.00	5.25
Moldova		18.00	12.00	9.00	12.00	8.00	6.00
Azerbaijan, Armenia, Georgia		16.00	16.00	16.00	16.00	16.00	16.00
Kazakhstan		9.75	6.50	4.88	12.00	8.00	6.00
Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan		12.00	8.00	6.00	12.00	8.00	6.00
<b>Baltic States:</b>							
Latvia, Lithuania, Estonia		19.50	13.00	9.75	19.50	13.00	9.75
<b>Foreign countries:</b>							
Europe	(tariff 1)	19.50	13.00	9.75	19.50	13.00	9.75

Region		Per minute tariff (nominal rubles)					
		For cities bordering on Kazakhstan			For Belgorod		
		<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>Reduced</u>
		8 a.m. through 8 p.m., local time	8 p.m. through 8 a.m., local time	00.00-24.00	8 a.m. through 8 p.m., local time	8 p.m. through 8 a.m., local time	00.00-24.00
	(tariff 2)*	21.90	14.60	10.95	21.90	14.60	10.95
Asia and Middle East	(tariff 1)	29.40	19.60	14.70	29.40	19.60	14.70
	(tariff 2)**	44.85	29.90	22.43	44.85	29.90	22.43
Vietnam		44.85	29.90	22.43	44.85	29.90	22.43
Turkey		19.50	13.00	9.75	19.50	13.00	9.75
Americas	(tariff 1)	24.00	16.00	12.00	24.00	16.00	12.00
	(tariff 2)***	38.85	25.90	19.43	38.85	25.90	19.43
Australia, Oceania		35.40	23.60	17.70	35.40	23.60	17.70
Africa		42.30	28.20	21.15	42.30	28.20	21.15
Tariffs marked (*), (**) and (***) apply to the following countries:							
* Bosnia and Herzegovina, Hungary, Greenland, Ireland, Iceland, Liechtenstein, Macedonia, Romania, Slovakia, Slovenia and Croatia							
** Bangladesh, India, Indonesia (incl. Timor), Jordan, Iraq, Iran, Yemen, Cambodia, China, Kuwait, Laos, Lebanon, Maldives, Nepal, Pakistan, Saudi Arabia, Syria, Thailand, Philippines, Sri Lanka							
*** all countries of North and South America except the United States, Canada and Alaska (US territory)							

As of December 31, 2001, U.S.\$ 1 = RUR 30.14.

### ***Domestic Long Distance Traffic***

In 2001, Rostelecom carried over 70% of the domestic long-distance traffic in the Russian Federation. The revenues from domestic long-distance telecommunication services in 2001 totaled RUR 7,568 million, or 29% of Rostelecom's revenues. In 2000 Rostelecom's domestic-long distance revenues were RUR 7,568 million (26% of total revenues) and in 1999 – RUR 7,449 million (23% of total revenues).

In 2001, the volume of domestic long-distance traffic amounted to 6,178.9 million minutes (including 1,158.7 million minutes from end-users and 5,020.2 million minutes from operators). Traffic growth equaled 25% in 2001, primarily due to the further upgrading of the Rostelecom network, expansion of local access networks by the LTOs and the overall increase of per capita income in Russia.

The table below sets forth data on domestic long-distance traffic including outgoing traffic to CIS countries and Baltic states.

**Domestic Long-Distance Communications (in million minutes)**

	<b>For the years ended December 31</b>				
	<b><u>1997</u></b>	<b><u>1998</u></b>	<b><u>1999</u></b>	<b><u>2000</u></b>	<b><u>2001</u></b>
Total volume of domestic long-distance traffic including:	3583	3918	3915	4960	6178.9
Internal domestic long-distance traffic	2951	3264	3915	4960	6178.9
Traffic to CIS countries and Baltic states	632	654	-	-	-
Growth of volume of internal domestic long-distance traffic	13.8%	10.6%	19.9%	26.7%	24.6%

Traffic with the CIS countries was reclassified as international in 1998; the reclassification was completed by January 1, 1999. Prior to 1998, traffic with the CIS countries was included in the volume of domestic long-distance traffic.

*Tariffs*

In all regions of Russia except for Moscow, Rostelecom does not receive any payments directly from end-users of its domestic long-distance services. Instead, Rostelecom is paid at a settlement rate by outgoing LTOs and alternative operators (overlay digital network operators) for the transit of the LTO's customer traffic through the Rostelecom network.

In Moscow, Rostelecom owns international and long-distance switches and renders customer services through the OAO Moscow City Telephone Network ("MGTS") which owns the connections to end-users. Prior to 2000, Rostelecom had an agreement with MMT whereby MMT, acting on behalf of Rostelecom, maintained international switches and billed customers for international and domestic long-distance services provided by Rostelecom. Rostelecom received these payments directly and paid MMT a commission for its billing, payment, monitoring and collection services which equaled 15.5% before, and 12.65% after, August 1998. At the Annual General Shareholders Meeting on June 26, 1998, shareholders approved the acquisition of MMT by Rostelecom. Starting from 2000, such services have been provided by the Rostelecom - MMTS-10 branch which was founded as a result of the MMT merger approved in June 1999. Rostelecom has a separate agreement with MGTS under which Rostelecom pays MGTS monthly, on average 14% of revenues collected in Moscow, for the right to channel international and long-distance traffic through the lines of MGTS.

The tariff that Rostelecom charges for the transit of domestic long-distance traffic from LTOs (the "linear settlement rate") is based on a fixed ruble amount for each 50 kilometers of distance. Rostelecom's linear settlement rate was set in 1993 in compliance with directives of the Ministry of Communications. It was regularly indexed according to inflation. However, the rate remained unchanged during the period between July 1996 and July 2001, despite its reduction in real terms due to the continuing inflation in Russia. LTOs paid Rostelecom for outgoing traffic at the linear settlement rate and for termination of domestic long-distance calls at the termination rate, while Rostelecom paid LTOs for each minute of incoming traffic originated by another LTO. The settlement rates could only be changed through a procedure established by regulating bodies.

On January 1, 1997, a special settlement rate (Integral Settlement Rate) was introduced based on a 1 min/50kilometers basis (linear component of the Integral Settlement Rate) and also taking into account the existing balance between the incoming and outgoing traffic of LTOs. Since then, Rostelecom has stopped charging LTOs for termination of each domestic long-distance call.

Since January 1, 1999, tariffs for all categories of clients, as well as settlement rates for domestic long-distance traffic of LTOs, has been regulated by the Ministry for Anti-Monopoly Policy.

Within the framework of the arrangements to reduce cross subsidies in the communications sector, Russia's Ministry for Anti-Monopoly Policy in June of 2001 decided to raise the linear component of the Integral Settlement Rate by 25%, effective July 1, 2001, and in October 2001 to raise it by another 25%, effective January 2002.

As part of Rostelecom's policy to eliminate the difference in tariff rates charged to government and non-government organizations, the domestic long-distance tariffs structure was adjusted on January 1, 1998, which resulted in increased tariffs for governmental end-users and lowered tariffs for commercial entities and individuals. In February of 1999, tariff rates for commercial entities and individuals in Moscow were increased by 15%. Since January 1, 2000, the tariffs have been raised by 18% for governmental users only. Presently, uniform tariff rates are applied to both commercial entities and individuals.

Table below illustrates the minute-based tariffs charged by Rostelecom in January of 2000, January and July of 2001 and January of 2002 to governmental bodies and other customers for long-distance connections (calls) between Moscow and given Russian cities. Rostelecom tariff rates are set and charged in rubles.

**Domestic Long-Distance Tariffs, nominal rubles  
January 2000**

City	Budget organizations	Individuals			Organizations		
		<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>
Zhukovsky	0.75	2.01	0.67	0.44	2.43	0.81	0.81
Tver	1.50	4.17	1.39	0.90	4.98	1.66	1.66
St. Petersburg	1.90	5.46	1.82	1.18	6.42	2.14	2.14
Novosibirsk	2.30	6.09	2.03	1.32	7.59	2.53	2.53
Irkutsk	3.10	7.17	2.39	1.55	8.76	2.92	2.92
Khabarovsk	3.90	8.34	2.78	1.81	10.77	3.59	3.59

**January 2001**

City	Budget organizations	Individuals			Organizations		
		<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>
Zhukovsky	0.90	2.01	0.67	0.44	2.43	0.81	0.81
Tver	1.80	4.17	1.39	0.90	4.98	1.66	1.66
St. Petersburg	2.30	5.46	1.82	1.18	6.42	2.14	2.14
Novosibirsk	2.80	6.09	2.03	1.32	7.59	2.53	2.53
Irkutsk	3.70	7.17	2.39	1.55	8.76	2.92	2.92
Khabarovsk	4.70	8.34	2.78	1.81	10.77	3.59	3.59

**July 2001**

City	Budget organizations			Individuals			Organizations		
	<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>
Zhukovsky	1.10	0.69	0.69	2.43	0.81	0.81	2.43	0.81	0.81
Tver	2.20	1.39	1.39	4.98	1.66	1.66	4.98	1.66	1.66
St. Petersburg	2.80	1.76	1.76	6.42	2.14	2.14	6.42	2.14	2.14
Novosibirsk	3.40	2.14	2.14	7.59	2.53	2.53	7.59	2.53	2.53
Irkutsk	4.45	2.80	2.80	8.76	2.92	2.92	8.76	2.92	2.92
Khabarovsk	5.65	3.56	3.56	10.77	3.59	3.59	10.77	3.59	3.59

**January 2002**

City	Budget organizations			Individuals			Organizations		
	<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>	<u>Peak</u>	<u>Off-Peak</u>	<u>On Weekends</u>
Zhukovsky	1.32	0.81	0.81	2.43	0.81	0.81	2.43	0.81	0.81
Tver	2.64	1.66	1.66	4.98	1.66	1.66	4.98	1.66	1.66
St. Petersburg	3.36	2.14	2.14	6.42	2.14	2.14	6.42	2.14	2.14
Novosibirsk	4.08	2.53	2.53	7.59	2.53	2.53	7.59	2.53	2.53
Irkutsk	5.34	2.92	2.92	8.76	2.92	2.92	8.76	2.92	2.92
Khabarovsk	6.78	3.59	3.59	10.77	3.59	3.59	10.77	3.59	3.59

In June 2001 the Company announced the introduction of its new long-distance tariffs, effective from July 1, 2001, to bring service prices in line with costs and offset inflation for the period from the last change of tariffs (tariffs for individual users and budget organizations were revised on October 1, 1999 and January 1, 2001, respectively). This decision was approved by Order of Ministry for Anti-Monopoly Policy No. 672 on June 8, 2001.

Long-distance tariffs for Moscow-based users have increased on average by 16%. Saturday, Sunday and holiday tariffs for residential users are equal to those applicable on business days from 8 p.m. to 8 a.m. Residential user rates have increased on average by 33%, depending on the time of day, day of week and destination of each call.

In order to eliminate the difference in tariff rates for government and non-government organizations, long-distance tariffs for government organizations were changed starting from July 1, 2001:

- the tariffs increased by 20% for the period from 8 a.m. to 8 p.m. on business days; and
- the tariffs reduced by an average of 25% for the period from 8 p.m. to 8 a.m., as well as for Saturdays, Sundays and public holidays.

Since January 10, 2002, long-distance tariffs applicable to government organizations have increased on average by 20%.



Tariffs on trunk line services rendered to government organizations were raised by 20% from January 1, 2001.

***Additional and New Services***

Although domestic long-distance and international telephone services remained the largest source of the Company's income in 2001, Rostelecom continued to expand the range of services provided both to end-users and to operators.

*Integrated Service Digital Network (ISDN) Services:* In 2001, Rostelecom connected 19 Russian regions and three operators of associated networks (Telmos, Comstar and Sovintel), to ISDN. International ISDN services were launched with four international operators – Finnet (Finland), Slovak Telekom (Slovakia), Teleglobe (Canada) and UkrTelecom (Ukraine). As a result, ISDN is accessible to 51 regions and five operators of associated networks. International ISDN services are available with respect to 30 countries and 34 international operators.

*Frame Relay Technology Services:* The Company used the Moscow Center for International Access to provide international Frame Relay technology services to Russian corporate clients and operators.

*International Roaming:* Rostelecom routes international roaming signal messages to 108 countries (253 international mobile communications operators). In 2001, access was provided to the networks of 45 operators. Russia's largest mobile operators use the services of the Company's international signal network.

*Intellectual Platform-Based Services:* In March 2001, *Free Phone 800*, the first service based on the Company's "intellectual platform", was launched. As an effective means of advertising and marketing, this service is widely used by foreign companies. Rostelecom made it available in Russia. In July 2001, the 809 Information Service, with an additional charge, was launched.

*Plastic Cards Used for the Payment of Domestic Long-Distance and International Service:* In early 2001, the Company and ZAO CB Guta Bank introduced new technology of payment for domestic long-distance and international communications services with VISA, EC/MC and Union Card of any issuing bank. In the autumn 2001, jointly with Guta Bank, the Company issued the ROSTELECOM Visa Electron international card. Further, the Company continued to increase the availability of domestic long-distance and international services under various types of specialized cards, including the World Card and the STC and STC-Intertone telephone service cards.

The following chart lists all services provided by Rostelecom to the end-users and operators:

<b><u>Principal types (groups) of services</u></b>	<b><u>Customer category</u></b>	<b><u>Scope of service</u></b>
<b>International telecommunications services</b>		
Automated international telephone communications	Russian corporate and private clients	Access from Moscow to any country except Afghanistan
Operator-assisted international telephone communications	Russian corporate and private clients	Access from Moscow to any country except Afghanistan
Russia Direct –RD	Russian clients traveling abroad	Access from 40 countries (47 operators) to Moscow only
Home Country Direct Service -HCD	Foreign operators (for their clients traveling to Russia)	Access from 54 Russian regions to 40 countries (47 operators)

<b><u>Principal types (groups) of services</u></b>	<b><u>Customer category</u></b>	<b><u>Scope of service</u></b>
Prepaid card international telephone communications	Russian private and corporate clients, including those traveling abroad	Access: - from Moscow to any country; - from 40 countries (45 operators) to any location in Russia.
Collect Call (paid by foreign party)	Russian corporate and private clients.	United States of America only
International FreePhone Service –IFS	Foreign operators for their subscribers	Access from 54 Russian regions to 16 countries
International integrated service digital network (ISDN)	Russian corporate and private clients; Russian operators.	Access from/to 51 Russian Regions to/from 30 countries (34 operators)
Leasing of international channels and circuits	Russian corporate clients; Russian and foreign operators.	Direct digital flows for lease arranged for 29 countries (35 operators). For other countries, leased channels are arranged by transit through third countries.
International Frame Relay services	Russian corporate clients; Russian and foreign operators.	Services available from Moscow and St. Petersburg for two countries (Lithuania and Latvia)
Other operators' international telephone traffic throughput services	Russian operators of the public telephone network and associated networks	Available from any location in Russia to any country
International roaming services for mobile network subscribers	Russian operators of mobile networks; foreign operators	Available to five Russian mobile network operators for 110 countries (266 foreign operators)
Direct unswitched transit of international flows/channels via Russia	Foreign operators	Can be arranged between points of access to Russia of all operating international trunk networks
Switched transit of international traffic via Russia	Foreign operators	Direct international exchange lines opened for 71 countries. Transit services provided to 69 foreign operators, including 13 CIS countries.
<b>Domestic long-distance telecommunications services</b>		
Automated domestic long-distance telephone communications	Russian corporate and private clients	Access from Moscow to any location in Russia
Operator-assisted domestic long-distance telephone communications	Russian corporate and private clients; Russian operators of the public telephone network and associated networks	Access from Moscow to any location in Russia
Prepaid card domestic long-distance telephone communications	Russian corporate and private clients	Access from Moscow to any location in Russia
Other operators' domestic long-distance telephone traffic throughput services	Russian operators of the public telephone network and associated networks	Throughout Russia
Intellectual Communication Network (ICN) national services	Russian corporate and private clients	Access to services from 68 Russian regions

<b><u>Principal types (groups) of services</u></b>	<b><u>Customer category</u></b>	<b><u>Scope of service</u></b>
ISDN domestic long-distance services	Russian corporate and private clients; Russian operators of the public telephone network and associated networks	Access to services from/to 59 regions and five associated networks of alternative operators
Leasing of domestic long-distance channels and circuits	Russian corporate clients; special users; Russian communications operators; television and radio companies	Throughout Russia
Group domestic long-distance telephone communications (GDLDTTC) services	Government ministries and agencies	Throughout Russia
Data transmission via MMTEL network	Corporate and private clients	City of Moscow
Open multimedia communications network services	Government authorities; Russian corporate and private clients	Services provided to a limited range of users and nine PCPs in 71 Russian regions
<b>Radio and television broadcasting services</b>		
Broadcasting	Television and radio companies	City of Moscow
<b>References and inquiries</b>		
Reference and inquiries desks of international entities (8, dial tone, 190)	Russian corporate and private clients; foreign operators	Throughout Russia
MMT references and inquiries (07)	Russian corporate and private clients; Russian operators	City of Moscow
MMT references and inquiries (245 0015)	Russian corporate and private clients; Russian operators	City of Moscow
<b>Additional services</b>		
MMT additional services	Corporate and private clients	MMT buildings

Rostelecom plans to commence the provision of the following services:

<b><u>Principal types (groups) of services</u></b>	<b><u>Customer category</u></b>
Packet telephony services	Russian operators of TelCo and ITSP
Intellectual network services	Russian operators and corporate clients

In 2001, the Group's revenues from the provision of other services excluding the transit of domestic long-distance and international traffic amounted to RUR 3,813 million, or 14% of Rostelecom's revenues for the reporting period. In 2000 these services accounted for 15% of Rostelecom's revenues (RUR 4,437 million) and in 1999 – 10% of Rostelecom's revenues (RUR 3,519 million).

### ***Present Network and Facilities***

Rostelecom provides its international and domestic long-distance telecommunications services through its ground and submarine cables, microwave lines and satellites. The resources of the trunk transportation network ensure the transfer of any type of information, including international traffic from foreign operators. Rostelecom's digital SDH network covers practically the entire territory of Russia.

#### ***Primary Network***

Rostelecom's primary network consists of trunk cables linked to the LTO networks and to Rostelecom's international switches for connections with foreign operators, as well as a satellite communications network using the resource of the LMI-1 satellite. As of December 31, 2001, the Company's digital network comprised 37,000 kilometers including 26,000 kilometers of fiber optic lines and 11,000 kilometers of microwave lines. A fundamental component of the network is a series of powerful FOLs between Moscow and Novorossiysk, Moscow and St. Petersburg, and Moscow and Khabarovsk, as well as a satellite communications network that includes three junction centers in Moscow, Novosibirsk and Khabarovsk and nine periphery switches in Barnaul, Kirov, Gorno-Altaysk, Kyzyl, Minusinsk, Yakutsk, Novokuznetsk, Yuzhno-Sakhalinsk and Salekhard.

The Company has installed international fiber optic lines accessing Finland, Denmark, Turkey, Italy, Japan, Korea, China, Estonia, Kazakhstan, Ukraine and Belarus. Major foreign operators can now send their non-commutated traffic through Russia. As new digital communication lines are built, the Company regularly decommissions its analog transmission lines. Thus, 4.6 thousand kilometers of trunk lines and 11.9 thousand kilometers of microwave cables were decommissioned during the period of 1998 through 2001.

The following table details the principle lines that make up Rostelecom's primary network since December 31, 2001:

<b><u>Line</u></b>	<b><u>Type of line</u></b>	<b><u>Length (km)</u></b>	<b><u>Transmission rate (Mbits/sec)</u></b>	<b><u>Channels</u></b>
Moscow-Khabarovsk	Digital Microwave	7,977	6 x 155	11,340
Moscow-Ekaterinburg	Fiber Optic Cable	2,400	2,488	30,240
Moscow-St. Petersburg	Fiber Optic Cable	1,163	2,488	30,240
Nakhodka-Naoetsu-Pusan	Submarine Fiber Optic Cable	1,762	565	15,360
Nakhodka-Khabarovsk	Fiber Optic Cable	897	2 x 622	15,120
Kingisepp-Copenhagen	Submarine Fiber Optic Cable	1,210*	2 x 565	15,360
Kingisepp-St. Petersburg	Suspended Fiber Optic	191	2 x 622	15,120
St. Petersburg-Kingisepp-Moscow	Digital Microwave	949	3 x 140	5,760
Novorossiysk-Istanbul-Palermo	Submarine Fiber Optic Cable	3,420*	565	15,360
Kirov-St. Petersburg-Finland	Fiber Optic Cable	197**	622	7,560
Kingisepp-Tallinn	Fiber Optic Cable	26**	2,488	30,240
Moscow-Novorossiysk	Fiber Optic Cable	1,653	2,488	30,240
Khabarovsk-Harbin (China)	Fiber Optic Cable	150**	622	7,560
Perm-Ekaterinburg	Digital Microwave	565	2 x 155	3,780
Apastovo-Shigony	Fiber Optic Cable	220	622	7,560
Ekaterinburg-Novosibirsk	Fiber Optic Cable	1,572	2,488	30,240

<u>Line</u>	<u>Type of line</u>	<u>Length (km)</u>	<u>Transmission rate (Mbits/sec)</u>	<u>Channels</u>
Ivanovka-Vladivostok	Fiber Optic Cable	61	622	7,560
St. Petersburg-Lyuban-Luga	Fiber Optic Cable	289	2,488	30,240
Zadonsk-Lipetsk-Tambov	Fiber Optic Cable	270	622	7,560
Apastovo-Kazan	Fiber Optic Cable	132	622	7,560
Russia-Kazakhstan (eastern part of border)	Fiber Optic Cable	220**	622	7,560
Vladimir-Vologda, with branches to Ivanovo, Kostroma and Yaroslavl	Fiber Optic Cable	665	622	7,560
Overlay digital network in Moscow Oblast	Fiber Optic Cable	709	2 x 622	15,120
Tula-Kaluga	Fiber Optic Cable	212	2,488	30,240
Kaluga-Belgorod up to Ukrainian border, with branches to Bryansk, Kursk and Belgorod	Fiber Optic Cable	974**	2,488	30,240
Moscow-Minsk, with branch to Smolensk	Fiber Optic Cable	480**	2,488	30,240
Tyumen-Surgut	Digital Microwave	712	622	7,560
Samara-Orenburg	Digital Microwave	386	155	1,890
Apastovo-Malaya Purga, with branches to Kazan, Naberezhnyie Chelny, Izhevsk and Yoshkar-Ola	Fiber Optic Cable	661	2,488	30,240
Novosibirsk-Khabarovsk	Fiber Optic Cable	5,480	2,488	30,240
Novorozhdestvenskaya-Stavropol-Makhachkala, incl.:	Fiber Optic Cable	270	2,488	30,240
Novorozhdestvenskaya-Stavropol-Kropotkin-Pyatigorsk-Budennovsk with branches to Mineralnyie Vody and Kislovodsk	Fiber Optic Cable	458	2,488	30,240
Budennovsk-Kizlyar-Makhachkala with branches to Cherkessk, Nalchik, Nazran and Vladikavkaz	Fiber Optic Cable	901	2,488	30,240
Aksai-Lugansk	Fiber Optic Cable	36**	622	7,560
Samara-Saratov-Volgograd	Fiber Optic Cable	928	2,488 x 2	60,480
Perm-Izhevsk	Fiber Optic Cable	657	2,488	30,240
Volgograd-Rostov-on-Don	Fiber Optic Cable	516	2,488	30,240
Volgograd-Elista-Budennovsk	Fiber Optic Cable	560	2,488	30,240
Kizlyar-Grozny	Fiber Optic Cable	140	155	1,890
Lyuban-Issad	Fiber Optic Cable	140	2,488	30,240

<u>Line</u>	<u>Type of line</u>	<u>Length (km)</u>	<u>Transmission rate (Mbits/sec)</u>	<u>Channels</u>
Issad-Petrozavodsk	Fiber Optic Cable	319	2,488	30,240
Moscow Ring	Fiber Optic Cable	8	9,953	120,960

\* Length of link owned by Rostelecom. See Item 4.B. – "Business Overview – Submarine Cables."

\*\* Length to the state border.

### *Switches*

Rostelecom owns 11 international digital switches, including three in Moscow, two in St. Petersburg (Lyuban) and one each in Rostov-on-Don, Samara, Ekaterinburg, Novosibirsk, Khabarovsk and Murmansk. The combined capacity of these switches is 104,830 channels. In addition, the Company has eight Automatic Switching Nodes (UAK), interconnected by digital channels and five Automatic Trunk Exchanges (AMTS), including four in Moscow and one in Pavlov Possad. The UAKs and their connecting channels constitute an integrated services digital network (ISDN) with channel switching to which the networks of LTOs and commercial operators are connected. The AMTSs of Moscow and Pavlov Possad route domestic long-distance traffic between switching centers as well as directly to and from end-users.

As of June 30, 2002, the Company's domestic long-distance trunk network consisted of 87,900 digital and 31,600 analog lines. 70% of all digital channels were connected through SS-7. 95.8% of all Russian AMTSs have access to the digital transit network.

62 AMTSs are able to provide ISDN services through the domestic long-distance network. The Company has begun to operate on the second level of capacity of the multimedia communications open network, which allowed the Company to connect subscriber units in 71 Russian regions and nine retail outlets. Subscribers connected to the open network of Rostelecom's multimedia communications can participate in, and arrange, both bilateral and multilateral video conferences, discuss and jointly edit textual and graphic documents, receive and send files, and receive and send various audio and video information.

A hardware and software platform has been put into operation to provide the following intellectual services: televoting (TV), an added-charge service (PMR), collect calling (FPH) and connections with a pre-paid credit card. As of December 31, 2001, 38 regions can access the FPH service.

### *Submarine Cables*

As part of its program to expand and upgrade its international telecommunications capabilities, Rostelecom utilizes modern submarine cables to establish traffic links between Russia and other countries. The Company is the terminal party and the major capacity owner in three international fiber optic cable systems: Denmark-Russia 1 (DK-R1), Russia-Japan-Korea (R-J-K) and Italy-Turkey-Ukraine-Russia (ITUR). Rostelecom owns 50%, 33% and 30% of the DK-R1, R-J-K and ITUR systems, respectively. The remainder is controlled by various international operators.

Rostelecom has 512 x 30 lines in the DK-R1 system, 485 x 30 lines in R-J-K and 509 x 30 lines in ITUR. In order to provide access to these systems and to establish direct high-quality international lines to remote sites of the world, Rostelecom participates in the construction of, and acquires capacity in, many international cable systems.

At present, the Company has interests in, or an indefeasible right of use of, 27 other systems, including global projects such as FLAG, APC, APCN, CANTAT-3, TPC-5, SEA-ME-WE 2, SEA-ME-WE 3, CHINA-US CN,

TAT-12/13 and TAT-14. Currently, the Company owns a capacity of 450 x 2 Mbits per second through these projects.

### ***Network Development Plans***

Since its foundation, the Company has been engaged in a significant capital investment program to modernize its entire international and domestic long-distance network. The initial phase of this program entailed the modernization and expansion of Rostelecom's existing primary international network facilities. The second phase involves expanding the capacity and updating the technology of the trunk lines and switches in the domestic long-distance network.

<b><u>Projects</u></b>	<b><u>Capacity (Lines)</u></b>	<b><u>Completion Date</u></b>
<b>Western Project</b>		
Submarine FOL Copenhagen (Denmark)-Kingisepp (Russia)	1,210	1993
DML Moscow-Kingisepp-St. Petersburg	15,360	1993
ISC in Moscow	14,190*	1993
ISC in Moscow	10,080*	1993
ISC in Moscow	22,560*	2000
ISC in St. Petersburg	6,286*	1993
ISC in Lyuban	9,510*	2000
FOL St. Petersburg-Finland	7,560	1995
FOL Kingisepp-Tallinn	30,240	1996
FOL Moscow-St. Petersburg	30,240	1997
FOL St. Petersburg-Lyuban-Luga	30,240	1998
FOL Lyuban-Issad	30,240	2001
FOL Issad-Petrozavodsk	30,240	2001
<b>Eastern Project</b>		
Submarine FOL Nakhodka (Russia)-Naoetsu (Japan)-Pusan (Korea)	15,360	1995
FOL Nakhodka-Khabarovsk	15,120	1995
ISC in Khabarovsk	9,420*	1995
ISC in Novosibirsk	9,720*	2000
FOL Khabarovsk-Harbin (China)	7,560	1996
FOL Ivanovka-Vladivostok	7,560	1998
FOL Russia-Kazakhstan	7,560	1998
FOL Novosibirsk-Khabarovsk	30,240	1999
Satellite communications network using the LMI-1 satellite capacity (Eastern segment), including		2000
Barnaul	300	2000
Gorno-Altai	150	2000
Kyzyl	150	2000
Novokuznetsk	150	2000
Salekhard	60	2000
Yuzhno-Sakhalinsk	150	2000
Yakutsk	240	2000
Kirov	120	2000
Minusinsk	150	2001
ISC in Murmansk	1,320	2001

<u>Projects</u>	<u>Capacity (Lines)</u>	<u>Completion Date</u>
<b>Southern Project</b>		
Submarine FOL Palermo (Italy)-Istanbul (Turkey)-Odessa (Ukraine)-Novorossiysk (Russia) (FOL ITUR)	15,360	1996
FOL Moscow-Rostov-on-Don-Novorossiysk	30,240	1996
ISC in Rostov-on-Don	8,880*	1996
FOL Novorozhdestvenskaya-Stavropol-Makhachkala	30,240	2000
FOL Kropotkin-Pyatigorsk-Budennovsk with branch to Mineralnyie Vody	30,240	1999
FOL Budennovsk-Kizlyar-Makhachkala with branches to Cherkessk, Nalchik, Nazran and Vladikavkaz	30,240	2000
FOL Aksai-Lugansk	7,560	2000
FOL Samara-Saratov-Volgograd	60,480	2000
FOL Volgograd-Elista-Budennovsk	30,240	2001
FOL Volgograd-Rostov-on-Don	30,240	2001
FOL Kizlyar-Grozny	1,890	2001
<b>Central Project</b>		
DML Moscow-Khabarovsk (Trans-Siberian link)	11,340	1997
ISC in Samara	9,900*	1996
ISC in Ekaterinburg	2,970*	1996
FOL Moscow-Ekaterinburg	30,240	1997
FOL Apastovo-Shigony	7,560	1997
FOL Perm-Ekaterinburg	3,780	1997
FOL Ekaterinburg-Novosibirsk	30,240	1998
FOL Zadonsk-Lipetsk-Tambov	7,560	1998
FOL Apastovo-Kazan	7,560	1998
FOL Vladimir-Vologda	7,560	1998
FOL Overlay Digital Network in Moscow Oblast	15,120	1998
FOL Tula-Kaluga	30,240	1999
FOL Kaluga-Belgorod to border with Ukraine, with branches to Bryansk, Oryol, Kursk and Belgorod	30,240	1999
FOL Moscow-Minsk with branch to Smolensk	30,240	1999
DML Samara-Orenburg	1,890	1999
FOL Apastovo-Malaya Purga with branches to Kazan, Naberezhnyie Chelny, Izhevsk and Yoshkar-Ola	30,240	1999
DML Tyumen-Surgut	7,560	1999
FOL Perm-Izhevsk	30,240	2000
FOL Moscow Ring	120,960	2001

\* total assembled capacity.

### ***Capital Construction and Investments in 2001***

In 2001, the Company put into operation the following facilities: 1,686.8 kilometers of fiber optic lines, long-distance switches with 10,800 channels, international telephone exchanges with 1,320 channels, one satellite station and automated exchanges with 2,600 numbers.



### *Major Investment Projects Put into Operation in 2001*

FOL Kizlyar-Grozny (140 kilometers): as the FOL was put into operation, the Company provided LTOs in the Republic of Dagestan and the Chechen Republic with access to Russia's trunk digital primary network.

With the launching of two sections of FOL Volgograd-Rostov-on-Don (516 kilometers) and FOL Volgograd-Elista-Budennovsk (561 kilometers), Rostelecom completed the construction of the Moscow-Samara-Volgograd-Rostov-Moscow digital circle segment in the South of Russia; the switch to the Southern Region allowed for the obtainment of two independent points of access to the digital trunk network.

The Company also created FOL Lyuban-Issad (140 kilometers), a high-rate digital transmission system, as a segment of the trunk digital primary network.

FOL Issad-Petrozavodsk (319 kilometers) enabled the Company to provide high-quality digital communications to users in the Republic of Karelia and Leningrad Oblast and contributed to the establishment of an integrated telecommunications environment operating in accordance with international standards.

The expansion of the three AMTSs of Moscow and the FOL Moscow Ring increased the number of domestic long-distance and international channels and resolved the problem of quality and range of services.

The launching of a telephone exchange in Murmansk enabled the Company to expand the switching capacity of the ISC in the Northwestern Region.

### **List of Facilities Put into Operation in 2001**

<b><u>Facility</u></b>	<b><u>Put into operation in 2001</u></b>
<b>Domestic long-distance cable communication lines, km</b>	<b>1,686.81</b>
FOL Volgograd-Rostov	516.2
FOL Volgograd-Elista-Budennovsk	560.99
FOL Kizlyar-Grozny	140.4
FOL Lyuban-Issad	140.98
FOL Issad-Petrozavodsk	319.46
FOL Moscow Ring 1 p.k.	8.78
<b>Satellite communications stations, units</b>	<b>1</b>
Rostelecom satellite communications network using the LMI-1 satellite resource (Eastern segment, 3 p.k., Minusinsk)	1
<b>International telephone switches, channels</b>	<b>1,320</b>
ISC in Murmansk	1,320
<b>Long-distance telephone switches, channels</b>	<b>10,800</b>
Expansion of EWSD-type AMT/ATS in the MTS-34 building, 1 p.k., of EWSD-type AMTS in the MTS-5 building	2,640
Expansion of EWSD-type AMTS in the MTS-10 building	4,530
Expansion of EWSD-type AMTS in the MTS-10 building	3,630
<b>Urban ATSS, thousand numbers</b>	<b>2.6</b>
Installation and connection of Convent-840 EATS in the p.5014 building	0.5
Expansion of EWSD-type AMTS/ATS in the building of MTS-34 1 p.k.	2.1

### ***Main Directions of the Development in 2002***

As a priority for 2002, the Company wants to construct and modernize the network to increase the volume of its existing and future services. The value of the Company's capital investments will reach 4.2 billion rubles in 2002 of which 1.1 billion rubles are to be applied for capital expenditures related to the technical maintenance of the Company's network. As priority investment projects are considered an estimated 1.1 billion rubles construction of new fiber optic lines oriented to the most promising directions, and a 2 billion ruble upgrade of the network with a view to increasing its throughput capacity and promoting new services. Development of new services are also planned.

The most significant projects in 2002 are expected to be as follows:

<b><u>Investment Project Description</u></b>	<b><u>Capacity (Lines)</u></b>	<b><u>Transmission Rate (Mbit/Sec)</u></b>	<b><u>Planned Completion Date</u></b>
FOL Yoshkar-Ola-Kirov with branch to Cheboksary	30,240	2,488	2002
FOL Russia-Kazakhstan International	30,240	2,488	2002
Baltic cable system, 1 <sup>st</sup> stage	60,480	2,488	2002
Reconstruction of FOL Moscow-Novosibirsk	120,960	9,953	2003
Additional supply of equipment to FOL Moscow-Novorossiysk	120,960	9,953	2003
FOL Gatikha-D. Konstantinovo with branch to Nizhny Novgorod	30,240	2,488	2002
FOL Kaliningrad-Gvardeysk with branch to Russian-Lithuanian border	7,560	622	2002
Construction of MNTS in Kaliningrad	1,300		
International FOL Russia-Azerbaijan	7,560	622	2002

a) The construction of new fiber optic lines will allow for new, strategically important, international directions for the Company and allow major cities to become connected to its networks. The Company's plans for 2002 include:

- Construction of FOL Russia-Kazakhstan, with access to Kazakhstan, which was already completed in the beginning of 2002.

The new FOL Russia-Kazakhstan provides Rostelecom's trunk network with a second outlet to Kazakhstan (Western Segment). The commissioned project includes a high-speed ring network based on the existing lines not only in the Russian Federation and the Republic of Kazakhstan, but also in the Chinese People's Republic.

FOL Russia-Kazakhstan passes through the settlements of Volzhsky-Khulkhuta-Yashkul-Elista. Its total length is 456 kilometers. The commissioned line is a part of the already existing FOL Samara-Saratov-Volgograd, with branches to Rostov-on-Don, Elista and Budennovsk. The construction was performed by Rostelecom, at its own expense.

The Company expects that the new trunk line will significantly improve conditions for Russian traffic transiting through Kazakhstan to the Central Asian republics and for Kazakhstan traffic transiting through Russia to Europe and the Asian-Pacific region. The Company also expects that newly commissioned FOL will improve the quality of Russia's telephone communications with the Central Asian countries as the

new line will not only add new channels operating in this direction, but will also allow traffic to travel in digital format.

- Completion of the construction of FOL Yoshkar-Ola-Kirov is intended to connect the cities of Kirov and Cheboksary to Rostelecom's trunk network;
- Construction of FOL Kaliningrad-Gvardeisk is required to provide access to Kaliningrad and Russia's state borders with Lithuania and Poland;
- Construction of two new FOLs: FOL Russia-Azerbaijan and FOL Gatikha-D.Konstantinovo-Nizhny Novgorod.

b) Upgrading of the network to increase the throughput capacity and develop new services:

- Construction of the Baltic Cable System (1st stage) jointly with Telia, Sweden, to upgrade the Moscow-St. Petersburg-Kingisepp line using the dense wave-length division multiplexing ("DWDM") technology, as well as broadening the Company's presence in the international cable systems market.
- Increase in the throughput capacity of the Moscow-Novosibirsk line, based on DWDM technology.
- Increase in the throughput capacity of the Moscow-Novorossiysk line, based on DWDM technology.
- The existing FOLs, additionally furnished with wavelength-division multiplex equipment, will provide for effective utilization of the existing communications lines in the long term and allow it to obtain the required throughput capacity. The upgrading of these lines will use the modern DWDM technology while preserving the existing PDH and SDH operable in parallel with DWDM, which will allow for the transfer of any type of information, at a rate higher than 10 Gb/s.
- Establishment of Rostelecom's data transmission centers and introduction of intellectual network services. Establishment of a flexible multiplexor network.

c) Apart from that, the Company's plans for 2002 provide for the following:

- upgrading of a 34Mb/s microwave line to Arkhangelsk;
- upgrading of a microwave line by two 17 Mb/s digital paths to Yakutsk;
- continuation of the work to increase capacity of the Eastern segment of Rostelecom's satellite network;
- upgrading of the ground satellite communications station in Petropavlovsk-Kamchatsky and installation of additional equipment at the ground station in Arkhangelsk;
- upgrading of telecommunications facilities of the Main Russian Television Center (GTsRT) in Ostankino;
- putting into operation the Moscow MTS-9 switching center, which will significantly broaden the offered range of services;
- expansion of ESWD-type AMTS in Pavlov Possad;

- expansion of the platform of the packet telephony exchange in Moscow and introduction of intellectual services and the construction of packet telephony gateways to St. Petersburg, Rostov-on-Don, Samara, Novosibirsk, Ekaterinburg, Khabarovsk. The first stage includes an introduction of the services for international vocal/facsimile transit via IP, executing settlements among operators and providing corporate customers with international and long-distance communications services based on IP-telephony.

#### *Rostelecom's Cooperation with Mobile Communications Network Operators*

The Company's cooperation with Russian operators of land-based mobile communications networks is aimed at expanding the provision of high-quality network services, including the establishment of national and international roaming.

As of December 31, 2001 the Company established, through its facilities, international roaming for KB Impuls, MTS, Uraltel, DonTelecom and Bitel. The international roaming for these mobile communications operators has been established with more than 170 foreign mobile operators in 85 countries, including 11 CIS countries.

In order to broaden the spectrum of its mobile communications services and to upgrade communications with Russia's remote regions, Rostelecom, in partnership with Globalstar L.P., a world-wide consortium, has launched the development of the Russian segment of the Globalstar Global System for Mobile Satellite Communications. In order to implement the project for the establishment of the Russian segment of Globalstar and subsequently provide mobile satellite communications services in Russia, the Company and Globalstar L.P. set up GlobalTel, a US-Russian joint venture. Rostelecom believes that the pooling of Globalstar's modern global mobile satellite communications facilities with the capacity of the Company's domestic long-distance trunk network creates additional opportunities for establishing national roaming and roaming with foreign operators and for selling communications services to Russian users. The Russian segment of the Globalstar system has been in commercial operation since the beginning of 2000.

#### *Satellite Communications*

Rostelecom is currently arranging for international fixed satellite channels using land-based telecommunications stations owned by AO Teleport TP and the Space Telecommunications State Enterprise. The Company leases a total of 468 compressed satellite channels from AO Teleport TP in the Intelsat systems. In the Intelsat system, 240 channels operate through the 342 satellite; 446 channels operate through the 62 satellite; and 570 channels operate through the 66 satellite.

The Space Telecommunications Federal State Enterprise provides Rostelecom with satellite channels through earth stations located in Dubna (operating through the 335.5 Intelsat system and the 14-degrees Intersputnik system) and Vladimir (operating through the 80 Intersputnik system and the Express-3 11 system) and the station in Medvezhyi Ozero (Intelsat 342 system). In addition, the Company uses the earth station in the Town of Lesnoye (Soyuzkontraktinform-MTUSI) operating within the Intelsat 359 system to provide 68 satellite communications channels. The Company operates a total of 342 channels (including compressed ones) via these stations.

In November 1997, Rostelecom entered into an agreement to lease 60% of the communications channel capacity of a new-generation satellite, the LMI-1, which became operative in November 1999, and forms the basis for the Rostelecom satellite communications network. Pursuant to the agreement, the Company has made an advance payment equal to 12 years' rent. The aggregate channel capacity of LMI-1, utilized by Rostelecom, consists of 22 transponders (trunks).

In 2001, a system for centralized control of land-based satellite stations was commissioned. The operated satellite network comprises three earth junctions and nine periphery earth stations on the territory of Russia. The composition and the locations of the earth satellite communications stations utilizing the LMI-1 resources were determined by the Company with due regard for the secondary network requirements for, among other things:

- access to the trunk network through long-distance transit switches (UAKs) for Gus-Khrustalny (Vladimir Oblast), Novosibirsk and Khabarovsk; and
- trunk digital communications for Kirov, Barnaul, Yakutsk, Yuzhno-Sakhalinsk, Kyzyl, Minusinsk, Salekhard, Gorno-Altai and Novokuznetsk.

Rostelecom, being the principal operator of the public network system, providing all types of services and annexing departmental network operators, it is therefore able to provide the following:

- access to communications at both the international and long-distance levels on the whole of the territory of Russia;
- testing and passing of signal load through SS-7, which allows for the coordinated operation of all types of digital networks based on the digital transit network (SS-7 includes ninety AMTSs and eight UAKs);
- connection to a bit synchronization trunk network, capable of providing for the synchronized work of network operators with high quality and reliability, which allows for the expansion of the offered range of services and increases quality thereof;
- multimedia communications (videoconferencing);
- ISDN and intellectual network services; and
- lease of channels with any throughput capacity.

## **Marketing Activities**

### ***Marketing Strategy of the Company***

The Company's marketing strategy provides for a stronger position of the Company on the market of end-users in Moscow and on the market of operators.

In order to implement this strategy, the Company has established a Commercial Directorate; within the next year the Company plans to set up commercial divisions in all of its branches.

The principal commercial objectives of Rostelecom for 2002 are as follows:

- forming a market monitoring system;
- optimizing the Company's tariff policy with respect to end-users in Moscow;
- expanding its presence on the operator market in order to increase traffic through Rostelecom's network:
  - upgrading the system of settlements with regional operators, thereby eliminating the cross-subsidy;

- introducing a flexible discount system for package services, which will, in turn, allow regional operators to apply a more flexible tariffication system for subscribers to retain regional corporate clients in their network;
- optimizing the tariff policy with respect to alternative operators;
- revising agreements with all international operators to overcome the tendency of the decrease in incoming international traffic; and
- penetrating the traffic-transit market "Europe-Asia";
- expanding the range of services:
  - introducing intellectual networks;
  - offering service packages and implementing a "one-stop shopping" marketing strategy;
- introducing a new approach to the management of client relations; and
- building up a sales and services system that introduces demand and sales-stimulation methods.

Throughout 2002, Rostelecom's main goal is to improve and advance the system of mutual exchanges among regular operators.

The introduction of a new billing system will enable the Company to upgrade the system of inter-operator payments for all communications services provided, as well as the systems used to manage contracts, monitor client profiles and provide relevant subdivisions with statistical and managerial information.

The Company expects that introduction of the billing system will allow the Company:

- to improve the technology of payments for international and domestic long-distance traffic exchanges with international and Russian operators and to conform it to international standards;
- to create a flexible automated system for billing and for storing contractual information;
- to automate the process of running reference data; and
- to resolve problems related to the transition from payments to associated operators to an integral payment plan with payments based on intermitting traffic.

The Company expects that introduction of new technologies in Rostelecom's network will allow Rostelecom to create additional traffic within the existing general-purpose network and to obtain additional income for both the Company and national operators. "Free call," "televoting," "premium tariff" and "virtual private networks" services will be based not only on the intellectual platform of Rostelecom but also on the platforms of other operators who will be able to be connected to the Rostelecom network next year.

The Company's marketing strategy provides for the development of relations with international communications operators, an optimized tariff policy with respect to outgoing and incoming rates and consideration of possible access to the international traffic transit market.

As it continues to work with the Moscow public, the Company plans to develop two programs in the end-user market comprising pre-paid cards communication services, as well as public phones network and phone centers.

The implementation of the marketing strategy will enable the Company to considerably increase its revenue, strengthen its position on the international operator market and position itself as a national business operator on the Russian market.

### ***Service Promotion Highlights***

Currently, one of the major objectives of the Company is to preserve its position in the long-distance telephone communications market, channel leasing, data transmission and other communications services while enhancing the image of Rostelecom and offering new services for consumers, with an aim toward expanding into new segments of the market.

In order to make customer relations more efficient and retain a strong client base, the Company expects to upgrade the following programs:

- 1) The updating of customer contracts;
- 2) Providing for services to be paid for by debit or credit card;
- 3) Establishment of a centralized operator service; and
- 4) Retail outlets.

### ***Upgrading Customer Contracts***

Rostelecom's current policy is to enter into contracts with corporations and organizations in Moscow for domestic long-distance and international services on the basis of a pre-paid system. The Company negotiates these contracts with all corporate clients from the public telephone network recorded in the MMT database (over 60,000 entities).

In 2001, the Company continued to enter into similar contracts with household subscribers. Initially, such contracts were made with the more active users in this market sector. However, the plan is to expand to include all public telephone network users in Moscow.

Corporate clients that pay for the communications services in advance are given a discount of 10% of the cost of their long-distance and international telephone calls, depending on the amount of the pre-payment. The households that enter into a contract and make advance payments of at least 2,000 rubles are granted a similar 10% discount plus additional discounts ranging from 2% to 10%, depending on the volume of outgoing traffic to foreign countries.

Rostelecom plans to develop individual tariff plans for all corporate clients, including discounts depending on the scope of the services provided and on the amount of the pre-payments. The Company expects that discounts for the scope of services provided will encourage growth in outgoing traffic, while discounts for pre-paying customers will increase the Company's capital and will be applied toward paying the Company's foreseeable expenses and settling its accounts.

### ***Debit and Credit Cards***

The Company also seeks to expand its portfolio of additional services, emphasizing payments for services with debit and credit cards.

The Company offers telecommunications services payable in advance with a pre-paid debit card (STC, etc.). Users of STC-type debit cards are offered telephone services (including pay phone use). Rostelecom branches offer two additional types of phone cards: the World Card for international communications and the Season Ticket Card for operator-assisted domestic long-distance calls. To fully implement this proposal, a network of agents is being set up to provide for the distribution of such debit cards.

In addition, in 2001 the Company created and made operational a system of accepting payments with bank-issued credit cards (VISA, Union Card, etc.). The Company plans to develop this system to facilitate:

- acceptance of payments for services provided in retail outlets operating POS-terminals;
- charging for services rendered on terms of credit to the customer's card account at the customer's request (by telephone); a special customer service group has been set up for this purpose; and
- providing for operator-assisted communications services paid for with a bank card (the is debited automatically upon instructions from the customer after the call is complete).

The Company intends to provide services for local, domestic long-distance and international telephone calls from pay phones by magnetic or other types of telephone cards that must be purchased by the customer.

### ***Unified Inquiry Service***

Creating a more efficient customer service is the objective of the call center set up by the Company as a unified information and technical support service. The customer service agents will address any problems or concerns that arise while using communications services (a combination of the 07 Inquiry Service (IS) and a center checking automated domestic long-distance and international communications, providing additional information and reference services regarding payment and offering advice from local specialists).

### ***Retail Outlets***

Retail outlets (call offices and telecommunications service centers) operate, to a certain extent, as representative offices of Rostelecom's Moscow branch. Such operations will be developed further to expand the network of mobile call offices and to broaden the range of services.

## **The Telecommunications Industry in Russia**

Prior to the early 1990s, the telecommunications network in the Soviet Union was inefficient, unreliable and under-utilized relative to networks in most developed countries. The existence of a modern, well developed telecommunications system was never a priority in the Soviet centrally planned and relatively closed economy. The Soviet government had no interest in developing private communications not related to state business.

The lack of investment during the Soviet era, together with the limited access to advanced Western technologies due to trade restrictions, resulted in an outdated telecommunications network, in which nearly all of the telephone switches were outdated and most switches and lines were analog. Because the rerouting capabilities of the system were very limited, certain circuit groups were congested while others were underutilized. In addition, international access was extremely limited as there was only one international switch, located in



Moscow, serving the entire country. Domestic long-distance access was limited by the low level of telephone penetration. Thus, although the network spanned a large geographical area, an inadequate number of lines connected the network at every level. The primary cause of low network usage in Russia has been the low level of domestic telephone penetration. The number of access lines per 100 inhabitants in Russia is significantly lower than in most developed countries. Another reason for the inefficiency and low level of the network's usage is the fact that the Russian network until recently consisted mostly of analog equipment.

### ***Current Structure of the Russian Telecommunication Industry***

Russia is a member of the International Telecommunications Union ("ITU"), a specialized intergovernmental organization under the UN involved in the facilitation of guidelines and treaties regulating the telecommunications industry. ITU's objective is world-wide coordination, standardization and international regulation of the telecommunication industry. Although the current international standards satisfactorily regulate telecommunication services and relevant payments, Rostelecom nevertheless seeks to regulate its relations with all international operators by bilateral agreements.

The telecommunications industry in Russia is generally divided between providers of local services and providers of long-distance and international services. The following is a brief description of the operations and functions of the various segments of the Russian telecommunications industry.

Eighty-nine Russian local telephone operators (LTOs) install and maintain subscriber access lines, provide local switching and transmission services and interconnect subscribers with Rostelecom's domestic long-distance and international network. Transmission between subscribers and local switches is typically via copper wire. Almost every LTO owns an automatic trunk exchange ("AMTS") which switches traffic between the LTO's network and the domestic long-distance trunk network operated by Rostelecom.

In Moscow, the Company owns certain long-distance switches and international switches, and provides services to customers through OAO MGTS ("Moscow City Telephone Network"). OAO The Moscow Long Distance and International Telephone ("MMT"), which the Company acquired as of August 28, 2000, provides technical servicing of long-distance switches and bills customers for the international and domestic long-distance services. Rostelecom receives the payments for its services in Moscow directly from subscribers but has an agreement with MGTS whereby Rostelecom pays MGTS approximately 14% of the Company's revenues in Moscow for Rostelecom's right to pass its international and long-distance traffic through the local lines owned by MGTS.

Rostelecom owns international switches in the cities of St. Petersburg, Ekaterinburg, Khabarovsk, Samara, Novosibirsk and Rostov-on-Don, while the long-distance switches in these cities and in all other regions of Russia are owned by the respective LTOs. LTOs bill their consumers for the services they provide and collect tariff proceeds; they then pay Rostelecom for traffic admission.

Rostelecom's telecommunications network provides basic voice telephone, telegraph and telex services, data transmission and a limited scope of videoconferencing services. Rostelecom also leases channels and provides access to its network to the owners of digital overlay networks ("DONs"), certain telecommunications operators in other CIS countries and to other entities in Russia. Rostelecom cooperates with 257 foreign administrations and operators (including those in the CIS and the Baltic countries) and performs mutual settlements for international telecommunications services with 106 foreign operators. This cooperation enables the Company to transfer international outgoing calls from outside Russia and enables foreign operators to switch international incoming calls through Rostelecom's network. Rostelecom also provides digital transit services across Russia for certain foreign operators and transmits a number of television and radio programs through its network to broadcasting facilities throughout Russia.

### ***Russia's Accession to the WTO***

Russia's government represented by the Ministry of Economic Development and Trade is currently negotiating with member countries of the World Trade Organizations conditions for Russia accessing the WTO, including the accession terms applicable to its telecommunications sector. The key point is liberalization of the telecommunications market in Russia, development of competition meaning available access to the market for new operators and equal conditions for all market participants, as well as limitation of anticompetition actions of major operators. This requirement directly affects interests of Rostelecom which is currently holding monopoly in long-distance and international wholesale services (operator market).

However, there are some factors attributable to Russia's fixed communications sector which inhibit the immediate liberalization. One of such factors is the practice of cross-subsidies, when sectors operating at loss, such as local networks, are supported at the expense of international and long-distance operations. In addition, Rostelecom and local telephone operators (LTOs) are substantially burdened with supporting and developing unprofitable operations including the delivery of services to hard-to-reach and sparsely populated areas. Also, Rostelecom provides services to various government agencies at tariff rates below the market.

Officials at Russia's Ministry of Communications have repeatedly stated that the market liberalization would be possible only after the cross-subsidies mechanism is removed and equal conditions for all participants in the sector are in place. In connection with this, the Ministry of Communications and Ministry for Anti-Monopoly Policy are working to gradually increase local tariffs, which would allow to refrain from the cross-subsidies practice. There are also plans to (possibly) organize a so-called universal service fund to finance construction and maintenance of telecommunications networks in low-profit and unprofitable sectors. The universal service fund concept has been approbated in some of the developed countries and in Eastern Europe. Such fund is formed with contributions from all operators of the country, allowing to distribute the social load among them evenly.

Due to the necessity of the reforms in the communications sector prior to the market liberalization, the Ministry of Communications has emphasized that it will not contemplate a change to Rostelecom's status as monopoly supplier of long-distance and international telecommunications services until 2005-2006 at the earliest.

As to opening the Russian telecommunications market for operators from WTO member countries, the Ministry of Communications is actively cooperating with the Ministry of Economic Development and Trade in respect of the continuing negotiations. In particular, the Russian side has come with a proposal to open the market for foreign operators not earlier than in 2010.

In the reported year, the Russian government has been engaged in lawmaking: in 2001 the Ministry of Communications presented to the Government of the Russian Federation a draft Federal Law "On Communications" designed to create a legal environment for strategic development of the communications sector and developed in consideration of Russia's interests in the telecommunications sphere, its information security doctrine, and the Concept Development of the Telecommunication Services Market.

### ***Restructuring of the Svyazinvest Holding Company***

The continuing restructuring of regional telecommunications operators performed by Svyazinvest affects interests of practically all Russian operators. In 2001, Svyazinvest began restructuring, creating 7 companies that will form a foundation for 89 existing local operators. Svyazinvest co-ordinates each of the stages of such restructuring with the Ministry of Communications and the Ministry for Anti-Monopoly Policy. Notably, the restructuring of the holding is aimed at preparing the companies forming Svyazinvest (including Rostelecom) for the future conditions of the liberalized by then communications market.

The next step in the restructuring will be to obtain approval from the Russian Ministry for Antimonopoly Policy. As of today, the Ministry for Anti-Monopoly Policy has approved the mergers of 5 of the 7 companies to be consolidated in the future. The next and final step will mark completion of the formal restructuring, which the Company expects will be finalized in the first or second quarter of 2003.

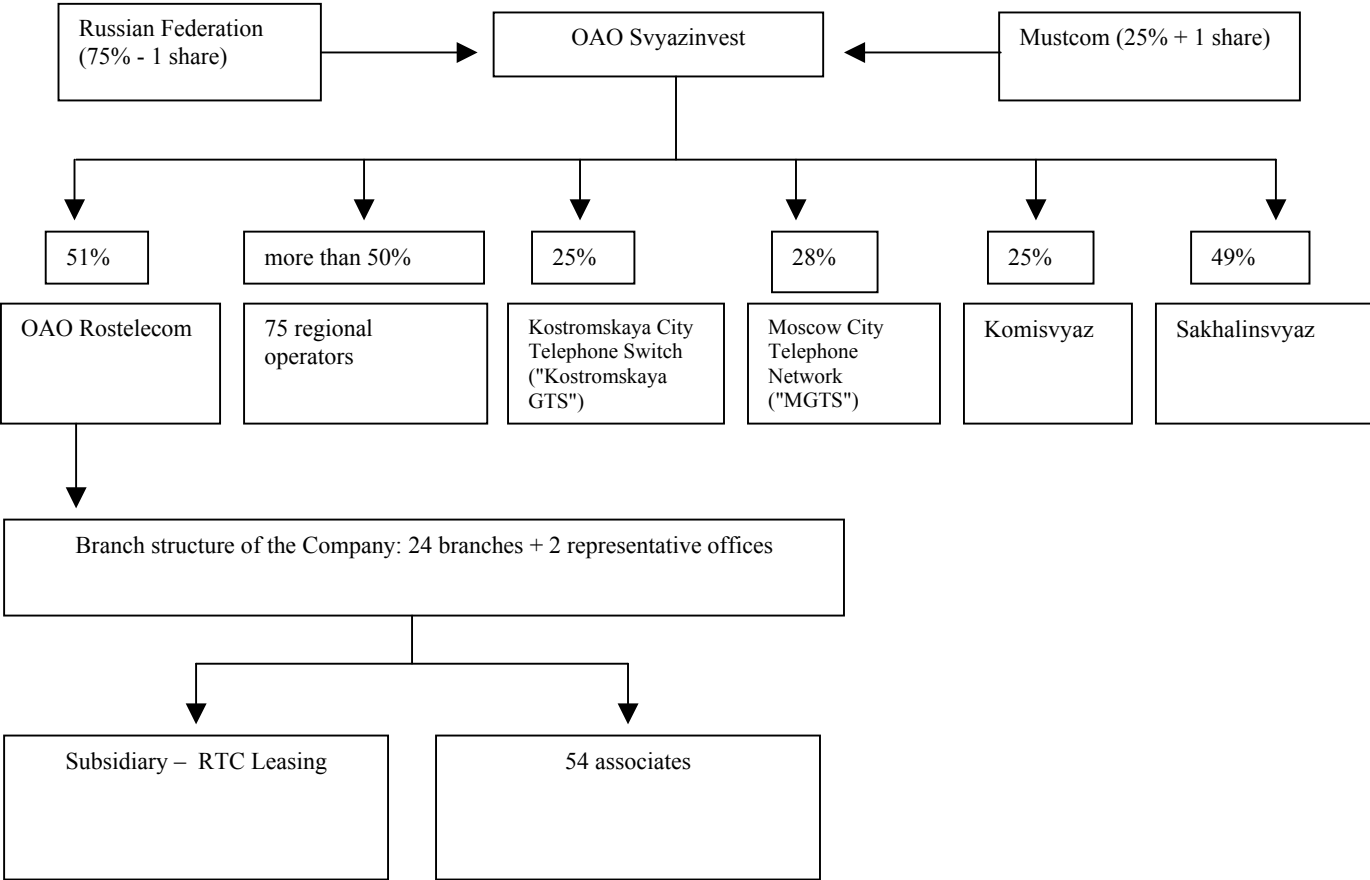
Rostelecom plans to finish the restructuring of its branch network which will result in 7 regional branches formed from the existing 17. The Company expects that by the end of 2002, 24 units in the branch structure of the Company will be consolidated into 10, which the Company believes will improve the Company's manageability and reduce administration costs.

The Company also intends to develop principles for interaction between Rostelecom's branches and consolidated regional operators of Svyazinvest, including the general scheme of network data interlacing, which will allow the establishment of an effective system for cooperation with interregional companies in non-regulated market conditions.

In 2001, the Group also implemented a program for optimization of investments into subsidiaries and dependent companies to dispose of non-core assets and concentrate value in the head office in Moscow. See for the details Item 4.A. – "History and Development of the Company – Divestitures."

All of the above arrangements of the Company and Svyazinvest are aimed at the preparation for liberalization of the telecommunications market.

The following diagram shows the place of Rostelecom in the Svyazinvest holding structure:



Revenues of the Company are generated primarily from international and long-distance traffic, and Rostelecom's share in international service revenues is practically equal to shares of overlay digital network operators ("ONSs") and local telecommunications operators ("LTOs").

Considering that demonopolization of the Russian telecommunications market is expected in the next 3-5 years, the Company expects to face a challenge to become a leader on the new liberalized market by creating an effective competitive business capable of satisfying customer needs, ensuring steady growth of profit and maximization of the Company's value for shareholders and investors.

Successful implementation of the Company's marketing strategy, including the security of positions on the long-distance services market, entering into the international market of transit services and capturing a dominant position in the high-tech services market, as well as realization of the Company's technological strategy envisaging an increased throughput capacity and digital network intellectualization, creation and development of a multiservice network, are all accomplishments which will allow Rostelecom to prepare for the oncoming market liberalization.

The principal factor affecting the Company's position in the telecommunications market is the imperfect legal and regulatory base governing the telecommunications industry in Russia, which is reflected in the current tariff policy, social obligations of Rostelecom, accession procedures and licensing policy dictated by the Ministry of Communications.

Being aware of the importance and value in retaining the position of Rostelecom, Svyazinvest supports the Company's monopoly on the telecommunications market and actively participates, jointly with Rostelecom, in the governmental reform of the telecommunications industry, asserts Rostelecom's rights for reimbursement of "social costs" and even distribution of social obligations among all market participants, and contributes to the optimization of the Company's interaction with other dependent entities of the Svyazinvest Group.

In light of the future market reform, the state also recognizes the influence exerted by Rostelecom on the current market and its future development.

Today, the Company almost fully satisfies other operators' demand for trunk network services and has the potential to retain this dominant position in the future. As a result of arrangements undertaken by the state in light of market liberalization, the Company may expect the long-distance market to become more attractive once the cross-subsidies practice is abandoned.

The Company expects that the market reform will shift the demand structure towards end-users' increased requests for modern digital services and matured pressure from alternative operators working in deregulated segments.

The Russian government has stated the importance to retain, in the process of reform, the system of integral control over the public network to assure effective management of network resources and national security. The efforts of the Russian government are focused on providing general conditions for effective utilization of investments in the sector, rendering modern communications services to bodies of state administration in accordance with growing demand, creation of conditions for Russia's integration into the European and global telecommunications complex, and ensuring efficient management of state property.

## **Competition**

Currently, Rostelecom seeks a leadership role in the reforms concerning the liberalization of the telecommunications market in Russia, by means of developing effective and competitive business practices that would enable it to anticipate customer needs.

Rostelecom believes that its unique networks, which have been created in the course of its ten year existence, can help it to attain its goals.

The Company acknowledges and conducts research of the competitive environment for purposes of monitoring the impact of competitors on Rostelecom's activities. In the course of building its development strategy, the Company takes into consideration the activities of other, alternative operators and operators of overlay networks. Rostelecom pays particular attention to the following companies:

*ZAO TransTelecom.* This company was established in 1997 with the intent to upgrade the information and technology segments in the infrastructure of the Ministry of Railways of the Russian Federation by means of construction of high-bandwidth telecommunications networks in the railroad precinct, as well as its profit-making exploitation. Currently TransTelecom is licensed to operate its dedicated telecommunications network without access to Public Services Networks, to lease communications tracts and channels and provide telematic services (including internet), data transmitting (ATM, Frame Relay, IP, X.25 services) and local, intra-zonal and domestic long-distance communications.

Initially TransTelecom planned to use a part of the capacity to satisfy the needs for telecommunications services of the Ministry of Railroads and the remaining part of capacity to provide telecommunications services to the third parties on a commercial basis. However, TransTelecom does not currently possess a license to provide trunk communications services. At the end of May 2002 representatives of Svyazinvest were elected to the Board of Directors of TransTelecom.

In the first half of 2002 a group comprising representatives of Ministry of Communications, Ministry of Railroads and Ministry of Economic Development and Trade was organized, which is expected to decide the future of TransTelecom.

*ZAO Sonera Rus* has Sonera Corporation as a shareholder. Since 1993, ZAO Sonera Rus, with offices in Moscow and Saint-Petersburg, has been representing Sonera Corporation in the Russian market.

ZAO Sonera Rus created a network by constructing two fiber optic lines: the FRL (Finnish-Russian Line) and the FROG (Finnish-Russian Optical Gateway). Sonera Rus is licensed to lease channels in Moscow, Saint-Petersburg and the North-Western region of Russia. It provides data transmission and telematic services but does not hold a license to provide international telecommunication services. The company's services are geared toward operators and internet-providers, as well as corporate clients seeking high-quality communications services.

*Golden Telecom, Inc.* is an operator of communications services and internet-access services in the big cities of Russia, the Ukraine, Kazakhstan and other CIS countries. In particular, the company provides local access services using their own overlay network in Moscow, Kiev, Saint-Petersburg and Nizhny Novgorod. It also provides data transmission services and access to the internet, domestic long-distance telecommunications services and cellular communications services.

Golden Telecom, Inc. includes three major operators: TeleRoss, Sovintel and Golden Telecom-Ukraine, and it conducts its activities in Russia and the CIS through its network of branches and joint ventures. Currently, the company provides a range of data and voice transmission services in 15 Russian cities: Moscow, Arkhangelsk, Vladivostok, Volgograd, Voronezh, Irkutsk, Krasnodar, Nizhny Novgorod, Novosibirsk, Samara, Syktyvkar, Tyumen, Ufa, Khabarovsk.

*Sistema Telecom* was established on July 1, 1998 as a subsidiary of OAO Aktsionernaya Finansovaya Kompania Sistema (OAO AFK Sistema).

Sistema Telecom participates segments which include the telecommunications market, including telephony, data transmission, internet, cellular communications, satellite communications and paging and tracking communications. MTU-Intel, Comstar, MTU-Inform, Telmos, Vypel-Sistema, MSS, MTS, Golden-Line and other companies are members of the Sistema Telecom group.

*OAO Comincom* has a Norwegian telecommunications operator Telenor as a shareholder.

The basis for the OAO Comincom communications network is the integrated transportation network mostly built on landline communications facilities provided for by the joint transmission of any traffic, and the satellite communication network. Currently the Comincom services include the following: local communication, domestic long-distance and international telephone communications through an allocated network and through the public services network; data transmission, Internet access, ISDN services, and videoconference services. The main Internet-provider of OAO Comincom in Moscow is the subsidiary, ZAO Combella.

In addition to the competitors mentioned above, the Company characterizes the Moscow telecommunication market as a generally highly competitive market, largely because of the presence of alternative operators, OAO Gazcom and OAO Enifcom. They are developing their businesses with the support of OAO Gazprom and RAO UES, respectively.

The Company understands that its readiness to develop and change along with the telecommunications market is crucial for retaining the leadership position in this market. In view of this objective, the Company has prepared and started implementing the program of priority measures, which the Company expects will allow it to reach its goals. This commercial approach aims to satisfy the needs of the customers and will be used as the driving force for further development of the Company.

Rostelecom views the following goals as its priorities for 2002:

- creation of a monitoring system to monitor the competitive environment of the market; and
- development and implementation of an aggressive marketing strategy.

The Company believes that its marketing policy for 2002 will allow it to strengthen its position on the individual client market in Moscow by optimizing the tariff policy with respect to end-users in Moscow. The Company also believes that it will allow it to strengthen its presence on the operators market by activating the Company's activities on this market so that the overall result is an increase in traffic volume in the Rostelecom network.

Contemplated reforms in the telecommunications industry and the reorganization of the holding, effectuated by Svyazinvest, will have certain repercussions in the competitive environment of the telecommunications industry. Currently, the conditions for formation in the liberalized telecommunications market, legal uncertainty in the future regulation of the telecommunications industry and Rostelecom's conditions for entering the demonopolized market, do not allow it to set forth a more precise assessment of the competitive environment. Until Rostelecom's social obligations and cross-subsidy costs are consistent with the Government's policies, as well as the other obligations Rostelecom faces before the Government are settled, one cannot speak of fair competition on the telecommunications market in Russia or assess its influence on the Company's operations.

### **Regulation of Russian Telecommunications Industry**

In accordance with the Russian Constitution, the provision of telecommunication services in Russia is governed by federal legislation, which includes codes, federal laws, presidential and governmental decrees,

government regulations and orders, procedures, letters and instructions issued by ministries and other federal executive authorities.

Rostelecom's business operates in an uncertain regulatory environment. The principal legal acts regulating telecommunications in Russia are the Federal Law on Communications, dated February 16, 1995, as amended, (the "Communications Law") and the Federal Law on Natural Monopolies, dated August 17, 1995, as amended, (the "Natural Monopoly Law").

The Communications Law establishes the legal basis for state supervision and development of the communications industry, including granting licenses to provide telecommunications services, allocation of radio frequencies, certification of equipment compatibility, development of comprehensive public networks and supervision of fair competition among the telecommunications providers. Under the Communications Law, the interconnected communications network (the "ICN") forms the basis for the Russian telecommunications industry. The ICN is a centrally managed complex of technologically linked telecommunications networks belonging to the LTOs, Rostelecom and governmental agencies in Russia. The Communications Law provides for equal rights of individuals and legal entities to participate in telecommunications operations and does not currently contain any special restrictions with regard to participation by foreign persons. All users and operators may, in compliance with the terms of the licenses issued to them, have access and the right to interconnect their networks with the ICN.

The Natural Monopoly Law establishes the legal basis for federal regulation of natural monopolies such as telecommunications and provides for state control over setting tariffs and over other activities of natural monopolies. Subject to the oversight of the Ministry for Anti-Monopoly Policy, the implementation of this law may have a significant impact on the ability of telecommunications providers to set tariffs. The Natural Monopoly Law also controls the types of transactions into which a regulated entity, such as a telecommunications provider, may enter. Regulated entities are subject to continuous reporting requirements, which include the submission of plans for capital investments. In addition, regulated entities may not refuse to conclude contracts with particular consumers if required by the regulatory authority.

The current regulatory framework does not clearly establish the interaction between the Communications Law and the Natural Monopoly Law, which has resulted in a number of contradictory decrees and decisions. As the primary provider of long distance telecommunications in Russia, Rostelecom has been, and will continue to be, subject to regulation under these laws as well as other Russian legislation. There can be no assurance that current or future government regulations will not have a material adverse effect on Rostelecom.

### ***Regulatory Authorities***

The authorities regulating the telecommunications industry are often empowered with overlapping and unclearly defined authority. The Ministry of Communications and Informatization ("MOC") has power over the telecommunications industry generally. In addition, the Federal Agency of Governmental Communications and Information under the President of Russia ("FAPSI") and the Ministry for Anti-Monopoly Policy are charged with oversight of the industry.

The MOC, in conjunction with other regulatory agencies, particularly the State Commission for Electrical Communications, is responsible for proposing the allocation of resources of the federal budget and budgets of federal subjects in the telecommunications industry and has supervisory responsibility for the technical condition and development of all types of communications. The MOC is responsible for licensing of telecommunications operators and the Russian Government through the Ministry for Anti-Monopoly Policy has control over tariffs, although the Ministry for Anti-Monopoly Policy would automatically cease to have jurisdiction over telecommunications if the telecommunications industry were no longer deemed to be a natural monopoly.

In accordance with the Law "On Federal Agencies of Governmental Communications and Information," dated February 19, 1993 (as amended), FAPSI is primarily responsible for the organization of governmental communications for the federal authorities of Russia, particularly the federal agencies with executive power.

The State Radio Frequencies Service and the Department for Supervision over Communications and Informatization are regulatory agencies supervised by the MOC. The State Radio Frequencies Service is primarily responsible for the development and implementation of a long-term policy for frequency allocation. Department for Supervision over Communications and Informatization is responsible for technical supervision of networks and equipment throughout Russia, including supervision over compliance by network operators with applicable regulations and by licensees with the terms of their licenses.

Resolution of the Russian Government No. 715 "On Improvement of the Mechanics of State Supervision of Communication Services Tariffs", dated October 11, 2001 ("Resolution No. 715") granted to the Ministry for Anti-Monopoly Policy authority to regulate tariffs on certain telecommunications services, including (i) the provision of access to local telephone network, regardless of the type of line the client is using (wireline or radio); (ii) local and domestic long-distance connections to fixed line clients; and (iii) distribution and broadcasting of public TV programs.

### ***Licensing to Provide Services***

The Communications Law requires that any person providing telecommunications services must obtain a license prior to commencing service, unless such service is essentially for internal uses (such as within an automobile, on a vessel, in an airplane, or in another means of transportation), are for internal production or technological purposes, or are used solely to service public administration, defense, security, and law enforcement authorities.

The Communications Law expressly authorizes any entity, foreign or domestic, to own and operate communications facilities in Russia, although the law also allows the promulgation of legislation to establish a list of communications networks and facilities that can only be owned by the state. Such legislation has not been implemented, although no assurance can be given that it will not. Further, no assurance can be given that no law or regulation will be enacted to impose limitations or restrictions on activities of foreign entities on the communications market of the Russian Federation.

Licenses to provide telecommunications services are issued by the MOC in accordance with the Regulation on Licensing in the Field of Telecommunications in Russia, which was enacted by Decree No. 642 of the Russian Government on June 5, 1994 (the "Licensing Regulation").

Under the Licensing Regulation, telecommunications licenses are issued and renewed for periods ranging from three to ten years and several different licenses to provide varying communications services may be issued to one entity. Renewals may be obtained upon application to the MOC and verification by appropriate governmental authorities that the licensee has conducted its activities in accordance with the licenses. Officials of the MOC have fairly broad discretion with respect to both issuance and renewal procedures. Both the Communications Law and the Licensing Regulation provide that a license may not be transferred or assigned.

In accordance with the Licensing Regulation, licenses to provide telecommunications services may be suspended by the MOC for a variety of reasons, including:

- failure to provide services within three months of the start-of-service date set forth in the license;
- provision of inaccurate information to consumers; or



- refusal to provide documents requested by the MOC.

Pursuant to the Licensing Regulation, licenses may be revoked by the MOC for the following reasons:

- failure to remedy the circumstances, which resulted in a suspension of the license within the established time;
- established practices of unfair competition by the licensee in performing the licensed services; or
- other grounds set forth by Russian law or international treaties.

Fees for registering licenses are established as multiples of the Russian minimum monthly wage, which is currently RUR 100. Currently, fees for registering licenses range from 20 times minimum monthly wage for local telephone services, to 40 times minimum monthly wage for data transmission and/or telematic services and to 90 minimum monthly wage for domestic and international long distance communication services.

While these fees are nominal, telecommunications licenses traditionally also require financial contributions to the development of the public switched telecommunications network ("PTN") of Russia. Certain licenses held by Rostelecom's jointly owned entities for cellular and mobile services require Rostelecom's jointly owned entities to make financial contributions towards the development of the PTN in the regions covered by those licenses. Failure by Rostelecom's jointly owned entities to make any of these financial contributions in accordance with the terms of the applicable license could lead to revocation of such license.

Licenses generally contain detailed conditions regarding the date by which service must begin, technical standards, the number of lines that must be in service and the percentage capacity, which must be operative by specified dates. Failure by Rostelecom to satisfy any such requirements could lead to the revocation of the license, which could have a material adverse effect on the business of Rostelecom. See Item 5.C. – "Research and Development, Patents and Licenses — Licenses."

### ***Radio Frequency Allocation***

Regulation of the use of radio frequencies and spectrum allocation are under the exclusive control of the MOC through the State Radio Frequencies Service. A frequency allocation by the State Radio Frequencies Service is necessary to receive a license to provide telecommunications services. Once a licensee receives a license for use of a radio frequency and a general frequency allocation from the State Radio Frequencies Service, the licensee must develop its frequency allocation and site plan, which is subject to approval. Each licensee must also pay certain fees.

### ***Equipment Certification***

Certain telecommunications equipment used in Russia is subject to periodic mandatory certification to confirm its compliance with the established standards and technical requirements. Certificates of compliance are issued to the supplier by the MOC. Further, all radio-electronic (high-frequency) equipment (involving frequencies in excess of 9 KHz) manufactured or used in, or imported into, Russia requires special permission from State Radio Frequencies Service. Special permissions are non-transferable. Failure to receive such certification could result in the mandatory cessation of the use of such equipment. To date Rostelecom has not experienced significant problems as a result of the failure of any of its equipment suppliers to obtain necessary certification.

## ***Competition and Pricing***

The Communications Law requires federal regulatory authorities to encourage and promote fair competition in the provision of communication services and prohibits abuse of a dominant position to hinder, limit, or distort competition. The Communications Law provides that tariffs for telecommunication services may be established on a contractual basis between the provider and the user of telecommunications services, thus confirming the policy of liberalization of prices for telecommunications services initially introduced by Presidential decree in 1991. However, the Communications Law also provides that "tariffs may be regulated by the state for specific types of communication services." Furthermore, the Ministry for Anti-Monopoly Policy is authorized to regulate tariffs for telecommunications services in accordance with the Natural Monopoly Law and may determine customers to whom telecommunications services must be provided.

Presidential Decree No. 221, dated February 28, 1995, "On Measures for Streamlining State Regulation of Prices (Tariffs)" and the Resolution of the Russian Government No. 239, dated March 7, 1995, as amended, provide that prices and tariffs for certain telecommunications services are subject to state regulation. Resolution No. 715 delegates tariff control over certain types of telecommunications services provided on the domestic market to the Ministry for Anti-Monopoly Policy, while previous regulations divided tariff control among federal executive bodies and the executive bodies of the federal subjects. To encourage fair competition, the supervising authorities have reduced their control over international tariffs. Thus, order of the State Communications Committee No. 142, "On Tariffs On International Telephone Services", dated August 19, 1998, allows telecom operators, and specifically Rostelecom, to freely determine prices (tariffs) on international telephone services they provide. Further, on January 25, 1999, the State Communications Committee allowed telecom operators to determine tariffs on international telegraph services.

In accordance with the Communications Law, the Ministry for Anti-Monopoly Policy is responsible for the stimulation and support of fair competition in the telecommunications industry. As Rostelecom has a dominant position in the telecommunications market, it is subject to anti-monopoly laws and regulations. In the event Rostelecom would be found to have breached any such law or regulation, sanctions imposed by the Ministry for Anti-Monopoly Policy could include the following: orders to "cease and desist" or to remit profits gained in anti-competitive behavior to the federal budget; imposition of fines on its executive officers; or the institution of civil or criminal suits. Fines for violations of anti-monopoly laws and regulations vary from 100 times minimum monthly wage per day of delay in performing the Ministry for Anti-Monopoly Policy's orders to 5,000 times minimum monthly wage for failure to file required notices and applications with the Ministry for Anti-Monopoly Policy. Fines may be imposed on both a company and its executive officers. For instance, the Ministry for Anti-Monopoly Policy may impose penalties of up to 15,000 times minimum monthly wage on companies charging more than the tariff rate established by the Ministry for Anti-Monopoly Policy. Rostelecom is not aware of any violation of anti-monopoly laws and regulations, which could lead to any such penalty, except for one immaterial breach related to the acquisition of the shares in ZAO "Uraltel" in 2001, for which a fine in the amount of less than USD 1,000 was imposed on the Company. As of the date of this report, this fine was fully paid by the Company.

### **4.C. Organizational Structure**

#### **Branches**

Rostelecom operates through various branches located throughout Russia. Most of Rostelecom's branches are local operations responsible for coordinating operations with the LTOs, particularly with respect to the providing of telecommunications services to the LTOs, and participation in the Company's joint projects in the places where the Company's own facilities connect to relevant regional communication networks. Rostelecom's branches are also responsible for negotiating settlements with the LTOs. The branches may operate in one or more geographically separate subdivisions to facilitate their operations within a specific region.

As of the end of 2001, Rostelecom has branches, located in Moscow, which function across the entire Rostelecom network. These branches include the Domestic and International Long Distance Telecommunications Facilities Construction Division ("SOMES"), which is responsible for network construction throughout Russia; The Moscow Long Distance and International Telephone ("MMT"), which operates a long distance switch for the Moscow loop with the Moscow City Telephone Network ("MGTS") in Moscow; the Main Center of the Domestic Long Distance Telecommunications Management ("GTsUMS"), which coordinates the activities of operating branches to resolve technical problems, and Rostelecom's Center of Informational Technology, which has been established to provide data transmission and telematic services, including, *inter alia*, Internet access, facsimile, electronic mail ("e-mail"), voice-mail and teleconferencing.

Under Russian law, a branch is not a legal entity distinct from its parent company, but rather can be analogized to a division within the corporate structure of a parent company. A branch may, however, own assets, incur liabilities and enter into contractual relationships to sue or be sued in a court of law on behalf of a parent company. Rostelecom's branches operate pursuant to internal regulations approved by the General Director of Rostelecom.

To expand its presence in the area of international organizations, Rostelecom joined the International Telecommunication Union ("ITU") and opened its representative office in Geneva (Switzerland) in August 1999 and registered its representative office in Yerevan (Republic of Armenia) in April 2002.

The representative office in Armenia was opened on April 15, 2002. In the first stage, the representative office, jointly with Armenian colleagues, shall research the market and the possibilities for introducing high level telecommunications technology into the Armenian market.

### **Optimization of the Organizational Structure**

To ensure its successful development in a competitive environment, the Company needs a manageable organizational structure, which would be able to flexibly respond to any changes in the market.

In October 2001, the Company started restructuring its territorial (regional) branches. The Board of Directors of Rostelecom, at its meeting held on November 2, 2001, approved the optimization of the Rostelecom structure as one of the priorities for 2001 to 2003. Before the end of 2003, the Company intends to reorganize its branches into seven combined branches. Restructuring of the branch network is expected to be effectuated by a stage-by-stage process, in accordance with the technological, organizational and economic optimization of the Company's structure.

On January 1, 2002, the Company opened its Central Branch Office in Moscow, and on July 1, 2002, it intends to open a Southern Branch Office in Rostov-on-Don. Territorial center of international communications and television (TTsMS-16) in Saratov is expected to be closed on July 1, 2002.

On April 1, 2002, the SOMES branch was closed, but the Company retained the functions of the branch. The Center for Informational Technology and Main Computing Center branches were closed on February 19, 2002, but the Company retained the functions of these branches as well.

The year 2002 will mark a key benchmark in implementing the optimization program for the Company's organizational structure:

- the Company intends to complete the restructuring of its branch network, which is expected to result in the formation of seven regional branches, on the basis of the already existing 17. The total branch structure of the Company is expected to comprise ten units instead of 24 by the end of 2002. The

Company expects that the restructuring will significantly enhance the Company's manageability and allow it to cut operating costs; and

- the Company intends to develop the principles of interaction between Rostelecom's consolidated branches and the integrated local operators of Svyazinvest, including the general scheme for interconnecting the Company's networks, which will enable the Company to create an effective system of cooperation with interregional companies in a non-regulated market environment.

### **Jointly-Owned Entities**

The Company intends to implement the program, adopted in 2001, to optimize investments in subsidiaries and dependent companies with the purpose of disposing of non-core assets and concentrating assets in the parent company, Rostelecom.

The Rostelecom Group includes the Company, its 27%-owned subsidiary, OAO RTC-Leasing ("RTC-Leasing"), a company registered in the Russian Federation, and associates.

#### *Subsidiary - RTC-Leasing*

The Company owns 27% of its subsidiary, RTC-Leasing, a company registered in the Russian Federation. The remaining ownership interests in RTC-Leasing are held by certain members of management, affiliates of Svyazinvest and other third parties. The principal activity of RTC-Leasing is the leasing of equipment to telecommunications companies in Russia.

The principal counterparty as lessee to finance leases entered into by RTC-Leasing is Rostelecom. Rostelecom transacts a substantial amount of its telecommunications infrastructure leasing through RTC-Leasing so as to take advantage of favorable tax legislation. Leasing of assets is based on terms set by and between the Rostelecom and RTC-Leasing. Given the related party nature of ownership, leasing transaction terms and related funds flow between these two entities are by nature not necessarily arms-length. Finance lease transactions between RTC-Leasing and Rostelecom have been eliminated in consolidation.

Despite the reduction in direct holding in RTC-Leasing during 1999, in the opinion of the directors of both Rostelecom and RTC-Leasing, the Company continues to exercise control of the management, policies, and day to day operations of RTC-Leasing since it has the ability to control the composition of the board of directors of RTC-Leasing. Further, based on the above, management considers RTC-Leasing a special purpose vehicle for financial accounting purposes. The Company continues to consolidate the results and financial position of RTC-Leasing.

Founded in April 1996, RTC-Leasing started business operations in the beginning of 1997. RTC-Leasing sought loans from manufacturers and banks to purchase telecommunications equipment from manufacturers. Rostelecom acted as a guarantor for most of these loans. When Rostelecom acts as lessee, it is usually entitled to purchase the leased equipment at the remaining value upon the expiration of the lease.

At the Extraordinary General Shareholders Meeting of RTC-Leasing, held on September 5, 2001, it was decided to increase the charter capital by placing 3,964,714 ordinary shares and 10,000 preferred shares through a closed subscription. The nominal value of ordinary and preferred shares is 10 rubles each. By the above decision, made at the Extraordinary General Shareholders Meeting, additional shares were placed with:

- Rostelecom – 1,075,873 ordinary shares;
- Non-Profit Partnership Center for Telecommunications Problems Research – 117,637 ordinary shares;

- ZAO North-West Telecombank – 787,645 ordinary shares;
- OOO Commercial Bank Russian Industrial Bank – 663,280 ordinary shares;
- ZAO Gamma-Invest – 663,279 ordinary shares;
- ZAO KFP-Finance – 657,000 ordinary shares;
- Individuals – 10,000 preferred shares.

Rostelecom acquired 1,075,873 shares of RTC-Leasing, by purchase, pursuant to Sale-Purchase Agreement No. 008-220/02, dated February 26, 2002.

Accordingly, following the placement of additional shares, as of February 26, 2002, the shareholders' structure of RTC-Leasing was as follows:

	<u>Total shares</u>	<u>% in charter capital</u>	<u>% of votes at general shareholders meeting</u>
<b>Ordinary shares</b>			
Rostelecom	1,129,873	27.06	27.26
NPF Rostelecom-Garantia	126,000	3.02	3.04
Non-Profit Partnership TsIPRT	117,637	2.82	2.84
ZAO North-West Telecombank	787,645	18.87	19.00
ZAO KB Russian Industrial Bank	663,280	15.89	16.00
ZAO Gamma-Invest	663,279	15.89	16.00
ZAO KFP-Finance	657,000	15.74	15.86
Treasury shares held by RTC-Leasing	20,000	0.48	-
<b>Total ordinary shares</b>	<b>4,164,714</b>	<b>99.77</b>	<b>100</b>
<b>Preferred shares:</b>			
O.G. Belov	1,667	0.04	-
N.P. Shemetova	1,666	0.04	-
P.G. Kaplunov	2,223	0.05	-
A.N. Borminsky	2,222	0.05	-
M.Sh. Margolin	2,222	0.05	-
<b>Total preferred shares</b>	<b>10,000</b>	<b>0.23</b>	<b>-</b>

During 2001, RTC-Leasing bought 10% of its ordinary shares from its shareholders other than Rostelecom, recorded them as treasury shares as of December 31, 2001, and excluded them for purposes of consolidation. In 2001, RTC-Leasing issued 10,000 preferred shares with a nominal value of 10 rubles, constituting 4.76% of the charter capital, and sold them at par value to parties affiliated with Rostelecom. The dividends on the preferred shares will be the largest of the following two sums: (i) 10% of the net profits, after taxes, as shown in the RTC-Leasing accounts prepared in accordance with the Russian accounting standards, or (ii) the amount of dividends on the ordinary shares. RTC-Leasing declared dividends for 2001 on ordinary and preferred shares in the amount of RUR 29.8 million and RUR 102.0 million, respectively.

### *Associates*

Besides its subsidiary, RTC-Leasing, Rostelecom currently owns equity interests in the following associates:

*ZAO Incom* (registered in the Russian Federation)

Rostelecom's share in ZAO Incom's charter capital is 54.4%.

As a result of accession of The Moscow Long Distance and International Telephone ("MMT") by Rostelecom in 2000, Rostelecom became the owner of the controlling interest in ZAO Incom (54.4%). Stakes in Incom are also owned by Mashinoimpex (Croatia), Nicola Tesla (Croatia) and Ericsson Business Networks AB (Sweden). Pursuant to MOC license, Incom renders international and long-distance telephone services.

*ZAO Globalstar Space Telecommunications (GlobalTel)* (registered in the Russian Federation)

The Group owns 51% of the shares of GlobalTel, a Russian closed joint stock company. GlobalTel was created in 1996 to provide access to a US-based global mobile satellite telephone network. Since the time of its launch, the global satellite network has experienced technical problems and low subscriber interest, as the result of which GlobalTel has only recently developed its operations beyond the development stage. The US owner of the satellite network also owns the remaining 49% of GlobalTel. The charter of GlobalTel, its by-laws and the way GlobalTel historically conducted its operations provide for substantive participation of both shareholders in the economic activities of GlobalTel. The minority shareholder has effective veto rights that would prevent the Group from causing GlobalTel to take an action that is significant in the ordinary course of its business. Because effective control of GlobalTel does not rest with the Group, management accounts for the investment in GlobalTel under the equity method.

*EDN Sovintel* (registered in the Russian Federation)

Rostelecom's share in Sovintel, a joint venture created in 1992 with Sovintel, a company incorporated under the laws of the State of Virginia, USA, is 50%. Sovintel began providing international communications services by operating its own digital overlay network (DON) and satellite channels, which enabled it to use international channels of Rostelecom. On the basis of the MOC license and agreements with public telecommunications network operators, Sovintel provides international and long-distance services as well as local traffic services in Moscow and St. Petersburg. Additionally, Sovintel holds a license to lease international, long-distance and local channels. Sovintel clients and partners include major business entities such as hotels, banks and international companies.

On March 29, 2002, Rostelecom's Board of Directors decided to terminate the Company's participation in EDN Sovintel by selling the Company's stake in Sovintel under a sale and purchase agreement between the Company and corporation SFMT-CIS, Inc. and OOO Teleross, which is a subdivision of Golden Telecom. See further details in Item 4.A. – "History and Development of the Company – Divestitures."

*ZAO Westelcom* (registered in the Russian Federation)

Rostelecom owns 50% of the charter capital of Westelcom, a joint venture created in 1992 with Russian Telecommunications Development Corporation. Westelcom was organized to provide technical services to Rostelecom in connection with the engineering, construction and operation of three international telephone exchanges (two in Moscow and one in St. Petersburg), as well as to attract investments in telecommunications projects in Russia. Currently, Westelcom renders services on data transmission, channel lease and lease of telecommunications equipment. In May 2002, the Group entered into an agreement to purchase a 95% interest in

telecommunication holding RTDC Holdings Inc., a US-registered corporation, which in turn owns 50% of Westelcom. As a result, the Group consolidated ownership of 100% of Westelcom.

*ZAO Telecom-Center* (registered in the Russian Federation)

Rostelecom's shares in the charter capital of ZAO Telecom-Center is 45%.

ZAO Telecom-Center was founded for the purposes of rendering services to Russian and foreign users. Currently, the main services of ZAO Telecom-Center are the channel leases, videoconference communications, data and TV signal transmissions.

*ZAO Teleport-TP* (registered in the Russian Federation)

Rostelecom owns 44% of the charter capital of Teleport-TP created in 1992 to lease satellite channels and sublease them to operators. Stakes in Teleport are also owned by Technopark (a Russian-Italian joint venture), Technocom (an Irish-Canadian joint venture) and Roscom. The Company uses Teleport services in the sectors where it lacks direct ground communications and in cases when the laying of landline facilities is not economically expedient. In the above cases, Teleport provides Rostelecom with access to high-quality digital international networks which are not accessible through Russian satellite and land-based operators. Currently, Rostelecom is leasing channels from Teleport Intelsat and Eutelsat, the latter of which was commissioned in September 1996. The main services of Teleport-TP are to provide local and domestic long-distance communications, data transmissions and lease of satellite channels.

*OAO MMTS-9* (registered in the Russian Federation)

Rostelecom's share in the company's charter capital is 36.86%. OAO MMTS-9 renders services on domestic long-distance communications, and leases real estate and telecommunications equipment.

*OAO RTComm.RU* (registered in the Russian Federation)

Rostelecom's shares in OAO RTComm.RU's charter capital is 25.00001%.

Rostelecom acquired a 25% plus 1 share in the charter capital of OAO RTComm.RU from RTC-Leasing in February 2002. The other shareholders of RTComm.RU are: ZAO KFP Finance (4%), RTC-Leasing (39.9999%), Svyazinvest (20%), Non-Profit Partnership Center for Telecommunications Problems Research (11%). The core business of RTComm.RU that was founded in February 2000 is the provision of internet services, in particular, leasing out communication channels and rendering telematic services, using internet trunk access nodes and communication channels, primarily leased from the Company. To perform these activities on the territory of the Russian Federation, OAO RTComm.RU obtained licenses to lease out communication channels and render telematic services. OAO RTComm.RU is also involved in the development of information technologies, creation, manufacturing and distribution of the software and hardware facilities in the sphere of local, corporate and global computer networking.

*ZAO Rustel* (registered in the Russian Federation)

Rostelecom's stake in the charter capital of ZAO Rustel is 25%. ZAO Rustel provides local and domestic long-distance communications services, leasing of communications channels, IP-communications and data transmissions.

On October 2, 2001, the Board of Directors of the Company resolved to increase the Company's share in ZAO Rustel from 12.5% to 25% by acquiring ZAO Rustel's shares in accordance with the agreement on the exchange for the property rights to software.

*NPF Rostelecom-Garantia* (registered in the Russian Federation)

Rostelecom owns 24.85% of the charter capital of NPF Rostelecom-Garantia. Also, the founders of the Fund are Svyazinvest, Non-Profit Partnership Center for Telecommunications Problems Research, RTC-Leasing, ZAO RTC-Invest. The Fund's core business is to arrange for non-governmental pensions and social support for employees of the founders, investors and participants of the Fund.

*OAO Moscow Cellular Communications* (registered in the Russian Federation)

Rostelecom became owner of 23.5% of the charter capital of Moscow Cellular Communications as a result of The Moscow Long Distance and International Telephone ("MMT") accession to Rostelecom. Shares in Moscow Cellular Communications are also held by Moscow City Telephone Network ("MGTS"), RTDC, Millicom International Holding, Microculus Surgery – Cellular Communications and the State Specialized Project Institute. Moscow Cellular Communications is engaged in the construction and operation of a NMT-450 cellular phone network in Moscow and the Moscow Region, and it also sells and leases cellular phones that operate within its network.

*ZAO NTTs Comcet* (registered in the Russian Federation)

Rostelecom owns 22.18% of the charter capital of ZAO NTTs COMCET. Shareholders of NTTs COMCET are the following operators: OAO MGTS (11%), OAO Uralsvyazinform (11%), OAO Tulatelecom (11%), OAO Uralsvyazinform (11%), individuals (33.82%). ZAO NTTs COMCET was founded in 1992. Its main business activities include scientific and technical services, and holding conferences, scientific seminars, and training Russia's LTOs representatives.

*OAO Giprosvyaz* (registered in the Russian Federation)

Rostelecom's share in the charter capital of OAO Giprosvyaz is 22%.

On March 13, 2002, the Board of Directors of Rostelecom decided to terminate its participation in OAO Giprosvyaz through the sale of 65,326 ordinary registered shares constituting 22% of the charter capital of OAO Giprosvyaz under the Sale-Purchase Agreement between the Company and the Non-Profit Partnership Center for Telecommunications Problems Research.

Therefore, on March 26, 2002 Rostelecom transferred 65,326 shares of OAO Giprosvyaz pursuant to Sale-Purchase Agreement No. 4-TsB, having terminated its participation in the company.

*ZAO Moskovsky Tsentr Novykh Tekhnologii i Kommunikatsii* (registered in the Russian Federation)

Rostelecom owns 20% of the charter capital of ZAO MTs NTT. Stakes in ZAO MTs NTT are also owned by AO RTC-Invest (20%), ZAO Sovet-Holding (20%), ZAO NTTs Comcet (20%) and ZAO Firm Trio-Service (20%). ZAO MTs NTT was founded in order to provide communications services oriented towards modern telecommunications technologies, arrange for training and practical education, demonstrate new technologies and communications services, and furnish modern equipment to digital communications networks. Additionally, ZAO MTs NTT performs maintenance center type functions for the SS-7 network, providing services for local communications, data transfer and ISDN telecommunications services.



*ZAO Telmos* (registered in the Russian Federation)

Rostelecom's share in the charter capital of ZAO Telmos is 20%.

*OOO Tver Telecom* (registered in the Russian Federation)

Rostelecom's shares in the charter capital of Tver Telecom is 15%. Tver Telecom provides local, intercity, and international communication services.

*ZAO Telecros* (registered in the Russian Federation)

Rostelecom's share in the charter capital of ZAO Telecros is 10%. Telecros leases out satellite telecommunications channels providing international space communications on the territory of the Russian Federation.

*ZAO WestBalt Telecom* (registered in the Russian Federation)

Rostelecom's share in the company's charter capital is 10%.

*ZAO Registrator-Svyaz* (registered in the Russian Federation)

Rostelecom's share in the company's charter capital is 5%.

On June 21, 2002, the Board of Directors of the Company has decided to purchase additionally issued shares of ZAO Registrator-Svyaz in the amount of 265 shares in the company.

The decision on the additional issuance of ZAO Registrator-Svyaz was made in connection with the adoption of the resolution of the Federal Commission for Securities Market No. 15 "On Ratio Own Funds Adequacy of Professional Participants on the Securities Market", dated July 18, 2001, and because ZAO Registrator-Svyaz must accumulate no less than 10 million rubles of its own funds by July 1, 2002. The Company is expected to increase its share in ZAO Registrator-Svyaz to 8.64%.

#### **4.D. Property, Plants and Equipment**

The principal facilities and properties of Rostelecom consist of buildings and site services, as well as telecommunication installations that include switches of various sizes, cable and transmission devices, and equipment for television and radio communications, as well as transportation vehicles and various mechanisms located throughout Russia.

Rostelecom owns the building in which its principal executive and administrative offices are located at 14 1<sup>st</sup> Tverskaya-Yamskaya Str., 125047 Moscow, Russia. In addition, Rostelecom owns a building at 5 Delegatskaya Str., 127091 Moscow Russia. Under Russian law, any transfer of Rostelecom's ownership rights in this property is subject to the prior approval of certain government bodies. Rostelecom also owns office and operational facilities throughout Russia related to the operation of the business. Rostelecom feels that its facilities are adequate for its present needs.

## Principal Tangible Fixed Assets

Values are expressed in millions of constant rubles as of December 31, 2001 purchasing power, according to net book values under IFRS.<sup>(1)</sup>

	<u>December 31, 2001</u>	<u>December 31, 2000</u>	<u>December 31, 1999</u>
Buildings and Site services	7,567	8,273	7,836
Cable and transmission devices	35,196	38,381	40,502
Other	8,335	10,008	9,749
Total <sup>(2)</sup>	51,098	56,662	58,087

<sup>(1)</sup> Refer to the Notes 2 and 32 to the Consolidated Financial statements for the year ended December 31, 2001 for details of differences of valuation of property, plant and equipment under IFRS and US GAAP.

<sup>(2)</sup> The Group owns all property, plant and equipment listed except for rent of satellite channels which is included in cable and transmission devices and amounted to RUR 1,527 million, RUR 1,690 million and RUR 2,090 million as of December 31, 2001, 2000 and 1999, respectively. The aggregated value of pledged property is RUR 13,114 million. Refer to the Notes 6 and 15 to the Consolidated Financial statements for the year ended December 31, 2001 for details.

Location of principal property, plant and equipment are described in Item 4.B. – "Business Overview – Present Network and Facilities." Major offices of Rostelecom are located in the destination cities of the primary network located in Russia.

The Group's capital expenditure program approved by the Board of Directors for the year ending December 31, 2002, projects capital expenditure of RUR 4,220 million. Refer to Item 4.B. – "Business Overview – Network Development Plans" (section "Main Directions of the Development in 2002") for details of the program. Construction in progress as of December 31, 2001, 2000 and 1999 amounted to RUR 3,345 million, RUR 1,757 million and RUR 3,016 million, respectively.

## Environmental

The Company believes it is in compliance with all material requirements relating to environmental protection and is not in violation of any environmental protection laws. Under various construction agreements to which the Company is a party, it assumes obligations to effect payments to cover costs for regeneration of forests, agricultural lands etc. In the absence of specific regulations requiring the Company to separately account such expenses and as long as certain amounts of such payments established in the Company's construction agreements significantly differ from each other, neither the exact, nor the average amount of such costs can be positively determined.

## Item 5. Operating and Financial Review and Prospects

### 5.A. Operating Results

The following discussion of the Group's financial position and results of operations should be read in conjunction with the Group's consolidated financial statements as of December 31, 2001 and 2000 and for the three years ended December 31, 2001, 2000 and 1999, together with the accompanying notes and supplemental information, appearing elsewhere herein ("the consolidated financial statements"). The consolidated financial statements incorporate the results of Rostelecom and its subsidiary, OAO RTC-Leasing ("RTC-Leasing").

Despite the reduction in direct holding in RTC-Leasing during 1999, in the opinion of the directors of both Rostelecom and RTC-Leasing, the Company continues to exercise control over the management, policies, and day

to day operations of RTC-Leasing since it has the ability to control the composition of the board of directors of RTC-Leasing. The Company continues to consolidate the results and financial position of RTC-Leasing.

On January 1, 2000, the operations of Rostelecom and The Moscow Long Distance and International Telephone ("MMT") were merged into one entity. The "uniting of interests" method of accounting has been applied to the merger with MMT as Rostelecom and MMT were under the common control of Svyazinvest which held 50.67% of the voting shares in each of the companies. Under the uniting of interests method the financial statement items of the combined entities for the period in which the combination occurs were included in the consolidated financial statements as if they had been combined from the beginning of the first period presented.

The accompanying consolidated financial statements have been prepared in accordance with and comply with International Financial Reporting Standards ("IFRS"), which differ in certain respects from accounting principles generally accepted in the United States ("US GAAP"). For a discussion of the differences between IFRS and US GAAP insofar as they relate to Rostelecom, see Note 32 to the accompanying consolidated financial statements for the year ended December 31, 2001.

Further, it should be noted that the financial data in the consolidated financial statements has been adjusted to take account of the effects of Russian inflation (as measured by movements in the General Price Index) in accordance with IAS 29, "Financial Reporting in Hyperinflationary Economies". See Note 4 to the accompanying consolidated financial statements for the year ended December 31, 2001 for more information on the methodology of such restatement. Due to such adjustments, increases or decreases in financial data for the years ended December 31, 2001, 2000 and 1999 are referred to below as "real" increases or decreases.

#### **Restatement of Previously Issued Financial Statements**

The consolidated financial statements of the Group for the year ended December 31, 2001, have been restated. The restated financial statements reflect the effects of (a) consolidating adjustments related to RTC-Leasing, (b) change in estimation of fair value of certain financial instruments, and (c) additional miscellaneous adjustments and reclassifications.

#### ***Consolidating Adjustments Relating to RTC-Leasing***

At the time of preparation of the Group's financial statements as previously reported, for the purposes of consolidation, the Group used estimated financial statements of its subsidiary, RTC-Leasing, for the year ended December 31, 2001. Subsequent to the issuance of the Group's financial statements as previously reported, Rostelecom became aware that RTC-Leasing finalized its financial statements in accordance with IFRS. The consolidated financial statements of the Group for the year ended December 31, 2001, as restated, reflect the effects of final adjustments and reclassifications to the financial statements of RTC-Leasing.

#### ***Change in Estimation of Fair Value of Certain Financial Instruments***

At the time of preparation of the Group's financial statements as previously reported, for the purposes of consolidation, the Group estimated that the fair value of the preferred shares of RTC-Leasing issued to individuals which are related parties to the Group was equal to the amount of preferred dividends paid in 2002 (refer also to Note 7 in the accompanying consolidated financial statements). Subsequent to the issuance of the Group's financial statements as previously reported, the Group reviewed its estimates of the fair value of these preferred shares. The Group now believes that the fair value of the preferred shares should be determined by a combination of expected future cash flows of RTC-Leasing and the expected future preferred dividend flows. Accordingly, the Group has recorded additional expense of RUR 242 million as part of wages, salaries, other benefits and payroll taxes in the Group's consolidated statements of operations for the year ended December 31, 2001, as restated. Further, subsequent to the issuance of the Group's financial statements as previously reported, the Group reviewed

its estimates with respect to recoverability of certain accounts receivable. As a result, the Group recognized additional bad debt expense of RUR 368 million.

Note 31 to the Consolidated Financial Statements provides information on reconciling the effects of the restatements for the year ended December 31, 2001.

### **Overview**

Rostelecom principal sources of income are revenues generated from the provision of domestic long-distance and international telecommunications services. Collectively, revenues from domestic long-distance and international traffic represented 83% and 80% of total revenues during each of the years ended December 31, 2001 and 2000, respectively. Rostelecom owns and operates the network and the international gateways through which the majority of Russia's domestic long-distance and international telecommunications traffic passes. Rostelecom network connects all of the LTOs which in turn own and operate local telephone networks in their areas. Consequently, Rostelecom does not bill the majority of telephone users directly, except in the Moscow area and certain business customers and governmental bodies elsewhere in Russia. Instead, Rostelecom receives payments from the LTOs or other entities which are responsible for billing their own local customers for national and international outgoing calls.

Rostelecom directly bills other international operators for incoming international calls and certain business customers in Russia who lease lines or otherwise receive services directly from Rostelecom. LTOs make payments to Rostelecom for domestic long-distance and international traffic at an agreed rate based upon minutes of traffic for the use of Rostelecom network and an agreed proportion of the receipts they collect from subscribers, respectively. During 2001, the linear component of the integral settlement rate which is used for settlements with regional operators for domestic long-distance traffic transmission was increased by 25%. Effective January 1, 2002, the linear component of the integral settlement rate was increased by another 25%.

Rostelecom has in the past experienced, and continues to experience, significant delays in payment from certain LTOs, certain government funded entities and government ministries, and some international operators in the CIS countries. Although management expects to fully recover such debts, it has established appropriate provisions for doubtful debts to cover such exposure.

Rostelecom is the primary provider of domestic long-distance telecommunications services in Russia. Revenues from domestic long-distance traffic represented approximately 29% and 26% of Rostelecom total revenues during the years ended December 31, 2001 and 2000, respectively. Rostelecom also holds the dominant position in the Russian market for international incoming and outgoing telecommunications services. Historically, the growth in the volume of international traffic was limited as a result of the capacity constraints on the Russian telecommunications network previously regulated under the former Soviet Union. Rostelecom has invested significantly in recent years to improve channel capacity for international calls and to enhance interconnections with other international operators. While these improvements have increased access for incoming international calls, the need for further development in Rostelecom domestic long-distance trunk network and the LTOs' networks and the general state of the Russian economy have continued to limit outgoing international traffic.

Due to the imbalance between incoming international calls (for which it receives foreign currency revenues) and outgoing international calls (for which it incurs foreign currency expenses), Rostelecom was a net payer of foreign currency during 2001.

### **Critical Accounting Policies**

The Group's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements which have been prepared in accordance with International Financial Reporting

Standards. Reported financial condition and results of operations of the Group are sensitive to accounting methods, assumptions and estimates that underlie the preparation of financial statements generally. The Group bases its estimates on historical experience and on various other assumptions that the Group believes are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Group believes that the following accounting policies are critical for understanding the Group's consolidated financial statements.

### ***Accounting for the Effects of Inflation***

IAS 29 "Financial Reporting in Hyperinflationary Economies", requires that financial statements prepared on a historic cost basis be adjusted to take account of the effects of inflation, for entities reporting in hyperinflationary economies. These consolidated financial statements have been restated in terms of the measuring unit current at the latest presented balance sheet date and the net gains or losses arising on the net monetary position of assets and liabilities during the periods presented have been included in the statement of operations and disclosed separately. The Group has utilized the general price index issued by Goskomstat in the application of IAS 29. The application of IAS 29 to specific categories of transactions and balances within the consolidated financial statements is set out as follows:

#### ***Corresponding Figures***

Corresponding figures for the previous reporting periods have been restated by applying to the amounts included in the previous years' financial statements the change in the general price index. Comparative financial information is therefore presented in terms of the measuring unit current as of December 31, 2001, being the latest date for which financial statements are presented.

#### ***Monetary Assets and Liabilities***

Cash and cash equivalents, available-for-sale investments, receivables, payables, interest bearing loans, current taxation and dividends have not been restated as they are monetary assets and liabilities and are stated in Rubles current at the balance sheet date.

Gains or losses on the net monetary position of assets and liabilities which arise as a result of inflation, are computed by applying the change in the general price index to the monetary assets and monetary liabilities during the period.

#### ***Non-monetary Assets and Liabilities***

Non-monetary assets and liabilities are restated from their historic cost or valuation by applying the change in the general price index from the date of recognition to the balance sheet date.

#### ***Consolidated Statement of Operations and Cash Flows***

Items included in the consolidated statement of operations and cash flows are restated by applying the change in the general price index from the dates when the items were initially recorded to the balance sheet date.

### ***Principles of Consolidation***

The Group comprises Rostelecom, its 27%-owned subsidiary, RTC-Leasing, and associates. Transactions and balances between the Company and its subsidiary are eliminated, and accounting policies of the subsidiary are adjusted to conform to those of the Group.

Associates in which the Group has significant influence but not a controlling interest are accounted for using the equity method of accounting. Significant influence is usually demonstrated by the Group owning, directly or indirectly, between 20% and 50% of the voting share capital or by exerting significant influence through other means. The Group's share of the net income or losses of associates is included in the consolidated statement of operations, and the Group's share of the net assets of associates is included in the consolidated balance sheet. An assessment of investments in associates is performed when there is an indication that the asset has been impaired or the impairment losses recognized in prior years no longer exist. When the Group's share of losses exceeds the carrying amount of the investment, the investment is reported at nil value and recognition of losses is discontinued except to the extent of the Group's commitment.

Investments in companies where the Group has neither control nor significant influence (usually less than 20%) are accounted for at cost. An assessment of such investments is performed when there is an indication that the asset has been impaired.

### **Property, Plant and Equipment**

For the purpose of determining the opening balance sheet on the first application of IFRS as of January 1, 1994, the Company performed a valuation of the property, plant and equipment, as reliable historical cost information and information regarding acquisition dates was not available. A brief description of the methodology applied in performing this valuation is set out below for each major asset category:

- Buildings and site services - current replacement cost;
- Cable and transmission devices - current replacement cost;
- Telephone exchanges - modern equivalent asset;
- Assets in course of construction - indexed historic cost.

Cost or valuation of the network comprises all expenditure up to and including the cabling and wiring to the local telephone operator's intercity exchange, and includes contractors' charges and payments on account, materials, direct labor, and interest costs on specific project financing up to the date of commissioning of the relevant assets.

Subsequent expenditures are capitalized if it can be clearly demonstrated that they extend the life of the asset or significantly increase its revenue generating capacity beyond its originally assessed standard of performance. Expenditure for continuing repairs and maintenance are charged to the statement of operations as incurred. Social assets are expensed on acquisition.

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the balance sheet along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the determination of net income.

Depreciation is calculated on property, plant and equipment on a straight-line basis from the time the assets are available for use, over their estimated useful lives (see Note 5 to the Consolidated Financial Statements for 2001 for details).

The useful lives and depreciation methods are reviewed periodically to ensure that the methods and the periods of depreciation are consistent with the expected pattern of economic benefits from items of property, plant and equipment.

At each balance sheet date an assessment is made as to whether there is any indication that the Group's assets may be impaired. If any such indication exists, an assessment is made to establish whether the recoverable amount of the assets has declined below the carrying amount of those assets as disclosed in the financial statements. When such a decline has occurred, the carrying amount of the assets is reduced to the recoverable amount. The amount of any such reduction is recognized immediately as an expense in the statement of operations. Any subsequent increase in the recoverable amount of the assets would be written back when the circumstances that led to the write-down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Determination of impairment involves the use of estimates which include, but are not limited to, the cause, the timing and the amount of the impairment. In evaluating assets for impairment, the Group typically considers technological obsolescence, discontinuance of services and other changes in circumstances. The recoverable amount is determined as the higher of the assets' net selling price and value in use. The value in use of the assets is estimated based on forecast future cash inflows and outflows to be derived from continuing use of the assets and from the estimated net proceeds on disposal, discounted to present value using an appropriate discount rate. The Group reviewed for impairment property, plant and equipment to be held and used, and based on this analysis, the Group believes that the carrying value of property, plant and equipment reflected in the consolidated financial statements as of December 31, 2001 does not exceed their fair value.

### ***Revenue and Operating Costs Recognition***

Revenue and operating costs for all services supplied and received are recognized at the time the services are rendered. Revenue is recognized when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of revenue can be reliably measured.

The Company charges regional telephone operators and other service providers in Russia either an agreed proportion of the amounts they collect from subscribers or an agreed accounting rate based on traffic minutes. For outgoing telephone traffic originating in Moscow, individuals are charged directly by the Company.

The Company charges amounts to foreign network operators for incoming calls and other traffic that originate outside Russia. The Company is charged by foreign operators for completing international calls.

These revenues and costs are shown gross in these financial statements, and exclude value added tax. Amounts payable to and receivable from the same operators are shown net in the balance sheet where a legal right of offset exists.

### **Economic Environment in the Russian Federation**

#### ***General***

Over the past decade Russia has undergone substantial political, economic and social changes. As an emerging market, Russia does not possess a fully developed business and regulatory infrastructure that would generally exist in a more mature market economy. The current Government is attempting to address these issues;

however, it has not yet fully implemented the reforms necessary to create banking, judicial and regulatory systems that usually exist in more developed markets. As a result, and as reflected in the Government's debt default and ruble devaluation in 1998, operations in Russia involve risks that are not typically associated with those in developed markets. Such risks persist in the current environment with results that include but are not limited to, a currency that is not freely convertible outside of the country, various currency controls, low liquidity levels for debt and equity markets, and continuing inflation. The Group will continue to be affected, for the foreseeable future, by these risks and their consequences. As a result, there are significant uncertainties that may affect future operations, the recoverability of the Group's assets, and the ability of the Group to maintain or pay its debts as they mature. The accompanying consolidated financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the Group's consolidated financial statements in the period when they become known and can be reasonably estimated.

### ***Currency Exchange and Control***

Foreign currencies, in particular the U.S. dollar, play a significant role in the underlying economics of many business transactions in Russia. Following the 1998 economic crisis, the ruble's value fell significantly against the U.S. dollar, falling from a pre-crisis rate of approximately 6 rubles to 1 U.S. dollar, to 27 rubles to 1 U.S. dollar by the end of 1999. During 2000 and 2001, the ruble's value fluctuated between 26.9 and 30.3 to 1 U.S. dollar.

The following table summarizes the exchange rate of the ruble ("RUR") to 1 U.S. dollar for the years ended December 31, 2001, 2000 and 1999.

<b><u>At December 31 -</u></b>	<b><u>Exchange rate</u></b>
2001	30.14
2000	28.16
1999	27.00

Source: Central Bank of Russia

The Central Bank of Russia has established strict currency control regulations designed to promote the commercial utilization of the ruble. Such regulations place restrictions on the conversion of rubles into foreign currencies and establish requirements for conversion of foreign currency sales to rubles.

### ***Inflation***

The Russian economy has been characterized by relatively high rates of inflation. The following table summarizes the annual rate of inflation for the past three years:

<b><u>For the years ended December 31 -</u></b>	<b><u>Annual inflation</u></b>
2001	18.8%
2000	20.2%
1999	36.5%

Source: State Statistics Committee of Russia

### **Taxation**

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. The ongoing tax reform tends to simplify tax legislation, reduce the number of taxes and tax rates, and, thus, the overall tax burden on businesses.



The reform is carried out through implementation of the Tax Code, which is intended to replace all of the existing tax laws. The first part of the Tax Code, which deals with the fundamentals of the tax system, was enacted starting from January 1, 1999. Effective January 1, 2001, the second part of the Tax Code was enacted.

Applicable taxes include value added tax, corporate income tax (profits tax), turnover based taxes, and unified social tax, together with others. Legislation related to these taxes is relatively new and untested, in contrast to more developed market economies. Tax declarations, together with other legal compliance areas (as examples, customs and currency control matters), are subject to review and investigation by a number of authorities, who are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia substantially more significant than typically found in countries with more developed tax systems.

### **Effects of Inflation and Changes in Foreign Exchange Rates**

IAS 29, "Financial Reporting in Hyperinflationary Economies", requires that financial statements prepared on a historical cost basis be adjusted to take account of the effects of inflation, for entities reporting in hyperinflationary economies. The accompanying consolidated financial statements have been restated in terms of the measuring unit current at the latest presented balance sheet date and the net gains or losses arising on the net monetary position of assets and liabilities during the periods presented have been included in the statement of operations and disclosed separately. The Group has utilized the General Price Index ("GPI") issued by Goskomstat, the official Russian Government Statistical Bureau, in the application of IAS 29.

Substantially all of Group's revenue, except for the revenue from international operators, which is denominated in U.S. dollars or other foreign currencies or equivalents, is denominated in rubles. The majority of its costs, other than payments to other international operators and certain domestic service providers and interest paid on foreign denominated debt, are denominated in rubles. Therefore, Rostelecom results of operations, and accordingly, year to year comparisons of Rostelecom international incoming traffic revenues, are significantly affected by the relative movements of domestic inflation and ruble exchange rates.

The following example illustrates the effects of relative movements of inflation and ruble exchange rate on year to year comparison of revenues from foreign operators: if foreign currency international incoming traffic revenues for any periods being compared are the same, but between the periods the rate of devaluation of the ruble has been slower than the rate of Russian inflation, the related revenues expressed in constant rubles will decline from one period to the next. Conversely, if the rate of devaluation has exceeded the rate of inflation, such revenues expressed in constant rubles will increase from one period to the next. During 1998, the rate of devaluation of the ruble exceeded the rate of inflation, while during 1999 to 2001, it was less than the rate of inflation.

The Group does not currently have, and has no plans to commence, hedging activities against such foreign currency fluctuations.

The following table illustrates the effects of both exchange variations and the indexation of historical amounts to adjust for Russian inflation on a fixed amount of U.S. dollar revenues.

<u>Date of payment</u>	<u>USD amount of payment</u>	<u>Rubles to USD exchange rate at time of payment*</u>	<u>Rubles amount initially recognized</u>	<u>Decrease in value of Rubles against USD from date of payment to December 31, 2001</u>	<u>Increase in GPI from Date of Payment to December 31, 2001</u>	<u>Rubles amount in constant Rubles in terms of purchasing power as of December 31, 2001</u>
January 1, 1998	100	5.96	596	406%	260.7%	2,150
December 31, 1998	100	20.65	2,065	46%	95.1%	4,029
December 31, 1999	100	27.00	2,700	12%	42.7%	3,854
December 31, 2000	100	28.16	2,816	7%	18.8%	3,345
December 31, 2001	100	30.14	3,014	-	-	3,014

\* Adjusted to take account of the redenomination of the ruble as of January 1, 1998.

### **Related Party Transactions**

The Group has entered in a number of transactions with related parties including transactions with the Svyazinvest Group, the Government and investee companies. See further details on related party transactions in Note 25 to the accompanying consolidated financial statements for the year ended December 31, 2001 and Item 7.B. – "Related Party Transactions."

### **Results of Operations for the Years Ended December 31, 2001 and 2000**

#### ***Revenues***

The Group's total revenues for the year ended December 31, 2001 amounted to RUR 26,293 million compared to RUR 29,607 million during 2000. The decrease of 11.19% is explained by inflation rates of 20.2% and 18.8% for the years 2000 and 2001, respectively, exceeding tariffs increases. Further, while there was a substantial increase in revenues from local operators both for domestic and outgoing international traffic driven by healthy traffic growth and settlement rates increases, it was offset by the decrease in revenues from international operators for the incoming international traffic as well as the decrease in revenues from subscribers in Moscow.

Revenues from local operators represented 44.06% and 35.96% of total revenues during the years ended December 31, 2001 and 2000, respectively. Revenues from local operators increased by 8.82% to RUR 11,585 million during the year ended December 31, 2001, from RUR 10,646 million during 2000, as a result of an increase in domestic and international long-distance traffic volumes and tariffs for local operators.

Revenues from local operators for outgoing international traffic increased by 31.28% to RUR 4,659 million during the year ended December 31, 2001, from RUR 3,549 million during 2000, as a result of an increase in outgoing international traffic and tariffs. The number of international outgoing minutes (not including the CIS countries) during the year ended December 31, 2001 increased by 5.35% compared to 2000, to 335 million minutes. The number of outgoing minutes to the CIS countries during the year ended December 31, 2001 increased by 19.33% compared to 2000, to 747 million minutes. During 2001, the Company implemented a more flexible tariff policy. As a result, tariffs used in settlements for traffic to the United States, Canada and several European countries were reduced. However, tariffs used in settlements for traffic to CIS countries were increased.

Revenues from local operators for domestic long-distance traffic increased by 7.34% to RUR 4,357 million during the year ended December 31, 2001 from RUR 4,059 million during 2000. The increase in revenue from domestic long-distance traffic is attributable to an increase in the linear component of internal settlements rate (as mentioned in section "Overview" above) and an increase in domestic long-distance traffic volumes by 28.55% in 2001 compared to 2000. The main reasons for the traffic growth were further modernization of Rostelecom network, including an increase in the number of automatic connections, extension of local access networks by regional telecommunications operators and the overall increase in per capita income throughout Russia.

Revenues from subscribers in Moscow represented 28.6% of total revenues during the year ended December 31, 2001, compared to 30.4% during 2000. These revenues decreased by 16.51% to RUR 7,512 million during the year ended December 31, 2001 from RUR 8,997 million during 2000. Revenues from subscribers for international traffic decreased by 21.63% to RUR 4,301 million during the year ended December 31, 2001 from RUR 5,488 million during 2000 as a result of a decrease in international traffic, as well as a decrease in tariffs for subscribers as a result of the implementation of the Company's flexible tariff policy and the impact of inflation. Revenues from subscribers for domestic long-distance traffic decreased by 8.49% to RUR 3,211 million during the year ended December 31, 2001 from RUR 3,509 million during 2000 as a result of impact of inflation which was partially offset by the increase in traffic.

Telephone revenue from foreign operators represented 19.88% of the Group's total revenues during the year ended December 31, 2001 compared to 23.85% during 2000. Telephone revenue from foreign operators decreased by 25.96% to RUR 5,227 million during the year ended December 31, 2001 from RUR 7,060 million during 2000 as a result of a decrease in international tariffs and traffic. International incoming traffic decreased by 3.12% to 869 million minutes during the year ended December 31, 2001 from 897 million minutes during 2000.

### ***Operating Expenses***

Total operating expenses decreased by 10.05% to RUR 24,016 million during the year ended December 31, 2001 from RUR 26,698 million during 2000 mainly as a result of a decrease in charges by international network operators, administration and other costs, collection of previously reserved debts and a decrease in wages, salaries and other staff costs. The decrease was partly offset by an increase in depreciation expense and loss on sale of property, plant and equipment.

Charges by international network operators for completing outgoing international calls during the year ended December 31, 2001 decreased by RUR 1,483 million, or 18.67%, compared to 2000. This decrease resulted from a decrease in international traffic and tariffs billed by other international network operators.

Charges by national network operators during the year ended December 31, 2001 decreased by RUR 73 million, or 3.70%, compared to 2000. The decrease mainly resulted from the impact of inflation on flat expenses which was partially offset by an increase in traffic volumes through national operators' network.

Administration and other costs decreased by RUR 1,340 million, or 31.54%, compared to 2000 as a result of cost reduction policy implemented by the Group's management during 2001.

As a result of improved collectibility of debts in 2001 as compared to 2000, the Group's bad debt provision decreased from RUR 1,912 million to RUR 1,585 million as of December 31, 2000 and 2001, respectively, and a recovery of bad debts of RUR 24 million was recognized in the Group's consolidated statement of operations for 2001.

During the year ended December 31, 2001, wages, salaries and other staff costs decreased by RUR 289 million, or 7.90%, compared to 2000 as a result of a 3.24% decrease in the number of personnel as a result of the Company's policy to enhance attrition and the effect of inflation of prior year payroll expenses for their

presentation in accordance with IAS 29. The decrease was partially offset by the cost of issuance of preferred shares in subsidiary as equity-based compensation amounting to RUR 242 million.

Depreciation of property, plant and equipment, including buildings and site services, cable and transmission devices, exchanges and other fixed assets, increased during the year ended December 31, 2001 by RUR 321 million, or 4.85%, compared to 2000. The increase resulted mainly from inflationary effects on the Group's historical cost of property, plant and equipment in accordance with IAS 29.

Other operating expenses during the year ended December 31, 2001 increased by RUR 520 million, or 26.89%, in real terms as compared to 2000, mostly due to a greater loss on sale of property, plant and equipment.

### ***Operating Profit***

Operating profit decreased by RUR 632 million, or 21.73%, to RUR 2,277 million during the year ended December 31, 2001 from RUR 2,909 million during 2000. This represents a decrease in the operating profit margin from 9.83% during the year ended December 31, 2000 to 8.66% during 2001.

### ***Net Interest Expense and Other Non-Operating Items, including Other Non-Operating Income, Net Foreign Exchange Gain (Loss) and Monetary Gain***

Net interest expense and other non-operating items increased from a net loss of RUR 144 million in 2000 to net income of RUR 1,271 million in 2001. This is primarily due to a decrease in gross interest expense by RUR 1,332 million, or 48.83%, to RUR 1,396 million during the year ended December 31, 2001, compared to RUR 2,728 million during 2000, of which the Group has capitalized RUR 80 million and RUR 274 million during 2001 and 2000, respectively.

Monetary gain of RUR 2,147 million and RUR 1,548 million for the years ended December 31, 2001 and 2000, respectively, resulted from application of IAS 29 and represents gains on holding net monetary liabilities in rubles and currencies other than ruble during an inflationary year. The gain is calculated by applying the change in the GPI to the average net monetary position (*i.e.*, the difference between monetary assets and monetary liabilities).

### ***Income Tax Expense***

The Group's income tax expense decreased during 2001 from a net income tax expense of RUR 4,420 million for 2000 to a net income tax benefit of RUR 765 million for 2001. The decrease was mostly the result of a change in the income tax rate from 35% to 24% as of January 1, 2002. The decrease was partially offset by an increase in the Group's current tax charge by RUR 659 million, or 34.04%, during the year ended December 31, 2001 compared to 2000 as a result of change in the income tax rate from 30% to 35% during 2001.

### ***Subsequent Events***

As described in Item 4.A. – "History and Development of the Company" (section "Divestitures") in March 2002, the Board of Directors of Rostelecom decided to terminate the Company's participation in EDN Sovintel by selling the Company's stake in Sovintel's charter capital under a sale and purchase agreement between the Company and corporation SFMT-CIS, Inc. and OOO Teleross, which is a subdivision of Golden Telecom. As a result of the transaction, Rostelecom would exchange its 50% stake in Sovintel's charter capital for 15% of Golden Telecom's shares and U.S. \$10 million in cash and U.S. \$46 million in notes payable in 90 days after transfer of shares. The Company's management believes that the sale of shares of Sovintel, whose business is not a core business for Rostelecom, will enable the Company to discharge its external debt. Additionally, the purchase

of shares of Golden Telecom, a leading provider of voice communications, data transmission and Internet services, is attractive for Rostelecom from the point of managing an internationally listed company.

In March 2002 the Board of Directors of Rostelecom decided to terminate its participation in OAO Giprosvyaz through the sale of the shares of OAO Giprosvyaz for the total amount of RUR 91 million.

On April 29, 2002 RTC-Leasing, through its wholly owned subsidiary RosTeleComLeasing AG (Switzerland), acquired a 95% stake in the telecommunication holding RTDC Holdings Inc. (USA) that holds major blocks of shares in a number of Russian operators, such as Westelcom, Nizhegorodskaya Cellular Communications, Moscow Cellular Communications, Delta Telecom, Dontelecom, Eniseytelecom, Baikalwestcom, Uralwestcom, AKOS and Sayan Telecom.

On June 21, 2002, the Board of Directors of the Company resolved to increase its shareholding in ZAO Westelcom from 50% to 100% through purchase of shares from the telecommunications holding RTDC Holdings Inc. (USA). The terms of the share purchase agreement are currently being agreed by the parties and the documentation will be submitted to the Ministry for Anti-Monopoly Policy to obtain a permission to complete the transaction.

On June 21, 2002, the Board of Directors of the Company also resolved to increase its shareholding in ZAO Moscow New Technologies and Communications Center ("MTsNTT") from 20% to 60% through purchase of 20% of shares in MTsNTT from each of RTC-Invest and Sovet Holding. As of June 28, 2002, the terms of share purchase agreements have been agreed and signed between the Company and the said counterparties. The documentation is being prepared for filing with the Ministry for Anti-Monopoly Policy to obtain a permission to complete the transaction.

In June 2002, RTC-Leasing purchased 100% interest in ZAO KB Russian Industrial Bank, a Russian bank.

In August 2002, RTC-Leasing entered into loan agreements with Sberbank, a Russian bank. The loans will be ruble-denominated and bear interest rates of 20 to 23% per annum. The total amount of the loans under the agreements will be RUR 4,863 million. Drawdown on the loans is dependent on a number of conditions precedent. The purpose of the loans is to finance acquisitions of equipment that RTC-Leasing will lease to operators of the Svyazinvest Group. The Company expects that RTC-Leasing will comply with the conditions precedent and draw down these loans during the second half of 2002.

## **Results of Operations for the Years Ended December 31, 2000 and 1999**

### ***Revenues***

Rostelecom total revenues for the year ended December 31, 2000 decreased by 9.61% to RUR 29,607 million from RUR 32,754 million during 1999 primarily as a result of the impact of inflation on flat tariff rates for domestic long-distance traffic, a decrease in direct international incoming traffic volumes and a reduction in tariffs for international traffic.

Revenues from local operators represented 35.96% of total revenues during the year ended December 31, 2000 compared to 30.36% of total revenues during 1999. Revenues from local operators increased by 7.06% to RUR 10,646 million during the year ended December 31, 2000 from RUR 9,944 million during 1999, as a result of an increase in domestic long-distance traffic which was partly offset by inflation.

Revenues from local operators for outgoing international traffic increased by 7.02% to RUR 3,549 million during the year ended December 31, 2000 from RUR 3,316 million during 1999 as a result of an increase in nominal tariffs for outgoing international traffic, which was partly offset by the impact of inflation. The number

of international outgoing minutes (not including the CIS countries) during the year ended December 31, 2000 decreased by 3.63% compared to 1999. The number of outgoing minutes to the CIS countries during the year ended December 31, 2000 increased by 4.86% compared to 1999.

Revenues from local operators for domestic long-distance traffic decreased by 1.44% to RUR 4,059 million during the year ended December 31, 2000 from RUR 4,118 million during 1999. The decrease in revenue from domestic long-distance traffic is also attributable to the impact of inflation on flat tariffs. This decrease was partly offset by a 26.69% increase in the volume of domestic-distance traffic during the year ended December 31, 2000 compared to 1999.

Revenues from subscribers in Moscow represented 30.4% of total revenues during the year ended December 31, 2000 compared to 29.9% of total revenues during 1999. These revenues decreased by 8.15% to RUR 8,997 million during the year ended December 31, 2000 from RUR 9,796 million during 1999. Revenues from subscribers in Moscow for international traffic decreased by 15.11% to RUR 5,488 million during the year ended December 31, 2000 from RUR 6,465 million during 1999 as a result of a decrease in international traffic and the impact of inflation. Revenues from subscribers in Moscow for domestic long-distance traffic increased by 5.35% to RUR 3,509 million during the year ended December 31, 2000 from RUR 3,331 million during 1999 as a result of an increase in traffic and nominal tariffs, partly offset by the effects of inflation.

Telephone revenue from foreign operators represented 23.85% of total revenues during the year ended December 31, 2000 compared to 30.32% of total revenues during 1999. Telephone revenue from foreign operators decreased by 28.91% to RUR 7,060 million during the year ended December 31, 2000 from RUR 9,932 million during 1999, as a result of a decrease in international tariffs. International incoming traffic decreased by 3.44% to 897 million minutes during the year ended December 31, 2000 from 929 million minutes during 1999.

### ***Operating Expenses***

Total operating expenses decreased by 2.32% to RUR 26,698 million during the year ended December 31, 2000 from RUR 27,333 million during 1999 mainly as a result of a decrease in charges by international and national network operators. This decrease was partly offset by an increase in depreciation and administration and other costs.

Charges by international network operators for completing outgoing international calls during the year ended December 31, 2000 decreased by RUR 2,273 million, or 22.25%, compared to 1999. This decrease resulted from a decrease in international traffic and the tariffs billed by other international network operators.

Charges by national network operators during the year ended December 31, 2000 decreased by RUR 108 million, or 5.19%, compared to 1999. This decrease was principally a result not only of a significant reduction in tariffs by alternative operators and the impact of inflation, but also the merger between Rostelecom and MMT which had previously billed Rostelecom for a portion of the Company's domestic and international traffic.

Depreciation of property, plant and equipment, including buildings and site services, cable and transmission devices, exchanges and other fixed assets, increased during the year ended December 31, 2000 by RUR 881 million, or 15.34%, compared to 1999. The increase resulted mainly from the use of new property, plant and equipment by Rostelecom.

Staff costs during the year ended December 31, 2000 increased by RUR 759 million, or 26.2%, compared to 1999 as a result of the effect of an increase in salaries.

Other operating expenses during the year ended December 31, 2000 increased by RUR 106 million, or 1.66%, in real terms as compared to 1999.

### ***Operating Profit***

Operating profit decreased by RUR 2,512 million, or 46.34%, to RUR 2,909 million during the year ended December 31, 2000 from RUR 5,421 million during 1999. This represents a decrease in the operating profit margin from 16.55% during the year ended December 31, 1999 to 9.82% during 2000, on the reduced total revenues for the year ended December 31, 2000.

### ***Net Interest Expense and Other Non-Operating Items, including Other Non-Operating Income, Net Foreign Exchange Gain (Loss) and Monetary Gain***

Net interest expense and other non-operating items decreased by 88.15% to RUR 144 million during the year ended December 31, 2000 from RUR 1,214 million during 1999 primarily as a result of a foreign exchange gain which was partly offset by increased interest expense. Rostelecom recorded a foreign exchange gain of RUR 545 million during the year ended December 31, 2000 compared to foreign exchange losses of RUR 3,934 million during 1999 as a result of the relative stability of the ruble against foreign currencies during the year ended December 31, 2000 compared with those during 1999 and depreciation of non-U.S. dollar currencies against the U.S. dollar. Gross interest expense decreased in real terms by RUR 46 million, or 1.66%, to RUR 2,728 million during the year ended December 31, 2000 from RUR 2,774 million during 1999, of which Rostelecom capitalized RUR 274 million and RUR 156 million during 2000 and 1999, respectively.

Monetary gain of RUR 1,548 million and RUR 3,578 million for the years ended December 31, 2000 and 1999, respectively, resulted from the application of IAS 29 and represent gains arising from holding net monetary liabilities in rubles and currencies other than ruble during an inflationary year. The gain is calculated by applying the change in the GPI to the average net monetary position (*i.e.* the difference between monetary assets and monetary liabilities). The reduction of monetary gain during 2000 reflects the declining rate of inflation and the decrease in net monetary liabilities.

### ***Income Tax Expense***

The Group's income tax expense increased by RUR 4,114 million to RUR 4,420 million during the year ended December 31, 2000 from RUR 306 million during 1999 primarily as a result of an increase in deferred tax expense which amounted to RUR 2,297 million during the year ended December 31, 2000 compared to benefit of RUR 1,325 million during 1999. The increase in deferred tax expense was due to an increase in the tax rate from 30% to 35%.

## **5.B. Liquidity and Capital Resources**

Rostelecom principal sources of funds historically have been cash flows from its operating activities and vendor financing arrangements related to capital expenditures. The repayment of certain vendor financing arrangements is secured against future revenue streams arising either from specified international operators or from the international incoming traffic deriving from specific assets. In these instances, escrow accounts are opened into which such revenue streams are paid in order that the obligations under the loan arrangements can be met, with any surplus arising periodically remitted to Rostelecom. Rostelecom expects to continue financing a significant portion of its capital expenditures from its internal sources and to raise the remaining amounts through external sources. There can be no assurance, however, that such external financing will be available to Rostelecom on commercially acceptable terms. However, the management believes that cash flows generated from operations will be sufficient to finance working capital needs and the Group's obligations will be repaid as they come due.

Rostelecom's outstanding indebtedness related to vendor financing loans and credit agreements decreased in real terms by RUR 5,561 million, or 45.08%, to RUR 6,776 million as of December 31, 2001 from RUR 12,337

million as of December 31, 2000, of which as of December 31, 2001, RUR 5,828 million was due within one year and RUR 948 million due between one and three years. As of December 31, 2001, approximately 83% of Rostelecom interest bearing loans was denominated in foreign currencies and consisted primarily of vendor financing related to capital expenditures and the credit facilities provided by various credit institutions, compared to approximately 72% of the total interest bearing loans which were denominated in foreign currencies as of December 31, 2000.

The Group had foreign currency denominated borrowings of RUR 5,624 million as of December 31, 2001 which are required to be repaid over future years. 49% was denominated in Japanese Yen, 34% - in U.S. dollars, 15% - in Euros, and 2% - in German Marks. Between January 1, 2002 and August 27, 2002, the Russian ruble has declined in value as compared to the Japanese Yen by approximately 15% and as compared to the U.S. dollar - by approximately 5%, and this has increased the ruble carrying value of these borrowings by approximately RUR 535 million. There is a risk that further loss of value of the Russian ruble may occur. Additional devaluation would both increase the Group's effective cost of borrowing and make it more difficult to incur additional indebtedness and repay or re-finance existing indebtedness.

The Group had also Russian ruble denominated borrowings of RUR 1,152 million as of December 31, 2001.

The Group's management has taken steps to implement cost reduction measures and has undertaken renegotiation of certain of the Group's interest bearing loans so that the scheduled repayment periods were extended. Subsequent to December 31, 2001, the Group extended the repayment schedule under the loan agreement with Sberbank (total amount due was RUR 200 million as of December 31, 2001). As of December 31, 2001, the Company owed RUR 2,707 million to Vnesheconombank who acts as an agent of the Russian Government. The Government decree provides for the possibility of a restructuring of Government's debts administered by Vnesheconombank over a 10-year period at an interest rate of 3% per annum. In accordance with the provisions of the decree, in 2001 the Group entered in negotiations with respect to restructuring this credit agreement on the above terms. As of August 27, 2002, the Group believes that it has complied with the documentary requirements of the decree and is awaiting a confirmation of the restructuring from the Ministry of Finance.

Rostelecom predicts that as a result of its ongoing campaign its indebtedness under loan agreements will decrease to \$152 million at the end of 2002 as compared to \$224.8 million at the end of 2001.

During late 1998 and subsequent years, certain of the Group's interest bearing loans were re-negotiated such that the scheduled payment periods were extended. The weighted average interest rate of loans was 9.4% and 11.9% as of December 31, 2001 and 2000, respectively. The Group does not use any financial instruments to hedge against its exposure to fluctuations in interest and foreign exchange rates.

The maturity profile of interest bearing loans, their currency and interest rate structure is presented in Note 15 to the accompanying consolidated financial statements for the year ended December 31, 2001 and in Item 4.A. – "History and Development of the Company – Borrowings."

The summarized maturity profile of the Group's interest bearing loans as of December 31, 2001 is presented below:

<b><u>(In million rubles)</u></b>	<b><u>Total</u></b>	<b><u>Current (less than 1 year)</u></b>	<b><u>Between 1 and 2 years</u></b>	<b><u>Between 2 and 3 years</u></b>
Interest bearing loans	6,776	5,828	692	256



The Company was in default on payments of principal and interest to Vnesheconombank (total amount due was RUR 2,707 million as of December 31, 2001 and August 27, 2002). Consequently, several other loans totaling RUR 1,760 million which contain cross default provisions were technically defaulted as of December 31, 2001, and were included in the current portion of interest bearing loans in the accompanying balance sheet. As of August 27, 2002 the Company has repaid RUR 933 million of the loans that contain cross-default provisions. EUR 31.2 million (RUR 825.7 million at the exchange rate as of December 31, 2001 or RUR 956.6 million at the exchange rate as of August 27, 2002) of these loans were outstanding and continued to be in technical default as of August 27, 2002. See further details in Item 13.A. – "Defaults."

## Cash Flows

A summary of the Group's cash flows is presented below (in RUR millions):

	<u>Year ended December 31,</u>		
	<b>2001</b>	<b>2000</b>	<b>1999</b>
Net cash flows from operating activities	5,630	6,936	8,320
Net cash used in investing activities	(1,986)	(4,159)	(4,851)
Including purchase of property, plant and equipment	(1,755)	(3,032)	(4,505)
Net cash used in financing activities	(2,827)	(3,698)	(3,695)

In 2001, net cash provided by operating activities decreased by RUR 1,306 million or 19% over 2000. This decrease is primarily attributable to the increase of income tax paid in 2001 (RUR 2,474 million paid in 2001 as compared to RUR 1,296 million paid in 2000) resulting from the increase of tax rate from 30% (in 2000) to 35% (in 2001) and higher taxable profits generated by the Group in 2001.

The decrease of cash provided by operating activities was also due to the decrease of accounts payable of RUR 574 million in 2001 as compared to the increase of payables of RUR 297 million in 2000.

Net cash used in investing activities during 2001 decreased by RUR 2,173 million or 52% comparing to 2000 primarily due to the decrease of cash used for purchase of property, plant and equipment. The Group's 2001 capital expenditures amounted to RUR 3,474 million that represents a decrease of RUR 1,106 over 2000 investments in property, plant and equipment. Such decrease partially resulted from the fact that the most of the Group's tangible assets are purchased for foreign currency, but the rate of inflation during 2001 exceeded the rate of ruble devaluation.

Net cash used in financing activities during 2001 decreased by RUR 871 million or 24% over 2000 primarily due to the second issue of short-term ruble-denominated bonds by RTC-Leasing in October 2001 as described in Note 16 to the Consolidated Financial Statements for the year ended December 31, 2001.

## Restrictions on Dividend Distribution

The Company's statutory accounting reports are the basis of profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year statutory net profit. For 2001, the statutory profit after taxation for the Company as reported in the published annual statutory reporting forms was RUR 2,233 million. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and, accordingly, the Group's management believes at present it would not be appropriate to disclose an amount of its distributable reserves.

## **Capital Expenditures**

The Group's capital expenditure program approved by the Board of Directors for the year ending December 31, 2002, projects capital expenditure of RUR 4.2 billion, of which RUR 1.1 billion are to be applied for capital expenditures related to the technical maintenance of the Company's network. Priority projects in the investment plan are the construction of new fiber-optic lines in the most promising areas, valued at RUR 1.1 billion, and upgrade of the Company's network to increase its throughput and promote new services, valued at RUR 2 billion.

The most significant projects in 2002 will be:

Construction of fiber-optic lines which will give the Group access to strategically important international areas, and link major cities to the Group's trunk network. As a result, the Group intends:

- to obtain access to the Kazakhstan market;
- to link up Kirov and Cheboksary to the Company's trunk network; and
- to obtain access to Kaliningrad and the state borders of Lithuania and Poland.

Modernizing the network to expand capacity and develop new services:

- Construction of a Baltic cable system (1st Stage) jointly with the Swedish company Telia which includes modernization of the Moscow-Saint Petersburg-Kingissep fiber-optic line using dense wavelength division multiplexing ("DWDM") technology, and also expanding the Group's presence in international cable systems. DWDM technology allows the Group to increase its network throughput capacity by 10 to 100 times. Networks using this technology operate much faster, have a higher throughput capacity, and have relatively low operating costs;
- Extension of the Group's "Moscow – Novosibirsk" and "Moscow – Novorossiysk" lines capacity by using DWDM technology;
- Construction of data transmission nodes and introduction of an intelligent network; and
- Construction of network of flexible multiplexes.

These capital investments are the first stage in the Group's investment program intended to prepare the Group for the changeover to an unregulated telecommunications market. See also Item 4.B. – "Business Overview – Main Directions of the Development in 2002."

## **Development Strategy**

The Group's strategic objective is to become a leader in an unregulated telecommunications market by setting up an efficient competitive business capable of anticipating its clients' needs, maintaining profit growth and maximizing Rostelecom's value for its shareholders and investors.

The main components of this strategy include the following:

### ***Marketing Strategy***

The Group continues to develop and improve its marketing strategy to meet its customers' demands and to monitor the competitive situation in the telecommunications services market. The Group's major marketing goals are the following:

- Optimizing tariff policy in relation to subscribers in Moscow based on costing analysis;
- Revision of settlements with the companies in the Svyazinvest Group to eliminate cross-subsidizing;
- Introduction of a flexible system of discounts for service packages for alternative operators to retain corporate clients in the regional networks;
- Access to transit international traffic between Europe and Asia;
- Extension of range of services provided and introduction of services of an "intelligent" network and package services ("one-stop shopping" concept); and
- Creating a system of sales and service, introducing promotion mechanisms.

To establish cooperation and increase international traffic, the Group is continuing its negotiations with international operators to further decrease international traffic tariffs and develop joint investment projects.

Rostelecom continues to develop close cooperation with governmental regulatory agencies, primarily through active participation in the improvements of the current and proposed laws on telecommunications and tariff setting procedures.

The Group's objective is to develop, on the basis of its existing trunk network, a modern, high-speed, multi-service package switching network which would be able to carry every type of traffic. The construction of ring configuration networks and digital connection to main regional cities is planned. See also Item 4.B. – "Business Overview – Marketing Activities."

### ***Operating Strategy***

To achieve a competitive advantage, the Group aims at a continuous improvement of its operating efficiency and cost reduction. During 2001, the Group developed a budgeting system and unified accounting policy. Further, Rostelecom is planning to introduce a management accounting system which would be based on common corporate principles and rules (an Enterprise Resource Planning system). Such a system would allow the Group to analyze the efficiency of each division, thus, facilitating the Group's decision-making process, and increase transparency of the Group.

Rostelecom plans to create an integrated billing system which would improve its system of settlements with telecommunications operators for services. The integrated billing system would include systems of contract maintenance and retention of clients' profiles and provide the management with timely operating information.

### ***Investment Policy***

The Group is implementing a new investment policy focused on commercially profitable investments. As a result, the Group would sell unprofitable non-core investments and use the proceeds of such dispositions for capital investments and repayment of indebtedness.

The new investment policy is based on the following principles:

- targeting commercial objectives in selecting investment projects;
- a system of analysis and assessment of economic efficiency for each investment project;
- a system for strict monitoring of implementation.

### ***Organizational Structure Policy***

For successful development of the Group in a competitive business environment, the Group believes that it needs to reorganize its corporate structure to be more easily manageable and flexible to changes in market conditions. Currently, the Group is finalizing reorganization of its management structure with the goal of creating transparent functional systems. It has also started a process of restructuring its regional branches.

The Group plans to undertake the following in 2002:

- Finalization of the reorganization of the Company's branch network resulting in 7 branches rather than the current 17. Overall, the Company will have ten branches as opposed to 24 at the end of 2001. This improvement will substantially increase the Company's manageability and facilitate reductions in administration costs.
- Finalization of principles governing the business relationships between Rostelecom and companies in the Svyazinvest Group. They will include a general scheme for interconnection of their networks, which will allow the creation of an effective system of cooperation with the LTOs in the conditions of an unregulated market.

### ***Human Resources Management***

The Group's new human resources management system is aimed at improving personnel loyalty, retention of qualified employees and attracting young professionals.

This new system of human resources management should provide the employees with the following:

- an effective motivation system;
- stability;
- professional growth and career development;
- continuous personal development;
- allow employees to reach their full potential.

In 2002 – 2003, the Company will establish its own Corporate University, based on the principles of training and continuous improvement of qualifications of professional staff. With the help of lecturers and training companies, study programs will be developed to conform precisely to the Company's special requirements.

Creating of a flexible compensation system is the part of the new human resources management system. The Company's objective is to increase the degree of its employees' commitment to attaining the Company's new

objectives. The Company's goal is for each employee to feel that he or she is part of a united team in which staff interests coincide with those of the Company.

To increase the efficiency, Rostelecom has begun a range of measures to optimize number of employees, including reduction of technical staff brought about by network modernization, redundancy of clerical staff resulting from reorganization of the Company's branch network, and also guaranteed pension provision for employees of pension age.

## **5.C. Research and Development, Patents and Licenses**

### **Research and Development**

Research and development costs are expensed as incurred. Rostelecom is involved in research and development activities related to the Group's program of technical development using the following research and development organizations: the state enterprise "The Central Research Institute of Telecommunications (TsNIIS-RTC)", OAO "Giprosvyaz", Autonomous Non-for-Profit Organization "Research Center of Telecommunications TsNIIS-RTC", ZAO "Engineering Center", OAO "Institute of Automatic Systems", for the following purposes:

- to increase the Group's revenues from telecommunications services;
- to expand the capacity of telecommunications cables and to ensure improved coverage of the telecommunications network; and
- to develop data transfer facilities and alarm systems increasing the range of services provided and allowing subscribers to manage independently the network functions of data transfer.

Research and development expenses of the Group amounted to RUR 41.4 million, RUR 72.0 million and RUR 97.2 million for the years ended December 31, 2001, 2000 and 1999, respectively.

### **Trademarks**

On April 10, 1995, the Company registered its trademark with Rospatent, a government agency which maintains the register of patents and trademarks. As a result of merger with MMT, the Company also obtained the trademark registered by MMT in 2000.

### **Licenses**

The following table summarizes the terms of the principal telecommunications licenses currently held by Rostelecom:

<u>License Number</u>	<u>Types of Services</u>	<u>Territory</u>	<u>Date Issued</u>	<u>Expiration Date</u>
8777	Domestic and International Long Distance Communications	Russian Federation	October 17, 1997	January 1, 2004
8701	Local Telephone Communications	5 republics, 32 regions, 3 areas and 1 autonomous region of Russia	October 17, 1997	November 1, 2005
13378	TV and Radio	Russian Federation	November 30, 1999	November 30, 2004

<u>License Number</u>	<u>Types of Services</u>	<u>Territory</u>	<u>Date Issued</u>	<u>Expiration Date</u>
	Broadcasting			
3226	Telematic Services	Russian Federation	May 15, 1997	May 15, 2007
3227	Data Transmission Services	Russian Federation	May 15, 1997	May 15, 2007
3136	Cellular telecommunications services in the 900MHz bandwidth	Novosibirsk Region	August 16, 1996	October 1, 2006
3137	Cellular telecommunications services in the 900MHz bandwidth	Khabarovsk Region	August 16, 1996	October 1, 2006
3138	Cellular telecommunications services in the 900MHz bandwidth	Amur Region	August 16, 1996	October 1, 2006
10857	Telegraph communications services	Russian Federation	October 9, 1998	October 9, 2003

Pursuant to License No. 8777, Rostelecom has been granted a non-exclusive right to operate the domestic long-distance and international public communications network of Russia (except for radio communications networks installed on vessels) and to settle accounts with foreign telecommunications providers, companies and international organizations in accordance with the rules of international telecommunications.

License No. 8701 authorizes Rostelecom to put into use 89,570 telephone numbers through the local telephone network. Pursuant to this license, Rostelecom is required to provide local telephone services to the State and other categories of users at discount rates in certain emergency circumstances and in accordance with procedures established by Russian legislation.

Pursuant to License No. 13378, Rostelecom has been authorized to provide television and radio broadcasting services to the public and develop television and radio broadcasting stations in Russia.

Under Licenses No. 3226 and No. 3227, Rostelecom is authorized to provide telematic and data transmission services to its customers. Under the terms of these licenses, by the licenses' expiration date, Rostelecom is required to develop capacity to provide telematic and data transmission services to at least 100,000 subscribers.

Under License No. 3136, Rostelecom is authorized to provide GSM cellular telecommunications services in 900 MHz bandwidth on the territory of the Novosibirsk Region. By December 31, 2006, the network capacity must be at least 12,300 numbers with 7% coverage of the territory. During the term of the license, Rostelecom is required to make a contribution of USD 8,409,000 to the State for the development of the public telecommunications network.

Under License No. 3137, Rostelecom is authorized to provide GSM cellular telecommunications services in 900 MHz bandwidth on the territory of Khabarovsk Area. By December 31, 2006, the network capacity must be at least 11,000 numbers with 7% coverage of the territory. During the term of the license, Rostelecom is required to make a contribution of USD 4,863,000 to the State for the development of the public telecommunications network.

Under License No. 3138, Rostelecom is authorized to provide GSM cellular telecommunications services in 900 MHz bandwidth on the territory of Amur Region. By December 31, 2006, the network capacity must be at least 7,000 numbers with 7% coverage of the territory. During the term of the license, Rostelecom is required to make a contribution of USD 3,187,500 to the State for the development of the public telecommunications network.

Total amount due under three licenses (No. 3136, 3137 and 3138) is USD 16.5 million. No payments were made as of December 31, 2001. The obligation would arise upon receiving a notice from the Federal Committee of GSM 900 operators. The Company has not yet received any invoices for payment. Management is confident that negotiations concerning the eventual fees due will result in significant reduction of the liability. As such, no accruals for cellular licenses have been included in the accompanying consolidated financial statements as of December 31, 2001. Management believes that until such uncertainty is resolved, such non-accrual and non-payment will not have a significant effect on the Company's operations.

License No. 10857 authorizes Rostelecom to provide telegraph services, including passing and processing international and long-distance telegraph traffic and providing AT/Telex network services.

Under the terms of its licenses, except for local telephone communications services, Rostelecom may refuse to provide all other types of its services to customers where: (i) provision of such services may endanger the state security and defense system; (ii) provision of such services is precluded by any physical, topographical or other natural circumstance; (iii) the customer does not agree with the terms and conditions on which such services are provided or does not make timely payments for the services; and (iv) the customer uses or intends to use the communications equipment for unlawful purposes or uses communications channels, trunks and equipment in violation of the technical rules or uses uncertified equipment.

#### **5.D. Trend Information**

The Company believes that the stage-by-stage increase of tariff rates which has been authorized by the Ministry for Anti-Monopoly Policy for government-regulated communications services is one of the most important development trends in the telecommunications market in Russia.

Rostelecom has been able to increase the tariff rates used for settlements with LTOs which did not require a parallel rise in tariffs for end-users and therefore, had no effect on traffic growth. As noted in section "Overview" above, the linear component of the integral settlement rate used for settlements with regional operators for domestic long-distance traffic transmission was increased by 25% commencing July 1, 2001. Effective January 1, 2002, the linear component of the integral settlement rate was increased by another 25%. This would increase national telephone revenue from local operators.

The Group expects that further development and modernization of the Group's network and introduction of new automatic network destinations, together with an improvement of the overall economic situation in Russia, would contribute to an increase of domestic long distance traffic from local operators and subscribers.

The Group expects that tariffs on settlements with international operators for incoming and outgoing international traffic will continue to decrease. Despite a short-term decrease in revenues from international operators, the Group believes a reduction in tariffs would be offset by an increase in international traffic in the long term.

## Item 6. Directors, Senior Management and Employees

### 6.A. Directors and Senior Management

Rostelecom is governed by its Board of Directors and the Management Board comprised of the General Director and other executive officers of Rostelecom (the "Executive Officers"). Pursuant to Rostelecom's corporate documents, the Directors are responsible for the strategic development of Rostelecom, and the Executive Officers are responsible for implementing these strategies and for the overall management of Rostelecom.

#### Board of Directors

As of December 31, 2001, the Board of Directors comprised the following persons:

<u>Name</u>	<u>Position</u>	<u>Year of Birth</u>
Stanislav P. Avdiyants	Executive Director - Director of Department of Economic and Tariff Policy of Svyazinvest	1946
Vadim E. Belov	Deputy General Director of Svyazinvest	1958
Nikolai P. Emelianov	General Director of OAO Novgorodtelecom	1948
Grigory M. Finger	Representative of Lindsell Enterprises Limited	1966
Nikolai M. Korolev	Shareholder of Rostelecom	1945
Alexander V. Lopatin*	Deputy General Director of Svyazinvest	1964
Anton I. Osipchuk	First Deputy General Director of Svyazinvest	1967
Stanislav N. Panchenko	Deputy General Director of Svyazinvest	1945
Viktor A. Polischuk	President of OAO Rossiyskaya Telekommunikatsionnaya Set'	1938
Vladislav S. Vasin*	First Deputy General Director of Svyazinvest	1950
Valery N. Yashin	General Director of Svyazinvest Chairman of Board of Directors	1941

\* Also a member of the Management Board.

**Stanislav P. Avdiyants.** Mr. Avdiyants held the position of the head of marketing service in Rostelecom from 1993 till 1998, and after that he worked as executive director and head of department for organization and planning of services and tariffs for domestic long-distance communications. From 1998 till 2000, Mr. Avdiyants held a position of deputy director of the department of economic forecasting and consolidated planning of Svyazinvest. Starting from 2000, Mr. Avdiyants has been holding a position of executive director and director of the department of economic forecasting and consolidated planning of Svyazinvest.

**Vadim E. Belov.** Mr. Belov has been a member of the Board of Directors of Rostelecom since November 18, 2000. In 1999, Mr. Belov was appointed as a Deputy General Director and member of the Management Board of Svyazinvest. From 1998 to 1999, he was a managing director of the Moscow representative office of SPK Capital Limited, an investment company. From 1997 to 1998, Mr. Belov held a position as the Deputy Chairman of the Management Board of International Financial Company, a commercial bank. During the period from 1995 to 1997, he served as a Deputy Head of the Anti-Monopoly Committee of the Russian Federation. Mr. Belov holds



a degree of an engineer from Murmansk High Engineering Maritime Professional School. Mr. Belov also holds a law degree from the Russian Academy of State Service.

**Nikolai P. Emelianov.** Mr. Emelianov has been General Director of OAO Novgorodtelecom since 1995. As of November 18, 2000 Mr. Emelianov was appointed a Member of the Board of Directors of Rostelecom. He holds a degree in radio engineering from Novgorod Polytechnic Institute.

**Grigory M. Finger.** Mr. Finger has been a member of the Board of Directors of Rostelecom Since June 24, 2000. Mr. Finger has been a representative of Lindsell Enterprises Limited since 1995. Mr. Finger is a member of the Board of Directors of OAO Trading House GUM since 1995. He holds a masters degree in computer sciences from the Moscow Institute of Chemical Engineering.

**Nikolai M. Korolev.** Mr. Korolev has been the General Director and the Chairman of the Management Board of Rostelecom since 1999. From 1993 through 1999, Mr. Korolev held the position of the First Deputy General Director of Rostelecom and Director of GTsUMS, Rostelecom's center for management of domestic long distance communications. Prior to this position, he was the Head of the Central Department of Main Line Communications of the Soviet Ministry of Communications. In 1992, Mr. Korolev became the Head of the Information Department of the Ministry of Communications of Belarus. Mr. Korolev is a member of the boards of directors of several Russian telecommunications companies, including GlobalTel and Sovintel.

**Alexander V. Lopatin.** Mr. Lopatin has been a member of the Board of Directors of Rostelecom since June 24, 2000. From 1995 to 1999, Mr. Lopatin was Deputy Director of Assets Management, Director of Assets Management and Financial Director of RAO UES Russia. Since 1999 he has been the First Deputy General Director of Svyazinvest.

**Anton I. Osipchuk.** Mr. Osipchuk has held the position of the First Deputy General Director of Svyazinvest since April 10, 2000 and has been a member of the Managing Board of Svyazinvest since September 18, 2000. Since June 9, 2000, he has been a member of the Board of Directors of Peterburgskaya Telefonnaya Set' and a Member of the Board of Directors of ZAO MobiTel. At OAO AB Inkombank from 1995 through 1996 he held the position of Head of Economic Department and, during 1996-1997, the position of the Deputy Administrator. From 1997 through 2000, Mr. Osipchuk was the Deputy General Director of Economics and Finance of OAO Telekominvest.

**Stanislav N. Panchenko.** Mr. Panchenko has been a Director of Rostelecom since July 1997. He has been the Deputy General Director of Svyazinvest since 1996. He is an engineer in telecommunications and has been working in the telecommunications industry for several decades.

**Viktor A. Polischuk.** Mr. Polischuk has been a member of the board of directors of Rostelecom since November 18, 2000. Mr. Polischuk has been President and Chairman of the Board of Directors of OAO Rossiyskaya Telekommunicatsionnaya Set' since 1995. Mr. Polischuk is a Doctor of Technical Sciences of Moscow Aviation Institute.

**Vladislav S. Vasin.** Mr. Vasin has been a Director since June 1998 and a member of the Management Board of Rostelecom since January 1999. Mr. Vasin has been the First Deputy General Director of Svyazinvest and a member of the management board of Svyazinvest since 1998. From 1994 to 1997, he was the First Deputy General Director of Rostelecom and, from 1997 to 1998, was also a director of MnSRT, the Rostelecom branch responsible for international communications. From 1993 to 1994, he was the First Deputy Minister in the Ministry of Communications of Belarus.

**Valery N. Yashin.** Mr. Yashin has been appointed the Chairman of the Management Board of Rostelecom on November 18, 2000. Since October 22, 1999, Mr. Yashin has held the position of General Director of

Svyazinvest. He started as a head of department in OAO "Peterburgskaya Telefonnaya Svyaz" in 1978 and became the General Director of that company in 1999. Mr. Yashin holds a degree in communications engineering from the Leningrad Electrical Technical Institute of Communications.

### Executive Officers

The Management Board of Rostelecom comprised the following Executive Officers:

<u>Name</u>	<u>Position</u>	<u>Year of Birth</u>
Alexei F. Aliokhin	Deputy General Director – Commercial Director of Rostelecom	1953
Pavel I. Alpetyan	Deputy General Director – Technical Director of Rostelecom	1952
Vladimir I. Androsik	Deputy General Director – Financial Director	1975
Dmitry E. Erokhin	First Deputy General Director of Rostelecom	1950
Sergei I. Glushko	Deputy General Director – Director for Development and Administrative Matters of Rostelecom	1966
Vadim Y. Izotov	Deputy General Director – Director for Information Technologies	1968
Sergei I. Kuznetsov	General Director of Rostelecom Chairman of Management Board	1953
Alexander V. Lopatin	Deputy General Director of Svyazinvest	1964
Alexander A. Lutsky	Chief Accountant of Rostelecom	1972
Marina D. Oleshek	Deputy General Director – Director for Structure Development and Personnel Administration of Rostelecom	1961
Vladimir A. Petrov	Deputy General Director – Director of Central Branch of Rostelecom	1953
Vladislav S. Vasin	First Deputy General Director of Svyazinvest	1950
Boris V. Zverev	Director of Rostelecom's Branch – The Moscow Long Distance and International Telephone ("MMT")	1944

The following biographies are of those Executive Officers who are not also Directors of Rostelecom:

**Alexei F. Aliokhin.** Mr. Aliokhin has been working as Commercial Director of Rostelecom since June 2001, and, starting from September 2001, as Deputy General Director–Commercial Director of Rostelecom. During the years of 1989-2001 he worked in ZAO Komstar; his latest position there was a commercial director. Mr. Aliokhin holds degrees from Karagandinsky Politechnic Institute and the Academy for Foreign Trade.

**Pavel I. Alpetyan.** Mr. Alpetyan has been a Deputy General Director of Rostelecom since March 1998. Starting from September 2001, he holds the position of Deputy General Director-Technical Director. From 1993 to 1996, he was the head of the Center for International Settlements of Rostelecom. Mr. Alpetyan is a member of the boards of directors of ZAO RTC-Internet and ZAO ROSPAK, ANO TsNIIS RTC. Prior to his appointment at Rostelecom, Mr. Alpetyan was the General Director of ZAO RTC-Center, a wholly-owned subsidiary of Rostelecom. Mr. Alpetyan holds a degree in radio engineering from the Polytechnic Institute of the City of Yerevan.

**Vladimir I. Androsik.** Starting from April 2001, Mr. Androsik has been holding the position of advisor to General Director for Economy and Finance, and in September 2001 he was appointed Deputy General Director-Financial Director. During 1997-2001 he worked in ZAO PeterStar, the last being deputy to financial director (starting from 2001), and from February 2000 – acting financial director. Mr. Androsik holds a degree of

economist-mathematician from the Saint-Petersburg University. He is a member of the board of directors of EDN Sovintel, ZAO Westelcom, ZAO GlobalTel, Moscow Cellular Communications ("MCC").

**Dmitry E. Erokhin.** Starting from October 2001, Mr. Erokhin holds the position of First Deputy General Director of Rostelecom. Starting from 1996, he worked in the branch TTsMS-9, holding the position of its director from May 1997. Before that, he worked for 18 years in TUSM-6 of TTsMS-9 of the Ministry of Communications of the USSR and for 5 years – in GPSI Rossvyazinform. He holds a degree of design engineer of radio equipment from Dagestan Politechnic Institute. Mr. Erokhin is a member of the Board of Directors of ZAO GlobalTel.

**Sergei I. Glushko.** Starting from April 2001, Mr. Glushko has been holding the position of General Director-Director of Rostelecom's branch SOMES, and starting from September 2001 he also holds a position of Director for Development and Administrative Matters. He has been working in the telecommunications sphere starting from 1996: in AOZT PeterStar and ZAO Petersburg Transit Telecom. Mr. Glushko holds a degree of radio engineer from the Kiev Higher Military Engineering School of Communications.

**Vadim Y. Izotov.** Starting from May 2001, Mr. Izotov has been holding the position of advisor to General Director on informational technologies. In September 2001 he was appointed as Deputy General Director-Director for Informational Technologies. Starting from 1996 and until he joined Rostelecom, he worked in ZAO Severo-Zapadny GSM. Mr. Izotov holds the degree of system engineer from Leningrad Politechnic Institute.

**Sergei I. Kuznetsov.** On February 23, 2001 Board of Directors appointed Sergei I. Kuznetsov as Acting General Director of Rostelecom. Mr. Kuznetsov's powers were upheld by the Annual General Shareholders Meeting of June 30, 2001. During the years of 1998-2001 (starting from September 1998) Mr. Kuznetsov held the position of General Director of a Saint Petersburg company ZAO Peter Star, and in 1995-1998 was a General Director of Telecominvest. Mr. Kuznetsov is a member of the Board of Directors of EDN Sovintel, RTC-Leasing, GlobalTel, Telmos. He holds a degree of a system engineer in electronic computers, has studied in foreign educational institutions (Columbia University, Fuqua Business School with the Duke University).

**Alexander A. Lutsky.** Mr. Lutsky was appointed as Chief Accountant of Rostelecom starting from July 2001. Before that, he held the position of financial director in ZAO Sankt-Peterburgskie Taksofony (from September 1997 till June 2000) and of financial director in ZAO Petersburg Transit Telecom (starting from July 2000). Mr. Lutsky is a qualified economist holding the degree from Leningrad Institute of Finance and Economics.

**Marina D. Oleshek.** Mrs. Oleshek has been holding the position of Deputy General Director of Rostelecom-Director for Structure Development and Personnel Administration of Rostelecom starting from September 2001. Previously (from 1990) she was the head of personnel departments, including the position of personnel director in cellular telecommunications company OAO Vympelcom (starting from January 1999). Mrs. Oleshek holds the degree of engineer from Moscow Communications Institute and received further education in the sphere of personnel management.

**Vladimir A. Petrov.** Mr. Petrov holds the position of deputy General Director in Rostelecom starting from May 2000, and deputy General Director-Director of Central Branch of Rostelecom starting from October 2001. From June 6, 1997 till May 12, 2000 he was a member of the Board of Directors of Inkom, MMTS-9, EDN Sovintel, Telebarents. He graduated from engineering faculty of the Kirov Politechnic Institute.

**Boris V. Zverev.** Starting from 1974, Mr. Zverev has been working in telecommunications enterprises. In 1994 he was appointed as General Director of State Enterprise Moscow Long-Distance and International Telephone. Starting from January 2000, he holds a position of director of Rostelecom's branch MMT (previously named MMTS-10). He holds a degree in telegraph and telephone communications from Leningrad Electrotechnical Institute of Communications.

## 6.B. Compensation of Directors And Executive Officers

The members of the Board of Directors and Management Board of Rostelecom were paid by Rostelecom a total of approximately RUR 9,798,630 for services performed in all capacities during the fiscal year ended December 31, 2001.

This amount includes annual salaries of the members of the Board of Directors and Management Board, as well as other compensation paid in accordance with internal regulations of the Board of Directors and the Management Board.

This amount also includes amounts of conditional and deferred salaries and compensations accrued for the 2001 financial year, even if such salaries and compensations are to be paid later.

The following table discloses the aggregate amount of compensation and other payments paid to each member of the Board of Directors of Rostelecom during the year ended December 31, 2001 on an individual basis:

<u>Name</u>	<u>Position</u>	<u>Compensation from Rostelecom (RUR)</u>
Stanislav P. Avdiyants	Executive Director - Director of Department of Economic and Tariff Policy of Svyazinvest	22,109
Vadim E. Belov	Deputy General Director of Svyazinvest	133,061
Vladislav S. Vasin	First Deputy General Director of Svyazinvest	380,993 in the capacity of a member of the Board of Directors; 215,278 in the capacity of member of the Management Board
Nikolai P. Emelianov	General Director of OAO Novgorodtelecom	133,060
Nikolai M. Korolev	Shareholder of Rostelecom	535,809
Alexander V. Lopatin	Deputy General Director of Svyazinvest	306,883
Anton I. Osipchuk	First Deputy General Director of Svyazinvest	133,061
Stanislav N. Panchenko	Deputy General Director of Svyazinvest	155,171
Viktor A. Polischuk	President of OAO Rossiyskaya Telekommunikatsionnaya Set'	133,060
Grigory M. Finger	Representative of Lindsell Enterprises Limited	155,170
Valery N. Yashin	General Director of Svyazinvest	155,171

The following table discloses the aggregate amount of compensation and other payments paid to each member of the Management Board of Rostelecom during the year ended December 31, 2001 on an individual basis:

<u>Name</u>	<u>Position</u>	<u>Compensation from Rostelecom (RUR)</u>
Sergei I. Kuznetsov	General Director	967,107.41
Alexei F. Aliokhin	Deputy General Director - Commercial Director	710,217.13
Pavel I. Alpetyan	Deputy General Director - Technical Director	964,594.88
Vladimir I. Androsik	Deputy General Director - Financial Director	468,175
Vladislav S. Vasin	First Deputy General Director of Svyazinvest	380,993 in the capacity of a member of the Board of Directors; 215,278 in the capacity of member of the Management Board
Sergei I. Glushko	Deputy General Director - Director for Development and Administrative Matters	732,219.79
Dmitry E. Erokhin	First Deputy General Director	403,622
Boris V. Zverev	Director of Rostelecom's Branch - The Moscow Long Distance and International Telephone ("MMT")	387,395
Vadim Y. Izotov	Deputy General Director - Director for Informational Technologies	485,581.45
Alexander V. Lopatin	Member of Management Board; Deputy General Director of Svyazinvest	306,883
Alexander A. Lutsky	Chief Accountant	476,702.82
Marina D. Oleshek	Deputy General Director - Director for Structure Development and Personnel Management	584,625.32
Vladimir A. Petrov	Deputy General Director - Director of Central Branch of Rostelecom	852,681

Until present, neither bonus or profit-sharing plan with respect to the Company's directors and members of Management Board, nor a program of options granting to Rostelecom's employees the right to purchase the Company's shares have been worked-out and implemented.

In accordance with regulations of the Federal Commission for Securities Market, Rostelecom must disclose any information regarding the compensation of each of its directors and executive officers. Such information is included in quarterly reports submitted by Rostelecom to the Federal Commission for Securities Market and is

available to shareholders and to the general public on the Federal Commission for Securities Market website. In addition, Resolution of the Federal Commission for Securities Market No. 32, dated August 12, 1998, requires entities such as Rostelecom to disclose any decisions of the board of directors establishing the amount of compensation and other payments to executive officers within five days after the adoption of such decisions.

Directors of Rostelecom do not receive salaries, bonuses or other payments except for Directors who are also Executive Officers of Rostelecom. However, the Company deems it necessary to pay compensation fees to its Directors in accordance with its internal Regulations on the Board of Directors.

On June 1, 2002 the Annual General Shareholders Meeting of the Company was held. Pursuant to the decision of the General Shareholders Meeting, the new Board of Directors of the Company was elected, including two independent directors. Thus, starting from June 1, 2002, the following persons started working in the Company's Board of Directors: Valery N. Yashin, Sergei I. Kuznetsov, Mikhail V. Slipenchuk, Victor A. Polischuk, Vadim E. Belov, Stanislav N. Panchenko, Nikolay P. Emelyanov, Alexander V. Lopatin, Irina M. Ragozina, Anton I. Osipchuk, Grigory M. Finger.

On June 1, 2002, after the Annual General Shareholders Meeting of the Company, the first meeting of the Company's newly elected Board of Directors was held, where the following key decisions were made:

Valery N. Yashin was elected as Chairman of the Company's Board of Directors. Members of the Management Board were appointed. Sergei I. Kuznetsov was appointed General Director, and the Management Board presently consists of:

- 1) Vladimir I. Androsik, Deputy General Director and Finance Director of Rostelecom;
- 2) Dmitry E. Erokhin, First Deputy General Director of Rostelecom;
- 3) Igor V. Zabolotny, Executive Director and Director of the Marketing and Sales Department of Svyazinvest;
- 4) Vadim Y. Izotov, Deputy General Director and Director of Information Technology of Rostelecom;
- 5) Alexander V. Lopatin, Deputy General Director of Svyazinvest;
- 6) Alexander A. Lutsky, Chief Accountant of Rostelecom;
- 7) Vladimir K. Mironov, Deputy General Director for Security of Rostelecom;
- 8) Alexander V. Mikhalev, Deputy General Director and Administrative Director of Rostelecom;
- 9) Marina D. Oleshek, Deputy General Director and Director for Organizational Development and Personnel Management of Rostelecom;
- 10) Vladimir V. Terekhov, Deputy General Director and Technical Director of Rostelecom.

## **6.C. Board Practices**

### **Board of Directors**

In accordance with the Rostelecom's Charter, the Board of Directors of the Company, which consists of eleven members, is elected by cumulative voting at the annual general shareholders meeting and remains in office until the next annual general meeting of shareholders. There is no limit to the number of terms to which

individuals may be re-elected to the Board. The general shareholders meeting, however, may adopt the decision to terminate the existing Board of Directors, provided that such decision is adopted with respect to all members of the Board of Directors. Each member of the Board of Directors may apply for resignation with prior written notification to other members of the Board. The Company's Charter provides that members of the Management Board may not constitute the majority of the Board of Directors and that the General Director may not also be the Chairman of the Board of Directors.

The Chairman of the Board of Directors is elected by a simple majority of the members of the Board of Directors and may be re-elected at any time by members of the Board of Directors.

The competence of the Board of Directors includes the following: convocation of the general shareholders meeting; increases in charter capital; formation of the Management Board and its early termination; formation and liquidation of subsidiaries and representative offices; adoption of decisions regarding participation in other entities; adoption of decisions regarding major transactions, interested party transactions and other issues.

Pursuant to the Company's Charter the meetings of the Board of Directors should take place at least once every quarter. A Board meeting related to the convocation of an annual general shareholders meeting should take place no later than 1 month after the accounting report filing maturity date allow for review of the Company's draft annual balance sheet, profit and loss account and the auditor's report.

The Board of Directors may be convened by the Chairman of the Board of Directors on his own initiative or by request of any member of the Board of Directors, the Audit Commission, the Company's auditor, the General Director or any shareholder (or group of shareholders) owning at least 2% of the Company's voting shares. A quorum of the Board of Directors is reached if more than half of the elected members are present at the meeting. Each member of the Board of Directors has one vote which may not be assigned to another member or any other person. All meeting minutes of the Board of Directors should be executed within ten days after the meeting.

### **Management Board**

The Company's Management Board is established and terminated by the Board of Directors. The number of members of the Management Board is also determined by the Board of Directors. The Chairman of the Management Board is the General Director or, in his absence, his first deputy, pursuant to an approval of the General Director, acts as the Chairman of the Management Board. The members of the Management Board are elected for a term of up to five years.

The competence of the Management Board extends, in particular, to the following: preliminary discussion of issues to be resolved at a general shareholders meeting; preparation of draft decisions of the Board of Directors with respect to (i) establishment, reorganization and liquidation of subsidiaries and representative offices of the Company, (ii) the amount dividends to be paid on each category of shares, and (iii) major and interested party transactions.

The meetings of the Management Board may take place when necessary but in no case less than once a month. The minutes of the Management Board should be executed within ten days after the meeting. The decisions of the Management Board are adopted by a simple majority of votes. Pursuant to the Company's Regulation "On the Management Board" it may adopt decisions if a quorum of at least half of the members are present at the meeting. In case of a split vote the Chairman of the Management Board has the decisive vote. Pursuant to the Regulation "On the Management Board" the members of the Management Board may not engage in any commercial activity similar to commercial activities of the Company. Members of the Management Board may not be members of boards of directors, management boards or directors of other companies unless the prior consent of the Board of Directors is obtained.

Members of the Management Board are supervised by the Board of Directors and report to the Board of Directors on the Company's internal policy, commercial activity, etc. At the beginning of each financial year the Management Board is required to provide the Board of Directors with an annual statement and report on the Company's activities for the previous financial year and suggestions regarding the distribution of profits.

### **Audit Commission**

The Company adopted new Regulation "On the Audit Commission" (the "New Regulation") at the General Shareholders Meeting, which took place on June 30, 2001, due to the fact that Svyazinvest, a controlling shareholder, has adopted the new unified "Standard Regulation on the Audit Commission of the Dependent Company." The New Regulation increased the role of the Audit Commission, broadened its rights and strengthened its independence, making it a more efficient body and providing greater transparency of the Company's activities. The New Regulation sets forth details in respect of the activities of the Audit Commission and requirements with respect to its conclusions, as well as providing for liability of the Company's management, in the event that it ignores requirements of, or misleads, the Audit Commission.

The Audit Commission is elected by a general shareholders meeting. The Audit Commission consists of three independent members. Each member may be terminated by a decision of a general shareholders meeting in the event of willful misconduct or any damage inflicted to the Company, provided that if the number of members of the Audit Commission falls below two, an extraordinary general shareholders meeting must elect new members of the Audit Commission. Pursuant to the amendments to the New Regulation adopted by the General Shareholders Meeting on June 1, 2002, the Audit Commission is elected at an annual general shareholders meeting for a term expiring on the date of the next annual general shareholders meeting.

Pursuant to the Company's Charter any shareholder or any other person nominated by a shareholder may be a member of the Audit Commission, provided, however, that a member of the Audit Commission may not be simultaneously the General Director, or a member of the Board of Directors, Management Board or Liquidation Commission. Members of the Audit Commission shall be elected and terminated ahead of term by a simple majority of votes of shareholders participating in the general shareholders meeting.

The Audit Commission elects its Chairman and its Secretary. The Audit Commission reviews the financial and business operations of the Company to the extent of its competence and, in particular: audits the financial and business documents of the Company; reviews the legal force of agreements executed on behalf of the Company, transactions and settlements with counter parties; analyzes the accounting statements and statistical records for compliance with the respective regulations; checks whether payments to suppliers of goods and services, payments to the budget, calculation and payments of dividends, and redemption of other obligations are made accurately and in due course; audits the balance sheets of the Company, its annual accounting statement, profit and loss account, reports to the tax inspectorate and governmental authorities for accuracy and performs other functions related to financial issues.

After the Audit Commission completes its financial review, it issues a conclusion which confirms that the data contained in the Company's financial statements is true and correct and provides information on whether there were any violations of the legislation of the Russian Federation with respect to bookkeeping. All documents of the Audit Commission (acts, opinions, instructions, etc.) shall be executed by all members of the Audit Commission.

The Audit Commission may meet as often as necessary. Any resolution at a meeting of the Audit Commission shall be adopted by a simple majority of all members of the Audit Commission. In the event of any disagreement, the minority of members of the Audit Commission may express in writing their special opinion which shall be submitted to the management bodies of the Company (the general shareholders meeting, the Board of Directors, etc.) together with the respective document (resolution, opinion, etc.). Members of the Audit Commission shall



be jointly and severally liable to the Company for the accuracy and reliability of each audit when they execute the acts, opinions or other documents on the basis of the performed audit.

#### **6.D. Employees**

The average number of staff on the payroll in the year 2001 was 35,410 (comparing to 36,595 in the year of 2000). As of December 31, 2001, Rostelecom employed 33,987 full time employees, including 20,035 male and 13,952 female. Divisions of Rostelecom employ over 20,300 specialists with higher and secondary education. 34% of all employees are aged below 40 years, 37% - 40 through 50 years and 29% over 50 years. The average monthly salary was equal to RUR 4,629. Title "Master of Communications" was conferred on 64 persons for many years of labor and contribution to the construction and operation of communications facilities, 13 persons are rewarded with the badge "Honored Radio Operator". In 2001, 6,312 employees were trained at foreign schools operated by manufacturers, educational centers of Rostelecom, training courses and seminars of various high schools in Russia. Rostelecom has contracts for training specialists with several high school specializing in communications. In addition, Rostelecom pays special scholarships to 30-35 students specializing in basic professions each semester.

All Rostelecom employees are covered by a collective bargaining agreement between Rostelecom and the Central Committee of the Telecommunications Union of Russia, which guarantees a minimum level of employment, salaries, benefits and working conditions for employees. The agreement is renegotiated periodically, but its terms do not change significantly. Rostelecom's current collective bargaining agreement was entered into on March 20, 2000 for a one-year period. On May 31, 2001, the collective bargaining agreement was extended for a period of one year from May 31, 2001 and remained in force as of December 31, 2001. On the basis of this agreement certain branches of Rostelecom have entered into collective bargaining agreements with the employees of such branches which contain additional social guarantees and benefits. The collective bargaining agreement is currently being renegotiated. The collective bargaining agreement remains in force until one of parties to this agreement initiated its renegotiation. While it has been renegotiated last time, the minimum tariff rate for the employees engaged in the core sphere of business of the Company has been increased.

Rostelecom presently has no overdue wage obligations to its employees. Rostelecom has not experienced any significant work stoppage since its formation and considers its relations with its employees to be good and that it is in compliance with all applicable labor laws.

Prior to January 1, 1997, Rostelecom did not have pension liabilities other than those payable under Russian law to the Russian government to provide funds for pension plans administered by the state. Rostelecom adopted an additional non-state pension program for its employees which took effect on January 1, 1997. In accordance with the program the Company has committed to contribute up to a maximum of 1% of salary for each employee choosing to participate in the scheme.

After adoption of the Law on Non-State Pension Funds in June 1998, Rostelecom is one of the participants of a non-profit entity Rostelecom Garantia which administers Rostelecom's pension program (the "Pension Program"). Participation in the Pension Program is voluntary. The participating employees contribute to the Pension Program, on a monthly basis, at least 2% of their salaries, with an additional amount equal to 2% of their respective salaries being contributed by Rostelecom. As of January 1, 2002, the Pension Program had 24,527 participants and 1,368 retired employees received corporate pensions from the Pension Program. The average amount of the pension is RUR 427 per month and pensions are indexed on a regular basis (last time indexed as of April 10, 2002).

Rostelecom agreed with the Central Committee of the Telecommunications Union of Russia the payment of a single aid in connection with retirement in the amount of doubled monthly wage on the date of retirement to the employees whose professional experience is 15 or more years. Additionally, the Company on its own initiative

pays aids in connection with retirement to employees whose length of work is less than 15 years, and to employees who is resigning from Rostelecom due to other reasons.

In their essence, these obligations are non-funded, and constitute the obligations of the common pension fund scheme with fixed payments. Under this pension fund scheme the expenses for pension payment are determined on the basis of method of forecasting levels of pension payments. Within this method the expenses for pension payments are accounted in financial statements with equal allocation of expenses for all average period of work of an employee.

Since 1995, Rostelecom has an automatic corporate insurance plan for its employees and members of their families. Since 1999, this plan operates through Skart. In addition, as of January 1, 1998, Rostelecom launched through its affiliate, Kostars Insurance Company, an accident insurance program covering all its employees. Since 2002, medical insurance is carried out through RESO-Garantia, chosen as a corporate insurer on the basis of a tender.

In addition to the supplementary pension, social and medical insurance schemes described above, the Company made contributions to the Government's social and medical insurance, retirement benefit schemes at the statutory rates in force during the year.

### **Optimization of the Personnel Structure of the Company**

In 2001 Rostelecom commenced optimizing the structure of the Company and restructuring the branches of the Company into seven integrated regional branches by the end of 2003. The Company is implementing policy to adjust the number of personnel along with the Company's structure.

The main components of optimization of the Company's structure and number of personnel, which commenced in 2001 and will continue during 2002-2003, are:

- optimization of administrative departments and structural divisions of branches;
- reduction of technical personnel in the course of modernizing networks (retiring communication lines from service);
- reduction of workforce as personnel reach retirement age;
- reorganization of workloads and reduction of low-qualified personnel;
- implementation of a system for preparing financial and management statements;
- increasing the efficiency of investments; and
- modifications to personnel policy, including training, enhancement of qualifications and motivational schemes.

In accordance with the policy to increase the manageability of the Company and its orientation to commercial activities and its human resources efficiency, the Company is changing its principles of personnel management. In order to realize Rostelecom's strategy and realize its goals, the Company believes that it must retain qualified personnel, managed by highly qualified managers within the framework of optimized structure. These objectives are the main priorities for personnel of Rostelecom from 2001 to 2005.

An important component of the Company's system of personnel management is the Program for Multilevel Training.

In 2001, training of employees of Rostelecom was aimed at increasing productivity through the studying of new methods of technical service for communication lines, and increasing qualifications of personnel who work with advanced technologies in new facilities. Corporate educational centers based at the branches of Rostelecom play a significant role in the process of retraining personnel. Substantial attention was paid to the training of executive personnel of the Company, aimed at installing management skills for new economic realities and rapidly changing environment.

Prior to 2003, the Company expects to establish Rostelecom Corporate University to restructure training expenses and tailor all educational programs to the particulars and special tasks of the Company. While increasing technical qualifications of specialists, the Corporate University will provide for special programs for acting managers and will establish a reserve of skilled workers oriented to the obtaining of knowledge and development of skills in strategic planning and management of resources, the creation of management teams in all branches of Rostelecom, and the building of a training system aimed at increasing profitability.

In 2001, the executive personnel of both the Company's General Administration and branches were significantly changed. The newly-appointed managers are young professional managers who trained in reserve corporate teams and were chosen as a result of competitive interviews held by the management of the Company.

One of the main tasks of Rostelecom is to achieve the image of an attractive employer in the market of high professional personnel, and the Company expects that this, in turn, will increase loyalty and retention of key specialists, and attract to the company young promising workers, thereby increasing the professionalism and efficiency of the Company's human resources.

A component of the new personnel management system which is being created in the Company is the development of a compensation scheme aimed at increasing efficiency of work by personnel and establishing appropriate remuneration for work.

In 2002 and 2003 the Company is planning:

- to develop and implement a system of personnel evaluation up to the level of mid-level managers;
- to create a bonus plan aimed at increasing profitability, quality of work and professionalism of the Company; and
- to implement a system of goal management for managers.

#### **6.E. Share Ownership**

The table below indicates, as of August 26, 2002, the number of Ordinary Shares and Class A Preferred Shares held by the members of Rostelecom's management (active prior to the Annual General Shareholders Meeting of the Company held on June 1, 2002, including those re-elected by the Annual General Shareholders Meeting of the Company or the Board of Directors of the Company on June 1, 2002) and the percentage such shares represent of all outstanding Company's shares of a class:

<u>Name</u>	<u>Number of Ordinary Shares Owned</u>	<u>Percent of Class</u>	<u>Number of Class A Preferred Shares Owned</u>	<u>Percent of Class</u>
Alexei F. Aliokhin	-	-	-	-
Pavel I. Alpetyan	2,400	0.0033	7,200	0.00296
Vladimir I. Androsik	-	-	-	-
Stanislav P. Avdiyants	1,100	0.00015	6,800	0.00280
Vadim E. Belov	-	-	-	-
Nikolai P. Emelianov	-	-	-	-
Dmitry E. Erokhin*	-	-	3,600	0.00148
Grigory M. Finger	-	-	-	-
Sergei I. Glushko	-	-	-	-
Vadim Y. Izotov	-	-	-	-
Nikolai M. Korolev	-	-	7,200	0.00296
Sergei I. Kuznetsov	-	-	-	-
Alexander V. Lopatin	-	-	-	-
Alexander A. Lutsky	-	-	-	-
Marina D. Oleshek	-	-	-	-
Anton I. Osipchuk	-	-	-	-
Stanislav N. Panchenko	-	-	-	-
Vladimir A. Petrov	-	-	-	-
Viktor A. Polischuk	-	-	-	-
Vladislav S. Vasin	-	-	-	-
Valery N. Yashin	-	-	-	-
Boris V. Zverev	169,536	0.02327	3,195	0.00132

\* After the election of the new Management Board by the new Board of Directors of the Company on June 1, 2002, Mr. Dmitry E. Erokhin is the only member of the Management Board of the Company who owns shares in the Company. As of August 26, 2002 neither the number nor the Class of the Company's shares owned by Mr. Dmitry E. Erokhin has changed as compared to June 25, 2002. As of August 26, 2002, no other member of the newly elected Board of Directors or Management Board of the Company owns shares in the Company. The Company's Class A Preferred Shares owned by Mr. Dmitry E. Erokhin have equal voting rights with the other Company's shares of the same class.

As of August 26, 2002, the members of Rostelecom's management (active prior to the Annual General Shareholders Meeting of the Company held on June 1, 2002, including those re-elected by the Annual General Shareholders Meeting of the Company or the Board of Directors of the Company on June 1, 2002) held, as a group of persons, the following number of Rostelecom's shares:

- 173,036 Ordinary Shares – 0.024% of all Ordinary Shares; and
- 27,995 Class A Preferred Shares – 0.0115% of all Class A Preferred Shares.

Within each class, shares held by Rostelecom's management (active prior to the Annual General Shareholders Meeting of the Company held on June 1, 2002, including those re-elected by the Annual General Shareholders

Meeting of the Company or the Board of Directors of the Company on June 1, 2002) have equal voting rights with the other shares of the same class.

## **Item 7. Major Shareholders and Related Party Transactions**

### **7.A. Major Shareholders**

The only voting securities presently outstanding are Rostelecom's Ordinary Shares, nominal value RUR 0.0025 per share. The following table sets forth, as of August 26, 2002 information with respect to the beneficial ownership of the outstanding Ordinary Shares by (i) each person or entity that beneficially owns in excess of 5% of Ordinary Shares and (ii) all newly elected officers and directors of Rostelecom as a group.

<u>Identity of Person or Group</u>	<u>Number of Ordinary Shares Owned</u>	<u>% of Class</u>
Svyazinvest	369,224,907	50.67%
ING Bank (Eurasia) ZAO/ING DEPOSITARY ING Barings as a nominee holder*	182,226,376	25.01%
National Depository Center, a non-commercial partnership, as a nominee holder	58,047,993	7.97%
Depository Clearing Company	37,041,585	5.08%
Officers and members of the Board of Directors as a group	0	0%

\* Rostelecom's American Depository Shares ("ADSs"), each representing six (6) Ordinary Shares, are publicly traded on the New York Stock Exchange under the symbol "ROS". Each ADS is evidenced by an American Depository Receipt ("ADR"). The Bank of New York serves as the depository for the ADRs. As of August 26, 2002, 30,371,063 ADSs were placed, representing 25.01% of all placed Ordinary Shares. Since certain of these Ordinary Shares and ADSs were held by the brokers or other nominees, the number of record holders in the U.S. may not be representative of the number of beneficial holders or of where the beneficial holders are resident.

As of August 26, 2002, the Company had a total of 728,696,320 Ordinary Shares placed. As of August 26, 2002, the register of shareholders included 15 holders of Company shares registered in the United States. They hold 242,000 ordinary shares of the Company (0.033% of all Ordinary Shares) and 2,800 Class A Preferred Shares (0.001% of all preferred shares of the Company).

Svyazinvest is the biggest shareholder in the Company, holding 50.67% of all Ordinary Shares. All the shareholders of Rostelecom total 21,963, including 21,743 individuals and 220 legal entities.

The Russian government has exercised, and is likely to continue to exercise, significant influence on the operation of the Company:

Prior to April 1997, the Russian Federation Government directly owned 38% of the charter capital (ordinary and preferred shares) of Rostelecom, representing 50.67% of voting shares. In April 1997, the Government announced the transfer of its ownership interest in Rostelecom to Svyazinvest, the holding company established by the Ministry of Communications ("MOC") to consolidate the Government's majority interests in various telecommunications companies throughout Russia. The transaction was consummated on July 25, 1997, when the MOC sold 25% plus one share of Svyazinvest at auction for approximately \$1.87 billion to a newly formed investment consortium. In addition, the Russian Government has the general authority to regulate tariffs and regulates domestic long distance tariff-setting to a limited extent. Pursuant to the provision on

telecommunications services in Russia, the Government also regulates licensing. Despite the uncertainties associated with respect to the Government's ability to use its regulatory powers to influence providers of telecommunications services, increased involvement of the Government in the management and operations of Rostelecom remains a possibility. In addition, the Government is a significant customer of the Company, and any decrease in the Government's utilization of Rostelecom's network could have a material adverse effect on the Company's operations.

The table below specifies the ownership structure of Rostelecom Ordinary Shares as of August 26, 2002.

<u>Shares Owners</u>	<u>Percentage of Ordinary Company Shares</u>
Svyazinvest:	50.67%
• Russian Government	75% - 1
• Mustcom Limited	25% + 1
ING Depositary, as nominee under Deposit Agreement	25.01%
All other investors	24.32%

No significant change in the percentage ownership held by any major shareholder has occurred during the past three years. Further, as a statutory matter, all voting Ordinary Shares have equal rights, including voting rights and none of the major shareholders have different voting rights.

The Company is not aware of any arrangements, which may entail a change of control over Rostelecom.

#### **7.B. Related Party Transactions**

During the three previous financial years up to the date hereof, Rostelecom entered into the following related party transactions:

On April 28, 1999, the Company as lessor, entered in to a lease agreement in relation to temporary usage of digital network capacity with EDN Sovintel as lessee.

On June 19, 1999, the Company entered into the Insurance Agreement with Closed Joint Stock Company Insurance Company Kostars. This Insurance Agreement provides for one year term which may be extended. The Company is affiliated with the Kostars, as it has the right to control 50% of the voting shares of Kostar. Pursuant to this Insurance Agreement the Company has insured the Company's employees against accidents at work resulting in disability, death or hospitalization.

On April 3, 2000, the Company entered into a Loan Agreement with Closed Joint Stock Company Globalstar – Space Telecommunications (GlobalTel). Pursuant to this Loan Agreement the Company agreed to extend a loan to GlobalTel within the year 2000. The term of the loan is 3 years and the loan shall be repaid prior to December 30, 2003.

On April 28, 2000, the Company entered into the Agreement for Operation and Maintenance of the Hardware and Software Complex of a Conjugation Unit with GlobalTel. Pursuant to this Agreement the Company shall operate and maintain the hardware and software complex of a conjugation unit in the city of Pavlov Possad of the Moscow Region. This Agreement expires in 2003.

On August 31, 2000, the Company entered into two 3-year Agreements for Operation and Maintenance of the Hardware and Software Complex with GlobalTel for two regions: in Kochenevo (the Novosibirsk Region) and in

Knyaze-Volkonskoye (the Khabarovsk District). Pursuant to these Agreements the Company shall operate and maintain the hardware and software complex of a conjugation unit in Kochenevo (the Novosibirsk Region) and in Knyaze-Volkonskoye (the Khabarovsk Region).

On August 3, 2000, the Company, as lessor, entered into a Lease Agreement with GlobalTel in relation to certain buildings and facilities leased to GlobalTel. The Agreement provides for a term of 8 years.

On January 14, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of safety maintenance equipment for Rostelecom network. In accordance with the terms of the Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-leasing which then leases the equipment to Rostelecom. The Agreement provides for a 5 year term. This transaction may be considered a related party transaction as Rostelecom controls 27% of the voting shares of RTC-Leasing.

On February 1, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreements with RTC-Leasing related to the purchase of measurement units. In accordance with these Agreements, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. Each Agreement provides for a 2.5 year term.

On February 26, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of equipment for FOL. In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 6 year term.

On April 3, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing. In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 5 year term.

On May 5, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of measurement units. In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 3 year term.

On May 19, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of measurement units. In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 3 year term.

On June 16, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of equipment for FOL. In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 4 year term.

On June 30, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of equipment for automatic controlling system for telephone exchanges. In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 5 year term.

On June 28, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of equipment for Internet trunk line of Rostelecom. In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 4 year term.

On August 25, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing. In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 4.5 year term.

On November 24, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of equipment for AMTS system, including extension AMTS T-6 for MTS-9 (Moscow). In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 5 year term.

On December 9, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of equipment for AMTS system, including SDH transmission system for MTS-5 (Moscow). In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 5 year term.

On December 9, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of equipment for AMTS system, including SDH transmission system for MTS-10 (Moscow). In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 5 year term.

On December 9, 2000, the Company (as lessee) entered into a Movable Property Financial Leasing Agreement with RTC-Leasing related to the purchase of equipment for AMTS system, including extension AMTS/ATS-34 (Moscow). In accordance with this Agreement, telecommunications equipment is acquired from a vendor of the Company's choosing, sold to RTC-Leasing which then leases the equipment to Rostelecom. The Agreement provides for a 5 year term.

On September 20, 2000, the Company (as agent) entered into an Agency Agreement with regard to paging services to be rendered in Moscow with Closed Joint Stock Company RTC-Page.

On May 15, 2000, the Company entered into an Information Services Agreement with Closed Joint Stock Company Information Agency InformKurier-Svyaz. The Agreement relates to collection, preparation and publishing Rostelecom's materials and information in the "InformKurier-Svyaz" magazine.

On October 6, 2000, the Company entered into an Agreement with EDN Sovintel for Maintenance of the Switch installed in the offices of Rostelecom in Moscow.

In January 2001, a Credit Agreement was entered into by RTC-Leasing and ING Bank (Eurasia) for U.S.\$ 2.9 million. See also Item 4.A. – "History and Development of the Company – Borrowings" (section "U.S. dollars Denominated Loans of the Group").

In May 2001, a Credit Agreement was entered into by RTC-Leasing and ING Bank (Eurasia) for U.S.\$ 3.2 million. See also Item 4.A. – "History and Development of the Company – Borrowings" (section "U.S. dollars Denominated Loans of the Group").



In August 2001, a Credit Agreement was entered into by RTC-Leasing and ING Bank (Eurasia) for JPY 150 million, for the purchase of telecommunications equipment. See also Item 4.A. – "History and Development of the Company – Borrowings" (section "Japanese Yen Denominated Loans of the Group").

In August 2001, a Credit Agreement was entered into between RTC-Leasing and ING Bank (Eurasia) for JPY 25 million. See also Item 4.A. – "History and Development of the Company – Borrowings" (section "Japanese Yen Denominated Loans of the Group").

In August 1999, a Credit Agreement was entered into by RTC-Leasing and Sberbank for RUR 350.2 million. See also Item 4.A. – "History and Development of the Company – Borrowings" (section "Ruble Denominated Loans of the Group").

In April 2000, a Credit Agreement was made between RTC-Leasing and Sberbank for RUR 492.8 million. See also Item 4.A. – "History and Development of the Company – Borrowings" (section "Ruble Denominated Loans of the Group").

On April 5, 2001, the Company entered into a Movable Property Financial Leasing Agreement with RTC-Leasing for Rostelecom's purchase of FOL Lyuban-Issad operating equipment, leased out by RTC-Leasing. The value of the leased equipment totals 45 million rubles. The Agreement is valid until 2006. Lease payments are calculated in the manner agreed by the parties and executed against invoices issued by the lessor. A material condition of the transaction is that the property (FOL Lyuban-Issad equipment) specified by the Company in an attachment to the agreement should be purchased from a vendor chosen by Rostelecom (Experimental Plant for Scientific Instrumentation under the Russian Academy of Sciences), and that this equipment should be available for lease pursuant to the terms of the Agreement.

On April 26, 2001, the Company entered into an Agreement for the Sale and Purchase of Shares with RTC-Leasing. Pursuant to the Agreement, Rostelecom acquired 25% plus 1 share, which constitutes 25% of the charter capital of OAO RTCComm.RU.

On May 30, 2001, the Company purchased equipment from RTC-Leasing under the Sale-Purchase Agreement. The Agreement, worth 165,000 rubles, stays in effect until all of the parties' respective obligations are fulfilled. A material term of the Agreement is that Rostelecom must buy a cable set, equipped with adapters.

On June 5, 2001, the Company entered into a Movable Property Financial Leasing Agreement with RTC-Leasing, pursuant to which Rostelecom was to purchase a loop fiber-optic digital line (Phase 1) leased out by RTC-Leasing. The Agreement remains valid until 2006 and its value is determined on the basis of lease payments calculated in the manner agreed by the parties and invoices issued by the lessor. A material provision of the Agreement stipulates that the equipment (required to engineer and operate the loop fiber-optic digital line), specified by the Company in an attachment to the Agreement, is to be purchased from a vendor chosen by Rostelecom and such equipment should be available for lease pursuant to the terms of the Agreement.

On June 5, 2002, the Company entered into a Movable Property Financial Leasing Agreement with RTC-Leasing acting as lessor. The Agreement is valid until 2007. Lease payments under the Agreement are determined by invoices from the lessor. A material provision of the Agreement stipulates that the property (AGENT RTC Q3), specified by Rostelecom in an attachment to the Agreement, is to be purchased from a vendor (Sumitomo Corp., Japan) chosen by Rostelecom, and that such property should be available for lease, pursuant to the terms of the Agreement. The value of the leased property is not determined yet.

On November 19, 2001, the Company entered into an Agreement with RTC-Leasing for the Sale and Purchase of Notes drawn up by OAO RTS. The Agreement stays in effect until full performance of all of the parties' respective obligations is achieved. A material provision of the agreement stipulates that RTC-Leasing is

to purchase, from Rostelecom, interest-free promissory notes, drawn up by OAO RTS, pursuant to the terms of payment and in installments.

On November 23, 2001, the Company novated the RTC-Leasing obligations to the Company into a debt obligation, documented as an agreement that stays in effect until full performance of all of the obligations by all of the parties. A material provision of the Agreement stipulates that RTC-Leasing's monetary obligations, pursuant to the Agreement on the Sale and Purchase of Notes, are novated into a debt obligation in the form of notes drawn by RTC-Leasing.

On February 26, 2002, the Company and RTC-Leasing entered into a Sale-Purchase Agreement of 1,075,873 additional ordinary registered shares of RTC-Leasing, which represents 25.83% of the charter capital in the process of placement. This decision was adopted at the Extraordinary General Shareholders Meeting of RTC-Leasing, on September 5, 2001. Pursuant to this decision, the charter capital was increased by placement, in the form of a closed subscription of 3,964,714 ordinary shares and 10,000 preferred shares. The nominal value of each ordinary share and one preferred share is ten rubles. In compliance with the above decision, adopted at the General Shareholders Meeting, additional shares have been placed as follows:

Rostelecom – 1,075,873 ordinary shares;

Non-Profit Partnership Center of Telecommunications Problems Research – 117,637 ordinary shares;

ZAO Northwestern Industrial Bank – 787,645 ordinary shares;

OOO Commercial Bank Russian Industrial Bank – 663,280 ordinary shares;

ZAO Gamma-Invest – 663,279 ordinary shares;

ZAO KFP –Finance – 657,000 common shares;

Individuals – 10,000 preferred shares.

The 10,000 preferred shares in RTC-Leasing were issued to individuals which are related parties to the Group. Preferred shares carry dividends amounting to the higher of 10% of the net income after taxation as disclosed in the Russian statutory accounts of RTC-Leasing and the dividends paid on ordinary shares. The Group estimated the fair value of the 10,000 preferred shares at RUR 242 million. The Group recorded 242 million rubles as wages, salaries, other benefits and payroll taxes in its consolidated statements of operations for the year ended December 31, 2001. In 2002, RTC-Leasing declared and paid preferred dividends in the amount of 102 million rubles. Because RTC-Leasing has little history of transacting business outside of the Group, and because the Russian leasing market is in its developing stage, in its estimation of the fair value of the preferred shares management could not base all of its estimations on historical or market data. Rather, management had to make significant assumptions that could affect the reported amount of wages, salaries, other benefits and payroll taxes.

During the reporting period, the Company has entered into transactions with the following associated companies:

On February 23, 2001, the Company and ZAO Interregional TransitTelecom (ZAO MTT) entered into an Operation and Maintenance Service Agreement for a term of 1 year, subject to extension. The material provision of the Agreement stipulates that, Rostelecom perform operations and maintenance services for the transit switching nodes of type AXE-10, assembled by ZAO MTT.

The Company and OAO RTComm.RU, entered into Agreement for lease of equipment and provision of communications services, dated July 25, 2001, pursuant to which Rostelecom acts as Lessor and OAO RTComm.RU acts as Lessee. The Agreement is made for a period of twenty four months. The value of the transaction is determined on the basis of monthly leasing payments and invoices issued by Rostelecom. Pursuant to the Agreement, Rostelecom must transfer to RTComm.RU, on the basis of a temporary holding and use, a set of technologically integral equipment designed for data transmission. To ensure the uniformity of operation and functioning of the equipment, Rostelecom undertakes to provide RTComm.RU communications with services related to leasing digital channels to pass IP-traffic and provide access to the Internet, as well as interact with foreign operators with respect to providing access to the global (international) internet network.

On October 2, 2001, the Board of Directors of the Company resolved to increase the Company's share in ZAO Rustel from 12.5% to 25% by acquiring ZAO Rustel's shares in accordance with the agreement on the exchange for the property rights to software.

On November 1, 2001, the Company and OAO Russian Telecommunications Network (OAO Rossiyskaya Telecommunicatsionnaya Set', "OAO RTS") signed an Agreement of termination of the joint activity. The Agreement is valid until full performance of the parties' respective obligations. A material provision of the Agreement stipulates that termination of the Joint Activity Agreement, concluded in 1998, under which Rostelecom and OAO RTS combined their contributions for objectives, be defined in the arrangement.

On April 3, 2002, the Company formed a Loan Agreement with ZAO Globalstar – Space Telecommunications (ZAO GlobalTel) expiring on December 30, 2002, for the purposes of performing lease payments under Agreements with RTC-Leasing. This transaction is considered a related party transaction since Rostelecom controls 51% of the voting shares of ZAO GlobalTel.

On March 13, 2002, the Board of Directors of Rostelecom decided to terminate Rostelecom's participation in OAO Giprosvyaz by alienating 65,326 registered ordinary shares, constituting 22% of OAO Giprosvyaz's charter capital, pursuant to a sale and purchase agreement formed between the Company and the Non-Profit Partnership Center of Telecommunications Problems Research. Securities Sale and Purchase Agreement No.4-TsB was approved and signed on March 26, 2002.

On June 1, 2002, the Company entered an Agreement on leasing of non-residential premises in Moscow, pursuant to which Rostelecom acts as lessee and OAO Moscow International Telephone Exchange ("MMTS-9") acts as lessor. The Agreement was concluded for a term exceeding one year, subject to extension. A material provision of the Agreement stipulates that MMTS-9 transfers to the temporary holding and use by the Company a non-residential building located at 9 Butlerova str., Moscow, and the lease payment for a certain period is to be specified in invoices issued by MMTS-9.

See further details on related party transactions in Note 7 and Note 25 to the accompanying consolidated financial statements for the year ended December 31, 2001.

On May 22, 2001, RTC-Leasing purchased 10% of its ordinary shares from ZAO RTC-Invest and ZAO Radiotelefon for RUR 175 million. At the time of the purchase, ZAO RTC-Invest was substantially owned by individuals that are related parties to the Group, including members of management of the Group. Except as discussed herein, during the reporting period, the Company did not enter into any transactions which could be considered to be in the interest of individuals entitled, directly or indirectly, to vote at general shareholders meetings of the Company and exert significant influence over the Company's affairs, nor in the interests of their close family members, or the interests of members of the Company's Board of Directors and Management Board and their close family members.

## **7.C. Interests of Experts and Counsel**

Not applicable.

## **Item 8. Financial Information**

### **8.A. Consolidated Statements and Other Financial Information**

This Amendment amends the 2001 Form 20-F filed by Rostelecom with the SEC on July 1, 2002. This Amendment is being filed by Rostelecom with the SEC in accordance with, and reliance upon, Release No. 34-45589 and contains the consolidated financial statements of Rostelecom for the year ended December 31, 2001 audited by Ernst & Young (CIS) Limited, and the consolidated financial statements of Rostelecom for the years ended December 31, 2000 and 1999, audited by ZAO PricewaterhouseCoopers Audit. The information (financial and other) and the audited consolidated financial statements of Rostelecom contained in this Amendment supercede and replace the information (financial and other) contained in (1) the 2001 Form 20-F filed with the SEC by Rostelecom on July 1, 2002 (other than with respect to the exhibits contained in that filing) and (2) the unaudited consolidated financial statements for the year ended December 31, 2001 of Rostelecom contained in Rostelecom's Form 6-K dated May 15, 2002.

The consolidated financial statements of the Group for the year ended December 31, 2001, have been restated. The restated financial statements reflect the effects of (a) consolidating adjustments related to RTC-Leasing, (b) change in estimation of fair value of certain financial instruments, and (c) additional miscellaneous adjustments and reclassifications.

#### ***Consolidating Adjustments Relating to RTC-Leasing***

At the time of preparation of the Group's financial statements as previously reported, for the purposes of consolidation, the Group used estimated financial statements of its subsidiary, RTC-Leasing, for the year ended December 31, 2001. Subsequent to the issuance of the Group's financial statements as previously reported, Rostelecom became aware that RTC-Leasing finalized its financial statements in accordance with IFRS. The consolidated financial statements of the Group for the year ended December 31, 2001, as restated, reflect the effects of final adjustments and reclassifications to the financial statements of RTC-Leasing.

#### ***Change in Estimation of Fair Value of Certain Financial Instruments***

At the time of preparation of the Group's financial statements as previously reported, for the purposes of consolidation, the Group estimated that the fair value of the preferred shares of RTC-Leasing issued to individuals which are related parties to the Group was equal to the amount of preferred dividends paid in 2002 (refer also to Note 7 in the accompanying consolidated financial statements). Subsequent to the issuance of the Group's financial statements as previously reported, the Group reviewed its estimates of the fair value of these preferred shares. The Group now believes that the fair value of the preferred shares should be determined by a combination of expected future cash flows of RTC-Leasing and the expected future preferred dividend flows. Accordingly, the Group has recorded additional expense of RUR 242 million as part of wages, salaries, other benefits and payroll taxes in the Group's consolidated statements of operations for the year ended December 31, 2001, as restated. Further, subsequent to the issuance of the Group's financial statements as previously reported, the Group reviewed its estimates with respect to recoverability of certain accounts receivable. As a result, the Group recognized additional bad debt expense of RUR 368 million.

Note 31 to the Consolidated Financial Statements provides information on reconciling the effects of the restatements for the year ended December 31, 2001.

See Item 18. — "Financial Statements" and "Index to Consolidated Financial Statements".

### **Legal Proceedings**

Rostelecom is subject to various legal proceedings. Rostelecom does not anticipate that the outcome of any of these legal proceedings will be material to its financial condition or results of operation. Other than as described below, Rostelecom does not believe that any of these legal proceedings have arisen other than in the ordinary course of its business operations.

The Moscow Inter-District Prosecutor filed a claim with the Tverskoi Intermunicipal (District) Court of Moscow for the benefit of Ms V.P. Yershova (the plaintiff) against Rostelecom for acknowledgement of the plaintiff's ownership right to 18 Rostelecom's preferred shares and transfer thereof to the plaintiff. The Company rejected the claim and requested the court to deny it. According to the plaintiff, the shares in question should have been transferred to her in the course of Rostelecom's privatization. The Company believes that the claim is without grounds. On November 17, 2000, the court satisfied the claim and affirmed the plaintiff's ownership right to 7,200 rubles worth of preferred shares of the Company. The Cassation Court left the decision unchanged. Currently, the Company is planning to file an application to appeal these court decisions in the Supervision Court.

Rostelecom filed a claim against Sberbank, a Russian bank, with the Moscow City Arbitrazh Court for recovery of RUR 29,580,850. The claim charged the Bank with improper performance of the Bank Account Agreement, by means of debit, of the Company's monies under the forged payment order in the electronic form. On July 6, 2001, the court ordered a technical examination to be conducted of the Sberbank's electronic settlements system. The initial examination failed to determine if the monies were debited as a result of fraudulent actions of the third parties. Currently, the parties are awaiting the results of a re-examination. The court hearings shall continue after completion of the examination.

The Russian Telecommunications Development Corporation ("RTDC") filed a claim with the Moscow City Arbitrazh Court against Rostelecom and ZAO Sistema Telecom (ZAO Dontelecom as a third party) to invalidate ZAO Dontelecom shares' Sale-Purchase Agreement for the value of U.S.\$ 3,583,922, dated February 1, 1999, between Rostelecom and ZAO Sistema Telecom. According to the plaintiff, the transaction is void because of the infringement on his right of first refusal for the purchase of ZAO Dontelecom shares. On June 21, 2001, the court denied the claim. This decision has not been appealed. On July 6, 2001, RTDC filed a claim with the same court for the transfer, to him, of the buyer's rights and obligations under the above mentioned Share Sale-Purchase Agreement. On August 28, 2001, the court satisfied the claim. Since the enforcement of the decision is impossible (the shares are currently held by foreign individuals which were not parties to the case), Rostelecom does not intend to appeal.

ZAO Telecros filed a claim with the Moscow City Arbitrazh Court against Rostelecom for recovery of RUR 21,060,000 of unjust enrichment. The plaintiff claims that it rendered to Rostelecom certain telecommunications services in 1998 for which Rostelecom did not pay remuneration. Rostelecom rejects the claim on the basis that the plaintiff failed to provide evidence of the alleged services rendered. The final court ruling is still pending. Rostelecom believes that the plaintiff's claims are without merits and intends to defend itself vigorously.

Over the reporting period and to date, there have been no court proceedings involving a member of the Board of Directors, or a member of the Management Board of the Company, or an affiliate of the Company acting as an opposing party to the Company or its subsidiaries or as a party, who has material interests different from the interests of the Company or its subsidiaries.

## **Policy on Dividend Distribution**

In accordance with the amendments to the Joint Stock Companies Law, which entered into force on January 1, 2002 (with a few exceptions), dividends on Ordinary Shares may be paid on an annual basis. Annual dividends are proposed by the Board of Directors of Rostelecom, based on the Company's year-end statutory accounting reports, and are approved by an annual general shareholders meeting of Rostelecom which is usually convened by the Board of Directors during the second or third quarter of each year.

Under Russian law, annual dividends may not exceed the amount proposed by the Board of Directors. The decision on payment of dividends, as well as the amount and form of the dividend payable, is adopted by a general shareholders meeting. See also Item 10.B. – "Articles of Association."

Pursuant to the Charter of Rostelecom, dividends on Class A Preferred Shares are paid annually upon decision of an annual general shareholders meeting. Dividends payable on Class A Preferred Shares are fixed by Rostelecom's Charter in the amount of 10% of Rostelecom's net profits, based on its year-end statutory accounting reports prepared in accordance with Russian accounting regulations, divided by the total number of Class A Preferred Shares. Rostelecom may not pay dividends on Ordinary Shares unless dividends on Class A Preferred Shares are fully paid. Furthermore, in the event the amount of dividends paid per Ordinary Share exceeds dividends payable per Class A Preferred Share, an annual general shareholders meeting of Rostelecom should increase the amount of dividends per Class A Preferred Share up to the amount of dividends per Ordinary Share.

Class A Preferred Shares carry no voting rights except on resolutions regarding liquidation or reorganization of the Company, changes to dividend levels of preferred shares, or the issuance of additional preferred stock. Such resolutions require two thirds approval of all shareholders including the owners of the preferred shares. Dividends on preferred shares are determined by Rostelecom's charter. The preferred shares have no rights of redemption or conversion. Owners of preferred shares also have the right to participate in general shareholders meetings and vote on all issues within the competence of such meetings, beginning with the meeting following the annual general shareholders meeting at which the decision not to pay, or to make partial payment only, in respect of dividends on the preferred shares is made. See also Item 10.B. – "Articles of Association."

## **8.B. Significant Change**

In March 2002, the Board of Directors of Rostelecom decided to terminate the Company's participation in EDN Sovintel by selling the Company's stake in Sovintel's charter capital under a sale and purchase agreement between the Company and corporation SFMT-CIS, Inc. and OOO Teleross, which is a subdivision of Golden Telecom. As a result of the transaction, Rostelecom would exchange its 50% stake in Sovintel's charter capital for 15% of Golden Telecom's shares and U.S. \$10 million in cash and U.S. \$46 million in notes payable in 90 days after transfer of shares. The Company's management believes that the sale of shares of Sovintel, whose business is not a core business for Rostelecom, will enable the Company to discharge its external debt. Additionally, the purchase of shares of Golden Telecom, a leading provider of voice communications, data transmission and Internet services, is attractive for Rostelecom from the point of managing an internationally listed company.

In March 2002 the Board of Directors of Rostelecom decided to terminate its participation in OAO Giprosvyaz through the sale of the shares of OAO Giprosvyaz for the total amount of RUR 91 million.

On April 29, 2002 RTC-Leasing, through its wholly owned subsidiary RosTeleComLeasing AG (Switzerland), acquired a 95% stake in the telecommunication holding RTDC Holdings Inc. (USA) that holds major blocks of shares in a number of Russian operators, such as Westelcom, Nizhegorodskaya Cellular Communications, Moscow Cellular Communications, Delta Telecom, Dontelecom, Eniseytelecom, Baikalwestcom, Uralwestcom, AKOS and Sayan Telecom.

On June 21, 2002, the Board of Directors of the Company resolved to increase its shareholding in ZAO Westelcom from 50% to 100% through purchase of shares from the telecommunications holding RTDC Holdings Inc. (USA). The terms of the share purchase agreement are currently being agreed by the parties and the documentation will be submitted to the Ministry for Anti-Monopoly Policy to obtain a permission to complete the transaction.

On June 21, 2002, the Board of Directors of the Company also resolved to increase its shareholding in ZAO Moscow New Technologies and Communications Center ("MTsNTT") from 20% to 60% through purchase of 20% of shares in MTsNTT from each of RTC-Invest and Sovet Holding. As of June 28, 2002, the terms of share purchase agreements have been agreed and signed between the Company and the said counterparties. The documentation is being prepared for filing with the Ministry for Anti-Monopoly Policy to obtain a permission to complete the transaction.

In June 2002, RTC-Leasing purchased 100% interest in ZAO KB Russian Industrial Bank, a Russian bank.

In August 2002, RTC-Leasing entered into loan agreements with Sberbank, a Russian bank. The loans will be ruble-denominated and bear interest rates of 20 to 23% per annum. The total amount of the loans under the agreements will be RUR 4,863 million. Drawdown on the loans is dependent on a number of conditions precedent. The purpose of the loans is to finance acquisitions of equipment that RTC-Leasing will lease to operators of the Svyazinvest Group. The Company expects that RTC-Leasing will comply with the conditions precedent and draw down these loans during the second half of 2002.

## **Item 9. The Offer and Listing**

Not applicable.

### **9.A. Listing Details**

The table below specifies the highest and lowest prices in U.S. dollars and the volumes of transactions with Rostelecom's Ordinary Shares in the Russian Trading System (RTS).

	<u>Month</u>	<u>Highest price</u>	<u>Lowest price</u>	<u>Average volume</u>
<b>1996</b>	January	1.15	0.92	430,239
	February	1.03	0.92	413,235
	March	0.93	0.84	269,138
	April	1.44	0.95	772,853
	May	1.95	1.42	601,395
	June	3.88	1.62	857,301
	July	2.80	1.85	468,457
	August	2.73	2.22	382,079
	September	2.70	2.23	385,338
	October	2.76	2.30	563,780
	November	2.69	2.31	675,636
	December	2.42	2.27	210,369
<b>1997</b>	January	3.55	2.50	1,075,861
	February	4.34	3.52	604,246
	March	4.14	3.72	308,915
	April	3.83	3.45	290,630
	May	4.05	3.79	646,000
	June	4.00	3.76	525,772

	<u>Month</u>	<u>Highest price</u>	<u>Lowest price</u>	<u>Average volume</u>
	July	4.98	3.97	1,471,052
	August	5.20	4.27	1,091,690
	September	4.39	4.11	806,271
	October	4.77	2.83	1,264,721
	November	3.45	2.53	851,402
	December	3.39	2.46	926,161
<b>1998</b>	January	3.54	2.55	1,101,861
	February	3.51	2.85	1,223,917
	March	3.78	3.29	1,111,102
	April	3.64	3.13	1,116,483
	May	3.61	2.58	1,614,233
	June	2.95	2.2	783,726
	July	2.86	1.87	960,527
	August	2.3	0.45	465,725
	September	0.665	0.3	157,211
	October	0.75	0.29	195,556
	November	1.1	0.64	214,993
	December	1.045	0.69	207,778
<b>1999</b>	January	0.915	0.61	97,319
	February	0.905	0.64	415,164
	March	0.92	0.77	235,613
	April	0.79	0.615	29,783
	May	1.72	0.82	506,562
	June	1.69	1.1	278,005
	July	1.92	1.35	272,623
	August	1.45	1.06	173,545
	September	1.165	0.74	384,050
	October	0.9	0.78	144,714
	November	1.505	0.86	341,943
	December	1.99	1.2	397,645
<b>2000</b>	January	2.78	2.15	190,222
	February	2.965	2.0	396,591
	March	4.9	2.76	568,573
	April	4.0	2.6	540,845
	May	3.33	2.02	415,330
	June	2.97	1.99	354,453
	July	2.59	2.16	393,249
	August	2.66	2.34	578,291
	September	2.41	1.5	537,295
	October	1.58	1.2	486,233
	November	1.475	0.92	460,853
	December	1.16	0.85	325,801
<b>2001</b>	January	1.144	0.83	442,700
	February	1.145	0.825	482,385
	March	0.95	0.773	357,022
	April	0.864	0.695	515,199
	May	0.860	0.752	462,472



	<u>Month</u>	<u>Highest price</u>	<u>Lowest price</u>	<u>Average volume</u>
	June	0.967	0.8	542,010
	July	0.907	0.715	403,344
	August	0.720	0.66	254,195
	September	0.705	0.505	660,792
	October	0.622	0.45	745,934
	November	0.895	0.607	1,011,223
	December	0.955	0.81	379,562
<b>2002</b>	January	1.100	0.925	967,073
	February	1.189	1.057	762,317
	March	1.285	1.151	595,106
	April	1.670	1.185	765,250
	May	1.560	1.147	643,842
	June	1.299	0.970	465,928
	July	1.215	0.948	621,103
	August (through August 26)	1.170	0.990	132,471

The table below specifies the highest and lowest prices in U.S. dollars and the volumes of transactions with Rostelecom's Ordinary Shares on the Moscow Interbank Currency Exchange ("MICEX").

	<u>Month</u>	<u>Highest price</u>	<u>Lowest price</u>	<u>Average volume</u>
<b>1997</b>	April	3.86	3.53	13,309
	May	4.06	3.81	18,011
	June	4.05	3.81	36,444
	July	5.06	3.91	93,289
	August	5.02	4.195	150,780
	September	4.46	4.11	62,173
	October	4.70	3.01	108,378
	November	3.50	2.53	64,566
	December	3.30	2.46	60,357
<b>1998</b>	January	3.43	2.56	107,878
	February	3.49	2.81	180,250
	March	3.80	3.27	124,605
	April	3.65	3.10	176,060
	May	3.58	2.55	506,583
	June	2.99	2.128	125,790
	July	2.897	1.867	120,252
	August	2.308	0.509	46,432
	September	0.883	0.322	24,523
	October	0.622	0.281	30,824
	November	1.079	0.536	27,116
	December	1.046	0.715	27,135
<b>1999</b>	January	0.867	0.642	25,033
	February	0.917	0.648	67,085
	March	0.918	0.741	52,018
	April	0.805	0.638	30,884

	<u>Month</u>	<u>Highest price</u>	<u>Lowest price</u>	<u>Average volume</u>
	May	1.266	0.745	149,344
	June	1.832	1.105	105,224
	July	1.914	1.35	85,668
	August	1.426	0.978	34,191
	September	1.209	0.713	42,782
	October	0.969	0.781	54,752
	November	1.546	0.857	130,781
	December	2.004	1.219	78,220
<b>2000</b>	January	2.89	2.037	74,261
	February	2.983	2.037	248,257
	March	4.827	2.851	343,023
	April	4.073	2.702	533,070
	May	3.401	1.987	408,600
	June	2.911	2.006	284,052
	July	2.652	1.388	707,248
	August	2.687	2.349	740,157
	September	2.437	1.477	907,429
	October	1.591	1.115	979,764
	November	1.483	0.934	853,881
	December	1.756	0.84	682,642
<b>2001</b>	January	1.128	0.797	979,125
	February	1.148	0.823	919,335
	March	0.969	0.76	716,176
	April	0.884	0.687	1,395,267
	May	0.873	0.754	1,910,210
	June	0.974	0.851	2,203,325
	July	0.91	0.704	1,047,514
	August	0.724	0.655	650,114
	September	0.703	0.5	1,126,710
	October	0.624	0.452	2,790,061
	November	0.933	0.606	4,972,552
	December	0.957	0.802	2,507,765
<b>2002</b>	January	1.100	0.906	5,154,651
	February	1.190	1.058	3,891,782
	March	1.290	1.128	4,279,019
	April	1.684	1.188	5,793,630
	May	1.564	1.131	5,405,538
	June	1.322	0.977	5,325,588
	July	1.230	0.956	5,371,249
	August (through August 26)	1.187	0.969	3,509,113

On February 17, 1998, Rostelecom was listed on the New York Stock Exchange. The table below specifies the highest and lowest sale prices in U.S. dollars, as of the moment of trade closure and the average volume of trading for the Company's American Depositary Shares on the New York Stock Exchange.

	<u>Month</u>	<u>Highest price</u>	<u>Lowest price</u>	<u>Average volume</u>
<b>1998</b>	February	21.25	20.44	226,467
	March	23.06	19.63	209,015
	April	21.44	18.75	130,486
	May	21.69	15.38	129,900
	June	17.63	13.00	105,081
	July	17.50	11.88	149,910
	August	14.00	3.25	289,050
	September	4.00	1.56	217,052
	October	4.81	1.63	262,382
	November	7.00	3.81	227,632
	December	6.75	4.06	121,881
	<b>1999</b>	January	5.81	3.69
February		5.38	3.81	107,216
March		5.50	4.63	92,595
April		4.69	3.69	86,895
May		7.50	5.06	258,100
June		10.19	6.81	128,176
July		11.75	8.13	105,748
August		8.44	6.69	80,462
September		7.25	4.31	121,715
October		5.81	4.56	100,225
November		9.19	5.25	196,710
December		11.75	6.88	186,426
<b>2000</b>	January	16.25	13.00	221,341
	February	17.50	12.69	371,865
	March	27.44	16.63	253,267
	April	23.00	16.00	194,528
	May	20.56	13.38	258,800
	June	17.50	12.50	116,290
	July	15.25	12.75	77,395
	August	15.94	14.13	117,350
	September	14.00	8.75	126,790
	October	9.31	7.13	161,150
	November	8.88	5.12	192,295
	December	6.75	4.88	186,350
<b>2001</b>	January	6.69	4.75	206,947
	February	6.86	4.97	123,435
	March	5.74	4.50	80,719
	April	5.14	4.13	113,990
	May	5.26	4.25	83,025
	June	5.80	4.60	78,900
	July	5.40	4.15	71,750
	August	4.35	3.85	40,027
	September	4.17	2.95	49,775
	October	3.71	2.72	107,722
	November	5.65	3.71	164,079
	December	5.59	4.75	79,463

	<u>Month</u>	<u>Highest price</u>	<u>Lowest price</u>	<u>Average volume</u>
<b>2002</b>	January	6.53	5.33	90,810
	February	7.10	6.28	53,784
	March	7.75	7.00	47,165
	April	9.89	7.15	119,555
	May	9.22	6.97	121,377
	June	7.74	5.84	157,145
	July	7.25	5.70	105,559
	August (through August 26)	7.09	5.98	99,994

### **9.B. Plan of Distribution**

Not applicable

### **9.C. Markets**

The Ordinary Shares of Rostelecom are traded on the New York Stock Exchange, The Russian Trading System and on the Moscow Interbank Currency Exchanges.

### **9.D. Selling Shareholders**

Not applicable

### **9.E. Dilution**

Not applicable

### **9.F. Expenses of the Issue**

Not applicable

## **Item 10. Additional Information**

### **10.A. Share Capital**

Not applicable

### **10.B. Articles of Association**

On June 1, 2002 the Annual General Shareholders Meeting of the Company approved the new Charter (the "New Charter") and internal corporate documents of the Company, including the Regulations on General Shareholders Meetings, the Regulations on the Board of Directors, the Regulations on the Management Board, the Regulations on the General Director and the Regulations on the Audit Commission. Adoption of the New Charter was required by virtue of amendments introduced into the Joint Stock Companies Law with the effect from January 1, 2002. Such amendments were introduced mainly to increase the protection granted to the minority shareholders of Russian joint stock companies under the old Joint Stock Companies Law and to provide more clarity on certain of its provisions.

The New Charter of the Company was registered by the Moscow Registration Chamber at the end of June, 2002 under the registration number 21833. The Regulations on General Shareholders Meetings, the Regulations on the Board of Directors, the Regulations on the Management Board, the Regulations on the General Director and the Regulations on the Audit Commission (hereinafter jointly referred to as the "Internal Regulations") do not require registration with any government authorities. As of August 27, 2002 the New Charter and the Internal Regulations are binding on the Company.

Described below are the material provisions of the New Charter, with a summary of certain requirements of Russian legislation also applicable thereto. This summary is subject to, and qualified in its entirety by reference to the terms of the New Charter and Internal Regulations filed as an exhibit to this Annual Report on Form 20-F.

### **The Registor; the Company's Objects and Purposes**

Rostelecom was registered by the Moscow Registration Chamber on September 23, 1993 with the state registration certificate number 021.833.

Pursuant to Article 3.1 of the New Charter, the main objective of the Company's activities is to satisfy the demand of individuals, business, governmental bodies, other public agencies of the Russian Federation and other consumers, for services of long-distance and international communications, radio and television broadcast and data transfer, and to obtain profits.

### **Directors' Powers**

The borrowing powers of the members of the Company's Board of Directors correlate with their powers to vote on a proposal, arrangement or contract in which they are interested as governed by provisions on related party transactions of the Joint Stock Companies Law and the New Charter.

Pursuant to the Joint Stock Companies Law and the New Charter, depending on the value of property involved or number of the Company's securities, a decision to enter into a related party transaction (being, generally, a transaction with senior managers of the Company or a person affiliated with the Company) must be adopted by the Company's Board of Directors or by its general shareholders meeting. Since the number of shareholders holding voting shares in the Company is currently more than 1,000, a decision on the approval of the related party transaction is adopted by the Board of Directors of the Company by a majority of votes of independent directors who do not have an interest in the transaction. An independent director is one who does not hold, and whose close relatives do not hold, and have not been holding during the year preceding the adoption of the relevant decision, a position in another management or executive body of the Company, and who is not affiliated with the Company (except through the directorship).

Should all members of the Board of Directors be deemed to be interested in the transaction and/or not to be independent directors, the transaction may be approved by a general shareholders meeting by a simple majority vote of shareholders that are not interested in the transaction.

A related party transaction should also be approved by a general shareholders meeting by a simple majority vote of shareholders that are not interested in the transaction if such transaction or several interrelated transactions: (i) involve the Company's assets having the value of 2% or more of the total balance sheet value of the Company's assets in accordance with the accounting reports as of the latest reporting date; or (ii) constitute subscription for or sale of the Company's shares amounting to more than 2% of the aggregate of the ordinary shares previously placed by the Company and ordinary shares into which previously placed convertible securities may be converted; or (iii) constitute subscription for the Company's securities convertible into ordinary shares that amount to more than 2% of ordinary shares previously placed by the Company and ordinary shares into which previously placed convertible securities may be converted.

Pursuant to the New Charter, the members of the Board of Directors are elected annually by a general shareholders meeting. The New Charter provides that members of the Board of Directors are elected by a cumulative vote as provided for in the Regulations on the General Shareholders Meeting and the Regulations on the Board of Directors (the "Board Regulations"). A general shareholders meeting of the Company may adopt a resolution on early termination of members of the Board of Directors' powers, provided that such resolution may be taken only with regard to all members of the Board of Directors simultaneously. Each member of the Board of Directors may at any time resign voluntarily with a written notice to all other members of the Board of Directors and to the Company. In such event, the authority of the remaining members of the Board of the Company does not terminate. However, in the event that the membership of the Board of Directors falls below the half of initial membership, the Board of Directors must adopt a decision to hold an extraordinary general shareholders meeting to elect the new Board of Directors.

Pursuant to the New Charter, any issues related to the legal status of the Company's Board of Directors that are not covered by the New Charter are governed by the Board Regulations adopted by a general shareholders meeting by a simple majority of votes of shareholders participating in the meeting.

### **Rights Attaching to the Company's Shares**

Pursuant to the New Charter, the Company's charter capital is comprised of 728,696,320 Ordinary Shares and 242,831,469 Class A Preferred Shares (issued and placed). All shares of the Company have equal nominal value. Shares of each category (Ordinary Shares and Class A Preferred Shares) grant equal rights to the holders of the shares of the respective category.

Ordinary Shares of the Company, except for treasury shares, grant to their holders the following principal rights, which generally distinguish them from Class A Preferred Shares: (i) to vote on all issues within the competence of a general shareholders meeting save for the limitations on voting on certain matters provided by the Joint Stock Companies Law; (ii) if holding, alone or together with other shareholders, 10% or more of the voting shares of the Company, demand the calling of an extraordinary general shareholders meeting; and (iii) to demand redemption by the Company of their shares under certain circumstances.

Class A Preferred Shares of the Company generally confer the right to: (i) an annual fixed dividend except for in the situations set forth in the Joint Stock Companies Law and the New Charter; and (ii) preference over Ordinary Shares in the distribution of profits and in the Company's liquidation. Generally, Class A Preferred Shares of the Company do not vote.

Pursuant to the Joint Stock Companies Law and the New Charter, once a year the Company may declare the payment of dividends on its placed shares. The decision on payment of dividends, as well as the amount and form of the dividend payable, is adopted by a general shareholders meeting. The total amount payable as dividend on each Class A Preferred Share is established by the New Charter as 10% of the Company's net profits upon results of the latest financial year, divided by the number of shares constituting 25% of the charter capital of the Company. If the amount of dividend payable by the Company on each Ordinary Share in a given year exceeds the amount payable as dividend on each Class A Preferred Share, the amount of the latter dividend must be increased up to the amount of dividend payable on Ordinary Shares. Dividends are not paid on treasury shares.

The New Charter does not establish any time limit on the expiry of the entitlement to a declared dividend.

In accordance with the New Charter, each holder of Ordinary Shares of the Company may participate in general shareholders meetings of the Company with the right to vote on any matter within its competence. Class A Preferred Shares of the Company confer no voting rights unless the New Charter and the Joint Stock Companies Law provide otherwise. Holders of Class A Preferred Shares have the right to vote on issues that (i) relate to amendments to the New Charter, which would limit their rights as preferred shareholders including the

granting to the holders of any other type of preferred shares priority in payment of dividend and/or preference in respect of the liquidation value of such Class A Preferred Shares and (ii) concern the reorganization or liquidation of the Company. They may also vote at general shareholders meetings following a meeting at which a decision was adopted not to pay dividends or to pay in part owed to holders of Class A Preferred Shares. Such right to vote extends until the dividends to which the holders of Class A Preferred Shares are entitled are paid in full.

The holders of both Ordinary Shares and Class A Preferred Shares of the Company may (i) freely alienate their shares without obtaining consent of other shareholders; (ii) participate in the distribution of the Company's net profits in the form of dividends and in the distribution of the Company's assets in the event of liquidation; (iii) enjoy pre-emption in acquiring additional shares being placed by the Company through open subscription and, in certain circumstances, by way of a closed subscription and (iii) freely access the Company's documents and receive copies thereof for a reasonable fee.

The Company's shareholders may also exercise other rights provided in Russian legislation and the New Charter.

The New Charter does not provide for any distribution of the profits of the Company other than in the form of dividends. The New Charter provides, however, that each shareholder of the Company may receive a pro-rated portion of the assets upon liquidation of the Company upon the settlement with all Company's creditors (including payment of all outstanding taxes and salaries). In the event that the assets of the Company are insufficient to pay the accrued but not paid dividends and the liquidation value of preferred shares to all holders thereof, the assets shall be distributed among holders of preferred shares pro rata to the number of shares held by them.

The assets remaining after the creditors' claims have been satisfied are used to effect, in the order of priority, the payments of: (i) declared but unpaid dividends on Class A Preferred Shares; (ii) the nominal value of the Class A Preferred Shares is to be paid to their respective holders (liquidation value of Class A Preferred Shares). The assets then remaining are to be distributed among the holders of Class A Preferred Shares and holders of ordinary shares in proportion to their shareholding in the total number of shares placed by the Company, adjusted to take the account of the previously paid nominal value of the Class A Preferred Shares.

According to the Joint Stock Companies Law and the New Charter, holders of voting shares have the right to demand that the Company redeems all or part of their shares in the event that a general shareholders meeting adopts a decision on the following issues and the relevant shareholder voted against or refrained from voting on such decisions: a decision to reorganize the Company, to make changes to the New Charter which limit such shareholder's rights, or to enter into major transactions that have not been approved by a decision of the Board of Directors of the Company.

Pursuant to the Joint Stock Companies Law and the New Charter, the Company may buy back its own placed shares. If the Company buys back its shares based on a decision of a general shareholders meeting to decrease the Company's charter capital, such shares should be cancelled immediately upon their buy back. If the Company wishes to buy back its shares but does not intend to decrease its charter capital, it may do so upon a decision of the Board of Directors provided that such decision may be adopted only if shares constituting at least 90% of the existing charter capital remain in circulation. Shares bought back but not cancelled immediately must be sold by the Company within one year at their market value. Otherwise, a general shareholders meeting will have to adopt a decision to reduce the charter capital by way of cancellation of the relevant shares.

The New Charter does not provide for any discrimination with regard to any existing or potential holders of the securities of Rostelecom in the event a shareholder owns a significant block of shares.

The Joint Stock Companies Law requires the Company to maintain a reserve fund to be used solely to cover the Company's losses and redeem the Company's shares in cases where other funds are not available. The New

Charter provides for a reserve fund in the amount of 15% of the Company's charter capital, funded through mandatory annual transfers of at least 5% of its net profits until the reserve fund has reached the 15% requirement.

The provisions of the New Charter governing the rights of holders of the Company's shares do not establish any action that is necessary to change the rights of holders of shares is are more significant than the requirements provided by Russian law.

### **General Shareholders Meeting**

The Company holds annual general shareholders meetings and extraordinary general shareholders meetings pursuant to the New Charter and the Regulations on General Shareholders Meetings.

The authority of general shareholders meetings of the Company is set forth by the Joint Stock Companies Law and the New Charter.

At an annual general shareholders meeting, shareholders must decide on the election of directors, the election and confirmation of the Company's Audit Commission and the approval of the Company's external auditor. They must also consider the annual report and financial statements submitted by the Board of Directors for the previous fiscal year.

The date of an annual general shareholders meeting shall be determined by the Board of Directors, but shall be not earlier than two (2) months and not later than six (6) months following the end of the previous fiscal year of the Company.

An extraordinary general shareholders meeting may be called in accordance with a decision of the Board of Directors adopted by a simple majority of its members present at the meeting. Such decision can be taken (i) at the initiative of the Board of Directors or (ii) upon the request of the Audit Commission, the Company's auditor or the holder(s) in the aggregate of at least 10% of the Company's voting shares as of the date of such request. Such requests shall be made in the manner and in time provided for in the Regulations on the General Shareholders Meetings. Such extraordinary general shareholders meeting should be held not later than forty (40) days following the day of the request made by the said persons. However, if the proposed agenda includes the election of the Board of Directors of the Company, such extraordinary general shareholders meeting should be held not later than seventy (70) days following the day of the request made by the said persons.

Under the New Charter, shareholders that (i) have fully paid for ordinary shares of the Company or (ii) have fully paid for preferred shares of the Company of any type (in the event that a preferred share of such type grants a vote on a particular item on the agenda of the meeting, or if holders of preferred shares have received the right to vote on all issues within the competence of a general shareholders meeting due to a decision not to pay dividends or to make partial payment of dividends on shares held by them) shall be included on the list of shareholders having the right to participate in a general shareholders meeting.

The list of shareholders entitled to take part in a general shareholders meeting is prepared on the basis of the shareholders register of the Company. The date as of which such list should be prepared is to be established by the Board of Directors and may neither fall earlier than the date of the adoption of a decision on holding the general shareholders meeting by the Board of Directors, nor may be more than fifty (50) days prior to the date of the general shareholders meeting to be called. However, if the proposed agenda includes the election of the Board of Directors of the Company, such list should be prepared as of the date no more than sixty five (65) days prior to the date of the general shareholders meeting. Where the proposed agenda includes issues that are to be voted by different composition of shareholders, the list of shareholders entitled to take part in such general shareholders meeting should be prepared as of the date at least forty five (45) days prior to the date of the general shareholders meeting.



All shareholders of the Company entitled to participate in a general shareholders meeting should be notified of such meeting not less than thirty (30) days prior to the date of the general shareholders meeting. Such notification should be made at least fifty (50) days prior to the date of the general shareholders meeting if the agenda includes the election of the Company's Board of Directors.

The Company is required to grant to its shareholders access to the information including the Company's annual report, audited financial statements (balance sheet and profits and loss statement) and auditor's report, information on candidates to the Board of Directors, and any draft amendments or modifications to the Company's charter in advance of a general shareholders meeting.

Shareholders may exercise the right to participate in a general shareholders meeting either in person or by proxy.

### **Limitations on the Right to Own Securities**

There are no restrictions/specific requirements with respect to foreign ownership of the Company's shares, including the right of foreign shareholders to exercise voting rights on the Company's shares, established either by Russian law or by the New Charter.

### **Anti Take-Over Provisions**

Acquisition of more than 20% of shares in a Russian joint stock company, including the Company, is regulated by Russian anti-monopoly legislation.

The Joint Stock Companies Law imposes certain requirements on a person who individually or together with the affiliates purchases 30% or more of ordinary shares in the Company.

A person purchasing such number of ordinary shares shall notify the Company not earlier than ninety (90) days and not later than thirty (30) days before the date of purchase. Upon purchase of shares, the buyer is obliged to make an offer to all other shareholders of the Company to purchase their ordinary shares and securities convertible into ordinary shares. Such requirement applies only to purchase of shares in joint stock companies with over 1,000 holders of ordinary shares, as is the case with the Company. Under the Joint Stock Companies Law a company's charter or a decision of a general shareholders meeting adopted by a simple majority of votes (without counting the votes of the buyer or its affiliates) may exempt the buyer from the obligation to offer to purchase the shares. The New Charter does not provide for such exemption.

Further, the same requirements apply for the purchase of every 5% of ordinary shares over and above 30% of the Company's ordinary shares already held by the buyer together with the affiliates.

The buyer who purchased shares in violation of the Joint Stock Companies Law may vote at a general shareholders meeting only with those shares that have been acquired in compliance with the Joint Stock Companies Law.

Pursuant to the Joint Stock Companies Law and the New Charter, a decision on the reorganization or liquidation of the Company must be taken by 75% of votes of the holders of both ordinary shares and Class A Preferred Shares participating in the relevant general shareholders meeting.

### **Ownership Disclosure**

Pursuant to Russian securities legislation, the Company is required to disclose in its quarterly reports to the Federal Commission for Securities Market, information on its shareholders owning 20% or more of its shares. In

addition, the Company is required to disclose the fact of appearance of a person owning more than twenty five (25) % of either Ordinary Shares or Class A Preferred Shares in the shareholders register.

Pursuant to Russian securities legislation, a person that has acquired 20% or more of shares or other issue securities of a Russian joint stock company, such as the Company, should notify the fact of such acquisition to the Federal Commission for Securities Market not later than five (5) days after the date of acquisition that may also need be followed by the relevant disclosure of such acquisition in a specific publication. In addition, any further 5% increase or decrease in such 20% shareholding should be disclosed within the same period of time.

Pursuant to the Securities Market Law, the Federal Commission for Securities Market must be notified of all acquisitions by foreign entities or individuals of shares of a Russian joint stock company, including the Company.

### **Charter Capital**

The amount of charter capital of the Company significantly exceeds the minimum requirement established by the laws of the Russian Federation for open joint stock companies.

In the event that the Company adopts a decision to decrease its charter capital, its General Director is required to notify all creditors of the Company of such decrease in accordance with the Joint Stock Companies Law. The state registration of the relevant amendments to the Company's charter which would be necessary for decreasing the charter capital would be carried out only upon such notification to the creditors is evidenced.

### **10.C. Material Contract**

#### **Merger Agreement Between Rostelecom and MMT**

On May 14, 1999, the Boards of Directors of Rostelecom and OAO The Moscow Long Distance and International Telephone ("MMT") approved the merger of MMT with and into Rostelecom. The agreement regarding the acquisition of MMT by Rostelecom (the "Agreement"), which was entered into on June 17, 1999, was approved by the General Shareholders Meeting of MMT on June 29, 1999 and by the Annual General Shareholders Meeting of Rostelecom on June 26, 1999. Svyazinvest did not vote at the general shareholders meeting of MMT and Rostelecom because it qualifies as an interested party; however, Svyazinvest fully supports such merger and believes that it was an important step towards consolidation of Rostelecom's subsidiaries.

In accordance with the terms of the Agreement, MMT was acquired by Rostelecom in accordance with the procedures established by Article 57 of the Civil Code of the Russian Federation. Thus, Rostelecom succeeded to all rights and liabilities of MMT as of the date of acquisition. All assets and liabilities of MMT were transferred to Rostelecom pursuant to the Agreement. All permissions and approvals of competent state authorities necessary in accordance with the Russian legislation were obtained by the parties to the Agreement.

In accordance with the Agreement all ordinary and preferred shares of MMT were converted into ordinary and preferred shares of Rostelecom on the date of acquisition. Rostelecom adopted the decision to increase the charter capital by placement of additional ordinary and preferred shares. Valuation of the companies showed that the value MMT was equal to 3.9% of the total value of Rostelecom as of the date of acquisition. Based on that, the shareholders of MMT were entitled to (i) 28,420,603 of additionally issued ordinary shares of Rostelecom, (ii) 9,473,534 of additionally issued preferred shares. Since the amount of ordinary stock of MMT was equal to 11,795,940 shares and the amount of preferred stock was equal to 3,931,980 shares, the following share exchange rates were established: 2.40935 of ordinary shares of Rostelecom for one ordinary share of MMT and 2.40935 of preferred shares of Rostelecom for one preferred share of MMT.

The objectives of the transaction were to consolidate the network, to develop a better mechanism for collecting payments for domestic long-distance and international communications services in Moscow, to eliminate parallel functions of Rostelecom and MMT and to optimize the layout of channel switching capacity required to provide international communications and data transfer services. Rostelecom believes that such actions enable it to improve the quality of its services and the control of payments, to reduce accounts payable and to coordinate the development of the Moscow network.

Before the merger, 80% of domestic long-distance and international traffic passing through the Moscow network was handled by switches owned by Rostelecom, and only 20% of such traffic was handled by switches owned by MMT. MMT billed the customers of the Moscow network on a monthly basis and followed up on such bills. On the average, customers paid Rostelecom directly two weeks following the receipt of bills issued by MMT. Rostelecom paid to MMT approximately 12.6% of total proceeds obtained by the Moscow network for international and domestic long-distance traffic. In addition, Rostelecom received approximately 87% of proceeds obtained by MMT from call offices located in Moscow.

Rostelecom believes that the merger with MMT was a successful and effective transaction because as a result Rostelecom consolidated proceeds from domestic long-distance and international outgoing calls originating in the city telephone network, improved the settlement system between Rostelecom and MMT and optimized its turnover taxes. As a result of the merger, Rostelecom now has direct access to its customers, has reduced its accounts receivable for the services provided and expenses related to doubtful and bad debts and gained experience required to develop billing centers in other major regions of Russia.

Rostelecom estimates that it has reduced its annual expenses and taxes by approximately U.S.\$ 2 million as a result of the rationalization and elimination of duplicative functions conducted by both companies, namely: reduction of operating expenses, reduction of the expenses related to social welfare expenditures and housing; optimization of turnover taxes and rationalization of the administrative functions. As a result of the merger, shareholders of MMT managed to exchange shares which had been unmarketable since August 1997 into shares of Rostelecom which rank among the most liquid shares in the Russian stock market.

#### **10.D. Exchange Controls**

##### **Capital Import and Export Restrictions**

The main regulatory body charged with overseeing and implementing currency and exchange control in the Russian Federation is the Central Bank of Russia.

Foreign exchange operations are governed by the Law No. 3615-I On Currency Regulation and Currency Control, dated October 9, 1992 (the "Currency Control Law") and numerous Central Bank letters, instructions, and orders. Certain other laws establish exemptions from the general currency control regime but, absent implementing legislation, their application remains untested.

Russian currency legislation distinguishes between "residents" (*i.e.*, Russian persons and entities having permanent residence in Russia, including Russian entities with foreign ownership) and "nonresidents" (*i.e.*, persons and entities established under foreign law not having permanent residence in Russia, including foreign company representation offices and branches).

Transactions with foreign currency among residents, and between residents and nonresidents must be conducted only through Russian banks that are licensed to engage in foreign currency transactions ("authorized banks") and available exemptions are limited.

Russian residents' operations with foreign currency and other "currency valuables", such as foreign currency denominated securities, and precious metals and stones are regulated primarily by the Currency Control Law. Any transaction involving the transfer of title or other rights to "currency valuables", or comprising an international money transfer or import or export of such valuables, is deemed to constitute a "currency operation". In addition, currency operations include ruble settlements between residents and nonresidents.

The regulation of operations with foreign currency and currency valuables is based on the distinction between those operations that are "current" and those that are effected "in connection with the movement of capital" ("capital currency operations").

Current operations are defined by the Currency Control Law by way of an exhaustive list and may be carried out by Russian residents without a license from the Central Bank.

Under the Currency Control Law, capital currency operations are comprised of: (i) direct investments; (ii) portfolio investments; (iii) transfers of foreign currency for the purchase of immovable property; (iv) deferrals of payments in foreign currency under export-import contracts for more than 90 days; (v) financial credits in foreign currency by institutions other than authorized Russian banks for periods exceeding 180 days; and (vi) all other operations with foreign currency that are not classified as current currency operations.

Capital currency operations may be performed on the basis of either a transaction-specific Central Bank permit or an exemption established by the Central Bank in its normative acts. The process of obtaining a Central Bank permit is time-consuming and may require a number of consents of other Russian governmental agencies.

Russian exchange control legislation limits the exchange of rubles for foreign currency and the use of foreign currency in Russia. Cash transactions in foreign currency are generally prohibited within Russia. Foreign currency may be freely exchanged for rubles in Russia, but the exchange of rubles for foreign currency in Russia is restricted.

Russian legal entities may purchase foreign currency through authorized Russian banks only to effect payments the list of which is established by Central Bank. The lawful purpose of the intended payment must be proved to the account bank requested to purchase foreign currency. The purchase of foreign currency to effect payments for works and services or intellectual property rights worth more than U.S.\$ 10,000 (or the equivalent in other foreign currencies) is subject to additional procedural regulations.

The procedure for purchase of foreign currency by non-residents differs depending on the type of the ruble accounts held by a non-resident with Russian authorized banks, to which the ruble payments are received. Generally, nonresidents may open the following types of accounts with Russian authorized banks: (i) K-type accounts (convertible accounts); (ii) N-type accounts (nonconvertible accounts); and (iii) F-type accounts (accounts for individuals only).

While non-residents may freely buy foreign currency using ruble amounts in their K- and F-type accounts, similar operations involving N-type accounts may not be carried out prior to 365 days after the date of purchase instructions to an account bank. The incoming payments to such ruble accounts are strictly regulated and certain payments may be received in N-type accounts only.

In addition, substantial amounts of rubles owned by non-residents are kept in S-type accounts. The restrictions on the investment, conversion and repatriation of such funds, which were frozen after the August 1998 financial crisis, are being eased step by step.

Russian legal entities are generally required to procure repatriation of all their foreign currency revenues to Russia, where such proceeds must be deposited to accounts with authorized banks. A part of this requirement is

the requirement that all export revenues of Russian legal residents in foreign currency be remitted to their onshore bank accounts. Once the foreign currency proceeds from the exports of goods, services, or intellectual property, among others, are repatriated, a certain percentage must be promptly sold in the domestic market for rubles. In August 2001, three years after the August 1998 financial crisis, the percentage of foreign currency export revenues subject to this mandatory conversion was decreased to its precrisis level of 50%.

A Russian entity may open or maintain offshore bank accounts in freely convertible foreign currencies only upon a prior approval of the Central Bank.

As a consequence of the Russian economy's progressive recovery from the negative consequences of the 1998 financial turmoil, the currency regulations have been gradually liberalized. Under the newly adopted regulations a number of capital currency operations were exempted from restrictive Central Bank permit and registration requirements (such as attraction of loans for more than 180 days by Russian corporate entities and opening accounts abroad in foreign currency that is "not freely convertible" (according to a list of such currencies approved by the Central Bank)). However, despite of the steps towards liberalization, a number of existing uncertainties as to the interpretation and implementation of provisions of the Russian currency regulations may deprive such amendments their positive effect.

### **Restrictions on the Remittance of Dividends, Interest or Other Payments to Non-Residents**

The Federal Law on Foreign Investment in the Russian Federation specifically guarantees foreign investors the right to repatriate their earnings from Russian investments. However, the Russian exchange control regime may materially affect the foreign investors' ability to do so.

Pursuant to the regime of non-residents' ruble accounts, ruble dividends on the underlying Ordinary Shares of the Company may be paid to the K-type account of the depositary and converted into foreign currency by the depositary for distribution to the owners of ADS without restriction.

As long as the buyer is not a Russian resident, ADSs or underlying Ordinary Shares of the Company may be sold by non-residents for foreign currency outside Russia without regard to Russian currency control. However, Russian currency control legislation will affect the ability of a non-resident to sell ADSs or underlying Ordinary Shares of the Company to a Russian resident. Without a transaction-specific Central Bank permit, Russian residents (unless they are Russian authorized banks or individuals) may, generally, purchase securities for rubles only and may not purchase foreign currency denominated securities, such as the Company's ADS.

Foreign investors may sell ruble-denominated shares, such as the underlying Ordinary Shares of the Company to Russian residents via their own K-type accounts or K-type accounts maintained by the Russian authorized banks for non-resident banks. Ruble proceeds from the sale of such shares received by a non resident to a K-type account may be converted into foreign currency without restriction.

However, the ability of the depositary and other persons to convert rubles into foreign currency is subject to the availability of the foreign currency in Russia's currency market. Although there is an existing market within Russia for conversion of rubles into foreign currency, the further development of this market is uncertain. At present, ruble is not convertible outside Russia. Also, there is currently no viable market for hedging of ruble investments.

Further, no assurance can be given that changes tightening the existing rules affecting foreign investors will not be introduced to the Russian currency legislation. In particular, no assurance can be given that the amount of proceeds from investments that may be repatriated will not be limited, trading with Russian residents in ruble-denominated shares will not become more cumbersome and further restrictions on the conversion of ruble earnings into foreign currency for the purposes of making dividend payments will not be imposed.

## **10.E. Taxation**

The following discussion summarizes certain material United States federal income and Russian income and withholding tax consequences to the beneficial owners arising from the ownership and disposal of ADSs or Ordinary Shares. The discussion which follows is based on (a) the United States Internal Revenue Code of 1986, as amended (the "Code"), the US Treasury regulations promulgated thereunder, and judicial and administrative interpretations thereof, (b) Russian tax law, and (c) the Convention between the United States and the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital (the "Tax Treaty"), all as in effect and available on the date hereof, and is subject to any changes (possibly on a retroactive basis) in these or other laws occurring after such date. It is also based, in part, on representations of the Depositary, and assumes that each obligation in the Deposit Agreement and any related agreements will be performed in accordance with its terms. The discussion with respect to the Russian law is based on the Company's understanding of current Russian law and Russian tax rules, which are subject to frequent change and varying interpretations.

The following discussion is intended as a general description only and is not intended as tax advice to any particular investor. It is also not a complete analysis or listing of all potential United States federal income or Russian profits tax and income withholding tax consequences to the owners of ADSs or Ordinary Shares. Each holder should consult its own tax adviser regarding the specific United States federal income tax consequences, as well as Russian tax consequences of the ownership and disposal of the ADSs or Ordinary Shares under its own particular factual circumstances.

### **Russian Profits Tax and Withholding Tax Considerations**

The following is a summary of certain Russian tax considerations regarding the ownership and disposal of ADSs or Ordinary Shares by a holder who is either a foreign citizen, not residing in the Russian Federation for more than 183 days in a given calendar year (a "Non-resident Individual") or is a foreign corporation (a legal entity incorporated outside of Russia), partnership or other entity established outside of Russia which does not conduct its business in the Russian Federation via a "permanent establishment" (a "Non-resident Entity"). Under Russian tax law, a "permanent establishment" for tax purposes is deemed to include a branch, subdivision, bureau, office, agency or any other permanent location in which activities are carried out on a regular basis for the purpose of deriving income in the Russian Federation or abroad. The definition of a permanent establishment also includes any organizations or individuals that has and regularly use the powers to conclude contracts or negotiate their essential provisions in Russian Federation in the name of a foreign corporation or other entity creating legal consequences for such foreign corporation or other entity (dependent agent). Where there is no difference in the treatment of a Non-resident Individual and a Non-resident Entity any of them may be referred to as a "Non-resident".

Russian tax rules applicable to securities, and in particular those applicable to Non-residents holding Russian securities, are characterized by significant uncertainties and by an absence of interpretative guidance. Both the substantive provisions of Russian tax law and the interpretation and application of those provisions by the Russian tax authorities may be subject to more rapid and unpredictable change compared to jurisdictions with more developed capital markets, legal and tax systems.

#### ***Applicability of the Tax Treaty to the U.S. ADS Holders***

Russian tax rules applicable to the U.S. holders of ADSs are characterized by significant uncertainties and by an absence of interpretative guidance. Russian tax authorities have not provided any reasonable guidance regarding the treatment of ADS arrangements, and there can be no certainty as to how they will ultimately treat those arrangements. In particular, it is unclear whether Russian tax authorities will treat the U.S. holders as the beneficial owners of the underlying shares for the purposes of the Tax Treaty. If Russian tax authorities do not

treat the U.S. holders as the beneficial owners of the underlying shares, then the U.S. holders would not be able to benefit from the provisions of the Tax Treaty. However, even if the U.S. holders are treated by the Russian tax authorities as the beneficial owners of the underlying shares, the U.S. holders still may be not able to benefit from the provisions of the Tax Treaty, or may experience significant expense and effort due to the complicated administrative procedures on the Russian side claiming these treaty benefits.

### ***Taxation of Income from Disposal of ADSs or Ordinary Shares***

The tax treatment of sales, exchange or other disposal of ADSs or Ordinary Shares will be different for Non-resident Individuals and Non-resident Entities.

### ***Taxation of Capital Gains from Disposal of ADSs or Ordinary Shares for Non-resident Individuals***

Non-resident individual holders of ADSs or Ordinary Shares generally should not be subject to any Russian income tax or withholding tax on the gain realized on the sale, exchange or other disposal of ADSs or Ordinary Shares outside of Russia if the ADSs or Ordinary Shares are disposed to Non-residents (arguably, a sale outside Russia to a Russian resident would also be exempt).

Sale, exchange or other disposal of ADSs or Ordinary Shares to Russian residents may be subject to Russian income or withholding taxes. In case Non-resident Individual holder sells, exchanges or in other way disposes ADSs or Ordinary Shares to a Russian resident purchaser, the latter may be required to withhold 30% of the gain realized on disposal of ADSs or Ordinary Shares. Although Russian tax rules provide for a procedure to determine a holder's tax basis for the purpose of determining taxable gain, there is a risk that in practice a Russian resident purchaser may arbitrarily withhold tax on the gross proceeds of the transaction.

A refund of tax withheld may technically be available for a Non-resident Individual holder of ADSs or Ordinary Shares pursuant to the provisions of an applicable tax treaty, upon submission of a relevant application. In practice, however, the procedure for obtaining such refunds is not defined. The law does not provide for advance treaty clearance of payments to Non-resident Individuals.

### ***Taxation of Capital Gains or Other Income from Disposal of ADSs or Ordinary Shares for Non-resident Entities***

Any capital gain or other income received by a Non-resident Entity as a result of sale, exchange or other disposal of ADSs or Ordinary Shares through a non-Russian stock exchange generally should not be subject to Russian withholding tax for a Non-resident Entity.

In case of sale, exchange or other disposal of ADSs or Ordinary Shares outside a stock exchange the purchaser is required to withhold 20% of the purchase price (or 24% of the gain if the seller can confirm the cost basis of the security in accordance with Russian rules) if more than 50% of Rostelecom's assets consists of immovable property located in Russia. There is an uncertainty in the Russian law as to whether telecommunication lines, comprising a large part of Rostelecom assets, are considered to be immovable property, thus the risk of withholding exists. The mechanism for withholding of the tax and remittance of the tax withheld to the Russian tax authorities is not defined in case the payer of income is a Non-resident with no tax registration in Russia.

Many tax treaties provide for relief from withholding tax on capital gain, though the Tax Treaty contains limitation similar to that in Russian law, and if not less than 50% of the assets is recognized to be immovable property no relief is available.

To claim the benefit of a reduced rate of withholding tax under an applicable tax treaty, a Non-resident normally should provide a certificate of tax residence confirming the eligibility for the treaty benefits, which must meet the requirements of Russian law. If such certificate has not been presented to the payer prior to the payment date, the payer of income is required to withhold tax at the full rate of 20% of the purchase price (or 24% of the gain if the seller can confirm the cost basis of the security in accordance with Russian rules). Non-resident holders eligible for a reduced rate under a double tax treaty are then entitled to file claims for refund which must be lodged with the Russian tax authorities within 3 years after withholding was made. There are practical problems in obtaining both the advance exemptions and the refund claims particularly where the beneficial owner of the dividend income and the registered owner are different entities. In addition there is significant uncertainty regarding the availability and timing of refunds even if the claim is approved.

No withholding tax should generally apply if 50% or less of Rostelecom's assets consist of immovable property located in Russia even in case of sale, exchange or other disposal of ADSs or Ordinary Shares outside a stock exchange.

### ***Taxation of Dividends***

Dividends on ADSs or Ordinary Shares paid to Non-resident Entities generally will be subject to Russian withholding tax deducted at source by the payer of such dividends at a rate of 15% for Non-resident Entities. For Non-resident Individuals the rate of withholding tax may generally be 30% if the payer of income chooses the conservative approach.

The withholding tax rate can be reduced in accordance with the provisions of an applicable double tax treaty, subject to the risks outlined in the section "Russian Profits Tax and Withholding Tax Considerations" above. The Tax Treaty reduces the rate of withholding tax on dividends to 10% (and to 5% if a Non-resident holder is an entity treated as a body corporate for the US tax purposes that owns at least 10% of the voting stock).

To claim the benefit of a reduced rate of withholding tax under applicable tax treaty, a Non-resident Entity normally should provide a certificate of tax residence confirming the eligibility for the treaty benefits, which must meet the requirements of Russian law. If such certificate has not been presented to the payer prior to the dividend payment date, the payer is required to withhold tax at the full rate 15% for Non-resident Entities. Non-resident Entity holders eligible for a reduced rate under a double tax treaty are then entitled to file claims for refund, with the Russian tax authorities within 3 years after withholding was made. There are practical problems in obtaining both advance exemptions and refund claims particularly where the beneficial owner of the dividend and the registered owner are different entities. In addition there is significant uncertainty regarding the availability and timing of refunds even if the claim is approved.

A refund of tax withheld may technically be available for a Non-resident Individual holder of ADSs or Ordinary Shares pursuant to the provisions of an applicable tax treaty, upon submission of a relevant application. In practice, however, the procedure for obtaining such refunds is not defined. The law does not provide for advance treaty clearance of payments to Individuals.

### **United States Federal Income Tax Considerations**

The following is a summary of the principal U.S. federal income tax consequences of the acquisition, ownership and retirement of Ordinary Shares or ADSs by a holder thereof. This summary only applies to Ordinary Shares or ADSs held as capital assets and does not address, except as set forth below, aspects of U.S. federal income taxation that may be applicable to holders that are subject to special tax rules, such as

- financial institutions,



- insurance companies,
- real estate investment trusts,
- regulated investment companies,
- grantor trusts,
- tax-exempt organizations,
- dealers or traders in securities or currencies,
- holders that own (or are deemed to own) ten percent or more (by voting power or value) of the Company's Ordinary Shares or ADSs,
- holders that will hold the Company's Ordinary Shares or ADSs as part of a position in a straddle or as part of a hedging, conversion or integrated transaction for U.S. federal income tax purposes or that have a functional currency other than the U.S. dollar.

Moreover, this summary does not address the U.S. federal estate and gift tax or alternative minimum tax consequences of the acquisition, ownership or retirement of Ordinary Shares or ADSs. Each holder should consult its tax advisor with respect to the U.S. federal, state, local and foreign tax consequences of acquiring, holding and disposing of Ordinary Shares or ADSs.

For purposes of this summary, a U.S. Holder is a beneficial owner of Ordinary Shares or ADSs who for U.S. federal income tax purposes is

- a citizen or resident of the United States;
- a corporation or partnership organized in or under the laws of the United States or any State thereof, including the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust (1) that validly elects to be treated as a United States person for U.S. federal income tax purposes or (2) (a) the administration over which a U.S. court can exercise primary supervision and (b) all of the substantial decisions of which one or more United States persons have the authority to control.

A Non-U.S. Holder is a beneficial owner of Ordinary Shares or ADSs other than a U.S. Holder.

If a partnership (or any other entity treated as a partnership for U.S. federal income tax purposes) holds Ordinary Shares or ADSs, the tax treatment of the partnership and a partner in such partnership will generally depend on the status of the partner and the activities of the partnership. Such partner or partnership should consult its own tax advisor as to its consequences.

### ***Ownership of ADSs in General***

For United States federal income tax purposes, a U.S. Holder of ADSs generally will be treated as the owner of the Company's Ordinary Shares represented by such ADSs.

The United States Treasury Department has expressed concern that depositaries for American depository receipts, or other intermediaries between the holders of shares of an issuer and the issuer, may be taking actions that are inconsistent with the claiming of United States foreign tax credits by U.S. holders of such receipts or shares. Accordingly, the analysis regarding the availability of a United States foreign tax credit for Russian taxes and sourcing rules described below could be affected by future actions that may be taken by the United States Treasury Department.

### ***Taxation of Dividends***

Subject to the discussion below under "Passive Foreign Investment Company Considerations", for United States federal income tax purposes, a U.S. holder will include in gross income the gross amount of any distribution made to such U.S. holder of cash or property, other than certain distributions, if any, of the Company's Ordinary Shares distributed pro rata to all Company's shareholders, including holders of ADSs, with respect to such U.S. Holder's Ordinary Shares or ADSs, before reduction for any Russian taxes withheld therefrom, as dividend income to the extent such distributions are paid out of the Company's current or accumulated earnings and profits as determined under United States federal income tax principles. Such dividends will not be eligible for the dividends received deduction generally allowed to corporate U.S. Holders. Subject to the discussion below under "Passive Foreign Investment Company Considerations," to the extent, if any, that the amount of any distribution by the Company exceeds its current and accumulated earnings and profits as determined under United States federal income tax principles, it will be treated first as a tax-free return of such U.S. Holder's adjusted tax basis in Ordinary Shares or ADSs and thereafter as capital gain. The Company does not maintain calculations of its earnings and profits under United States federal income tax principles.

If the Company pays a dividend in Russian rubles, any such dividend will be included in a U.S. Holder's gross income in an amount equal to the United States dollar value of Russian rubles on the date of receipt, which, in the case of ADSs, is the date they are received by the depository. The amount of any distribution of property other than cash will be the fair market value of such property on the date of distribution. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date the dividend is received to the date such payment is converted into U.S. Dollars will be treated as ordinary income or loss.

The 10% Russian withholding tax provided under the Tax Treaty (and 5% if a Non-resident holder is an entity treated as a body corporate for the U.S. tax purposes that owns at least 10% of the voting stock) generally will be treated as a foreign income tax, and subject to certain limitations, generally may be claimed as a credit against a U.S. Holder's United States federal income tax liability. In the event Russian tax is withheld at a 15% or 30% rate, a U.S. Holder may not be entitled to claim a credit for the excess of the amount withheld over the 10% rate provided in the Tax Treaty, since the procedures for claiming refunds and the practical likelihood that refunds will be made available in a timely fashion are uncertain. A U.S. Holder who does not elect to claim a foreign tax credit for foreign income tax withheld, may instead claim a deduction, for United States federal income tax purposes, in respect of such withholding, but only for a year in which such U.S. Holder elects to do so for all creditable foreign income taxes.

The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. For this purpose, dividends that the Company distributes generally will constitute "passive income," or, in the case of certain U.S. Holders, "financial services income."

Subject to the discussion below under "Backup Withholding Tax and Information Reporting Requirements," a Non-U.S. Holder generally will not be subject to United States federal income or withholding tax on dividends received with respect to Ordinary Shares or ADSs, unless such U.S. Holder conducts a trade or business in the United States and such income is effectively connected with that trade or business.

### ***Taxation on Sale or Exchange of Ordinary Shares or ADSs***

Subject to the discussion below under PFIC Considerations, a U.S. Holder generally will recognize gain or loss on the sale or exchange of the Ordinary Shares or ADSs equal to the difference between the amount realized on such sale or exchange and such U.S. Holder's adjusted tax basis in the Ordinary Shares or ADSs. Such gain or loss will be capital gain or loss. The maximum marginal United States federal income tax rate applicable to gain realized by a noncorporate U.S. Holder will be lower than the maximum marginal United States federal income tax rate applicable to ordinary income if such U.S. Holder's holding period for such Ordinary Shares or ADSs exceeds one year and will be further reduced if such U.S. Holder's holding period exceeds five years and such Ordinary Shares or ADSs were acquired on or after January 1, 2001. Gain or loss, if any, recognized by a United States Holder generally will be treated as United States source income or loss for United States foreign tax credit purposes. The deductibility of capital losses is subject to limitations.

The initial tax basis of a U.S. Holder's Ordinary Shares or ADSs will be the United States dollar value of the Russian rubles denominated purchase price determined on the date of purchase. If the Ordinary Shares or ADSs are treated as traded on an "established securities market," a cash basis U.S. Holder, or, if it elects, an accrual basis U.S. Holder, will determine the dollar value of the cost of such Ordinary Shares or ADSs by translating the amount paid at the spot rate of exchange on the settlement date of the purchase. If a U.S. Holder converts United States dollars to Russian rubles and immediately uses that currency to purchase Ordinary Shares or ADSs, such conversion generally will not result in taxable gain or loss.

With respect to the sale or exchange of Ordinary Shares or ADSs, the amount realized generally will be the United States dollar value of the payment received determined on (1) the date of receipt of payment in the case of a cash basis U.S. Holder and (2) the date of disposition in the case of an accrual basis U.S. Holder. If the Ordinary Shares or ADSs are treated as traded on an "established securities market," a cash basis taxpayer, or, if it elects, an accrual basis taxpayer, will determine the United States dollar value of the amount realized by translating the amount received at the spot rate of exchange on the settlement date of the sale.

Subject to the discussion below under "Backup Withholding Tax and Information Reporting Requirements," a Non-U.S. Holder generally will not be subject to United States federal income or withholding tax on any gain realized on the sale or exchange of such Ordinary Shares or ADSs unless:

- such gain is effectively connected with the conduct of a trade or business in the United States; or
- such Non-U.S. Holder is an individual and has been present in the United States for 183 days or more in the taxable year of such sale or exchange and certain other conditions are met.

### ***PFIC Considerations***

A Non-U.S. corporation will be classified as a "passive foreign investment company," (a "PFIC"), for United States federal income tax purposes in any taxable year in which, after applying certain look-through rules, either

- at least 75% of its gross income is "passive income"; or
- at least 50% of the gross value of its assets is attributable to assets that produce "passive income" or are held for the production of passive income.

Passive income for this purpose generally includes dividends, interest, royalties, rents and gains from commodities and securities transactions.

Based on certain estimates of the Company's gross income and gross assets and the nature of the Company's business, the Company believes, and this summary assumes, that it will not be classified as a PFIC for the Company's taxable year ending December 31, 2001. The status of the Company in future years will depend on its assets and activities in those years. The Company has no reason to believe that its assets or activities will change in a manner that would cause it to be classified as a PFIC, but there can be no assurance that it will not be considered a PFIC for any taxable year. If the Company were a PFIC, a U.S. Holder generally would be subject to imputed interest charges and other disadvantageous tax treatment with respect to any gain from the sale or exchange of, and certain distributions with respect to, Ordinary Shares or ADSs.

If the Company were a PFIC, a U.S. Holder could make a variety of elections that may alleviate the tax consequences referred to above, and one of these elections may be made retroactively. However, it is expected that the conditions necessary for making certain of such elections will not apply in the case of the Company's Ordinary Shares or ADSs. A U.S. Holder should consult its own tax advisor regarding the tax consequences that would arise if the Company's were treated as a PFIC.

### ***Information Reporting and Backup Withholding***

A U.S. backup withholding tax and information reporting requirements apply to certain payments to certain noncorporate holders of Ordinary Shares or ADSs that are United States persons. The payer will be required to withhold backup withholding tax on payments of dividends on, and to the proceeds from the sale or redemption of, Ordinary Shares or ADSs made within the United States to a holder of Ordinary Shares or ADSs that is a United States person, other than an exempt recipient, such as a corporation, if the holder fails to furnish its correct taxpayer identification number or otherwise fails to comply with, or establish an exemption from, the backup withholding requirements. Payments within the United States of dividends and the proceeds from the sale or redemption of Ordinary Shares to a holder that is not a United States person will not be subject to backup withholding tax and information reporting requirements if an appropriate certification is provided by the holder to the payer and the payer does not have actual knowledge or a reason to know that the certificate is incorrect. The backup withholding tax rate was 31% for the year 2001 through August 6, 2001, and 30.5% for the remainder of tax year 2001. The backup withholding tax rate is 30% for years 2002 and 2003, 29% for years 2004 and 2005, and 28% for years 2006 through 2010.

In the case of payments to a foreign simple trust, a foreign grantor trust or a foreign partnership, other than payments to a foreign simple trust, a foreign grantor trust or foreign partnership that qualifies as a withholding foreign trust or a withholding foreign partnership within the meaning of the applicable U.S. Treasury Regulations and payments to a foreign simple trust, a foreign grantor trust or a foreign partnership that are effectively connected with the conduct of a trade or business in the United States, the beneficiaries of the foreign simple trust, the persons treated as the owners of the foreign grantor trust or the partners of the foreign partnership, as the case may be, will be required to provide the certification discussed above in order to establish an exemption from backup withholding tax and information reporting requirements. Moreover, a payer may rely on a certification provided by a payee that is not a United States person only if the payer does not have actual knowledge or a reason to know that any information or certification stated in the certificate is incorrect.

**The above summary is not intended to constitute a complete analysis of all tax consequences relating to the ownership of Ordinary Shares or ADSs. Purchasers of Ordinary Shares or ADSs should consult their own tax advisors concerning the tax consequences of their particular situations.**

### **10.F. Dividends and Paying Agents**

Not applicable.

## **10.G. Statement by Experts**

Not applicable.

## **10.H. Documents on Display**

Rostelecom is subject to the informational requirements of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith files periodic reports and other information with the U.S. Securities and Exchange Commission (the "Commission"). Reports and other information filed by Rostelecom may be examined without charge at the public reference facilities maintained by the Commission at Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such materials also are available by mail from the Public Reference Branch at prescribed rates. In addition, such material is available for inspection and copying at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005. As a foreign private issuer, Rostelecom is exempt under the Exchange Act from, among other things, the rules prescribing the furnishing and content of proxy statements and the short-swing profit recovery provisions set forth in Section 16 of the Exchange Act.

## **10.I. Subsidiary Information**

Not applicable.

## **Item 11. Quantitative and Qualitative Disclosures about Market Risk**

The Group's significant market risk exposures are interest rate risk and exchange rate risk. Interest rate risk mainly relates to floating rate debt denominated primarily in Japanese Yen, U.S. dollars and Euro. As of December 31, 2001, approximately 39% of the Group's interest bearing loans carried floating interest rates. Exchange rate risk relates to the Group's foreign currency indebtedness and, to a lesser extent, its foreign currency denominated cash, receivables and payables and foreign currency denominated revenues and costs. As of December 31, 2001, approximately 83% of total indebtedness was denominated in foreign currencies. The Group does not use financial instruments, such as foreign exchange forward contracts, foreign currency options, interest rate swaps or forward rate agreements, to manage these market risks.

The Group's consolidated financial statements are presented in Russian rubles. However, approximately 23% of the Group's revenues are denominated in currencies other than the Russian ruble, principally Special Drawing Rights ("SDR") and U.S. dollar. In addition, approximately 38% of the Group's costs (excluding depreciation and bad debt recovery) are denominated in currencies other than the Russian ruble, principally SDR and U.S. dollar. To the extent that Rostelecom is not naturally hedged against changes in exchange rates, the Group is exposed to foreign exchange gains and losses. The Group is not engaged in any active hedging of the foreign exchange risk arising out of its operating activities.

### **Interest Rate Sensitivity**

As of December 31, 2001, the Group had outstanding borrowings of RUR 6,776 million of which approximately RUR 2,632 million bore interest at floating rates. The interest rate on the Group's floating rate debt is determined principally by reference to London Inter Bank Offered Rate (LIBOR). The additional net financing expense to the Group that would have resulted from a hypothetical, instantaneous and unfavorable change of 100 basis points in the interest rate applicable to these loans is approximately RUR 26 million. The above sensitivity analysis is based on the assumption of an unfavorable 100 basis point movement of the interest rates applicable to each homogeneous category of financial assets and liabilities. A homogeneous category is defined according to the currency in which financial assets and liabilities are denominated and assumes the same interest rate movement within each category.

## **Exchange Rate Sensitivity**

Rostelecom has exchange rate exposure primarily with respect to indebtedness denominated in currencies other than ruble. RUR 5,624 million of the Group's interest bearing loans are denominated in foreign currencies, including RUR 2,748 million in Japanese Yen, RUR 1,896 million in U.S. dollars, and RUR 881 million in Euro. The additional interest expense to the Group that would result from a hypothetical 10% change in foreign currency exchange rates would be approximately RUR 72 million. Such a change would also have resulted in an estimated foreign exchange loss of approximately RUR 562 million. This sensitivity analysis assumes an unfavorable 10% fluctuation in the exchange rates affecting the foreign currencies in which the indebtedness is denominated. Between January 1, 2002 and August 27, 2002, the Russian ruble has declined in value as compared to the Japanese Yen by approximately 15% as compared to the U.S. dollar - by approximately 5%, and as compared to Euro – by approximately 16%.

## **Item 12. Description of Securities Other Than Equity Securities**

None.

## PART II

### **Item 13. Defaults, Dividend Arrearages and Delinquencies**

#### **13.A. Defaults**

As disclosed in Note 15 to the Consolidated Financial Statements for the year ended December 31, 2001, as of December 31, 2001, the Group was in technical default on payments of principal and interest on the loan provided by Vnesheconombank. Total amount due was RUR 2,707 million as of December 31, 2001. However, the Company does not anticipate that Vnesheconombank will call for immediate repayment of the loan for the following reason. The Government decree provides for the possibility of a restructuring of Government's debts administered by Vnesheconombank over a 10-year period at an interest rate of 3% per annum. In accordance with the provisions of the decree, in 2001 the Group entered in negotiations with respect to restructuring this credit agreement on the above terms. As of August 27, 2002, the Group believes that it has complied with the documentary requirements of the decree and is awaiting a confirmation of the restructuring from the Ministry of Finance.

As stated in Note 15 to the Consolidated Financial Statements for the year ended December 31, 2001, several other loans totaling RUR 1,760 million which contain cross default provisions were technically defaulted as of that date. As of August 27, 2002, the Company has repaid RUR 933 million of the loans that contain cross-default provisions. EUR 31.2 million (RUR 825.7 million at the exchange rate as of December 31, 2001 or RUR 956.6 million as of August 27, 2002) of these loans were outstanding and continued to be in technical default as of August 27, 2002.

#### **13.B. Dividend Arrearages and Delinquencies**

None.

### **Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds**

Rights of shareholders were extended significantly by virtue of amendments introduced to the Joint Stock Companies Law (most of the amendments became effective from January 1, 2002).

Under the amended Joint Stock Companies Law shareholders were granted preemptive rights with respect to open and closed subscriptions for additional issues of securities. They were also granted the right to retain rights in any new company formed as a result of a corporate restructuring proportionate to their shareholding in the old company. Furthermore, as a result of the permission to circulate fractional shares, minority shareholders will no longer face forced buy-outs during share consolidations.

See also Item 10.B. – "Articles of Association".

**Item 15. [Reserved]**

**Item 16. [Reserved]**

## PART III

### **Item 17. Financial Statements**

Not applicable.

### **Item 18. Financial Statements**

This Amendment amends the 2001 Form 20-F filed by Rostelecom with the SEC on July 1, 2002. This Amendment is being filed by Rostelecom with the SEC in accordance with, and reliance upon, Release No. 34-45589 and contains the consolidated financial statements of Rostelecom for the year ended December 31, 2001 audited by Ernst & Young (CIS) Limited, and the consolidated financial statements of Rostelecom for the years ended December 31, 2000 and 1999, audited by ZAO PricewaterhouseCoopers Audit. The information (financial and other) and the audited consolidated financial statements of Rostelecom contained in this Amendment supercede and replace the information (financial and other) contained in (1) the 2001 Form 20-F filed with the SEC by Rostelecom on July 1, 2002 (other than with respect to the exhibits contained in that filing) and (2) the unaudited consolidated financial statements for the year ended December 31, 2001 of Rostelecom contained in Rostelecom's Form 6-K dated May 15, 2002.

The consolidated financial statements of the Group for the year ended December 31, 2001, have been restated. The restated financial statements reflect the effects of (a) consolidating adjustments related to RTC-Leasing, (b) change in estimation of fair value of certain financial instruments, and (c) additional miscellaneous adjustments and reclassifications.

#### ***Consolidating Adjustments Relating to RTC-Leasing***

At the time of preparation of the Group's financial statements as previously reported, for the purposes of consolidation, the Group used estimated financial statements of its subsidiary, RTC-Leasing, for the year ended December 31, 2001. Subsequent to the issuance of the Group's financial statements as previously reported, Rostelecom became aware that RTC-Leasing finalized its financial statements in accordance with IFRS. The consolidated financial statements of the Group for the year ended December 31, 2001, as restated, reflect the effects of final adjustments and reclassifications to the financial statements of RTC-Leasing.

#### ***Change in Estimation of Fair Value of Certain Financial Instruments***

At the time of preparation of the Group's financial statements as previously reported, for the purposes of consolidation, the Group estimated that the fair value of the preferred shares of RTC-Leasing issued to individuals which are related parties to the Group was equal to the amount of preferred dividends paid in 2002 (refer also to Note 7 in the accompanying consolidated financial statements). Subsequent to the issuance of the Group's financial statements as previously reported, the Group reviewed its estimates of the fair value of these preferred shares. The Group now believes that the fair value of the preferred shares should be determined by a combination of expected future cash flows of RTC-Leasing and the expected future preferred dividend flows. Accordingly, the Group has recorded additional expense of RUR 242 million as part of wages, salaries, other benefits and payroll taxes in the Group's consolidated statements of operations for the year ended December 31, 2001, as restated. Further, subsequent to the issuance of the Group's financial statements as previously reported, the Group reviewed its estimates with respect to recoverability of certain accounts receivable. As a result, the Group recognized additional bad debt expense of RUR 368 million.

Note 31 to the Consolidated Financial Statements provides information on reconciling the effects of the restatements for the year ended December 31, 2001.



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Notes to Consolidated Financial Statements	F 9 – F 56

**Item 19. Exhibits**

<b><u>Number</u></b>	<b><u>Description</u></b>
1.1.	Charter (Articles of Association) of Open Joint Stock Company Long-Distance and International Communications Rostelecom (restated version No.5), approved by the General Shareholders Meeting on June 1, 2002; <sup>1</sup>
1.2.	Regulations on the General Shareholders Meeting of the Open Joint Stock Company Long-Distance and International Telecommunications Rostelecom (restated version), approved by the General Shareholders Meeting on June 1, 2002; <sup>1</sup>
1.3.	Regulations on the Board of Directors of the Open Joint Stock Company Long-Distance and International Telecommunications Rostelecom (restated version No.2), approved by the General Shareholders Meeting on June 1, 2002; <sup>1</sup>
1.4.	Regulations on the Management Board of the Open Joint Stock Company Long-Distance and International Telecommunications Rostelecom (restated version No.1), approved by the General Shareholders Meeting on June 1, 2002; <sup>1</sup>
1.5.	Regulations on the General Director of the Open Joint Stock Company Long-Distance and International Telecommunications Rostelecom (restated version No.1), approved by the General Shareholders Meeting on June 1, 2002; <sup>1</sup>
1.6.	Amendments and Additions to the Regulations on the Audit Commission of OJSC Rostelecom (Restated) approved by the Annual General Shareholders Meeting on June 30, 2001; <sup>1</sup>
1.7.	Regulations on the Audit Commission of OJSC Rostelecom (restated version), approved by the General Shareholders Meeting on June 30, 2001; <sup>1</sup> and
4.1.	Merger Agreement No.465 between Open Joint Stock Company Long-Distance and International Telecommunications Rostelecom and Open Joint Stock Company the Moscow Long Distance and International Telephone, dated June 17, 1999. <sup>1</sup>

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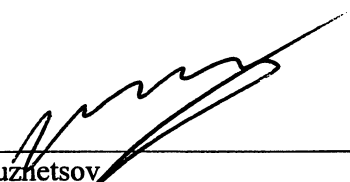
<sup>1</sup> Previously filed with the SEC as an exhibit to the 2001 Form 20-F filed by the Company with the SEC on July 1, 2002.

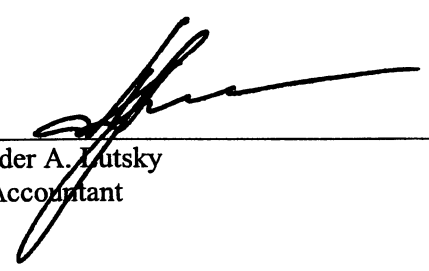
## SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and has caused and authorized the undersigned to sign this amendment to its Annual Report on Form 20-F for the fiscal year ended December 31, 2001 on its behalf.

Dated: August 30, 2002

OPEN JOINT STOCK COMPANY OF  
LONG DISTANCE AND INTERNATIONAL  
TELECOMMUNICATIONS ROSTELECOM

By:   
Sergei I. Kuznetsov  
General Director of Rostelecom

By:   
Alexander A. Zitsky  
Chief Accountant


## CERTIFICATION

I, Sergei I. Kuznetsov, General Director of Open Stock Company of Long Distance and International Telecommunications Rostelecom ("**Rostelecom**"), certify that:

1. I have reviewed this annual report on Form 20-F of Rostelecom;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report; and
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.

Date: August 30, 2002

By:

  
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Sergei I. Kuznetsov  
General Director of Rostelecom

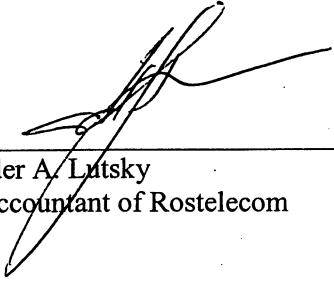
## CERTIFICATION

I, Alexander A. Lutsky, Chief Accountant of Open Stock Company of Long Distance and International Telecommunications Rostelecom ("**Rostelecom**"), certify that:

1. I have reviewed this annual report on Form 20-F of Rostelecom;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report; and
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.

Date: August 30, 2002

By:

  
\_\_\_\_\_  
Alexander A. Lutsky  
Chief Accountant of Rostelecom