

Open joint stock company  
Far East Telecommunications Company

## **AGREEMENT OF ASSOCIATION**

**OJSC Far East Telecommunications Company**  
**reorganization in the form of segregation**  
**(cellular business segregation into a subsidiary**  
**company)**

Vladivostok  
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## **1. Authorization for reorganization: objectives, tasks and effects of segregation**

The main aim of OJSC FETEC cellular business segregation into a subsidiary company is giving liquidity to the business for the purpose of its subsequent sale. Sale of cellular business without its segregation into a subsidiary company is impossible for the reasons specified in section 3 of the Agreement. Sale of Company cellular business is required by decrease in its cost reasoned by thought competition on cellular market and reduction in financial results of cellular business performance as reflected in Company development program till 2012.

Main features of cellular business in Magadansky and Kamchatsky branches, competitive situation, dynamics and outlook of financial indicators of the business as well as directions for future development are given in cellular business development plan attached hereto.

## **2. Targets for investing funds received from assets sale and their effectiveness**

Company plans to use funds received from cellular assets sale as a source of Company investment program 2010 financing and for releasing Company debt load through paying credits and loans. Option for the funds application will be chosen by comparison of return on assets formed in the course on Company investment program implementation and interests payable for borrowed capital service. We believe that if return on assets is more than 10% and weighted average interest is below 10%, funds investment into communications facilities will be preferable than Company debt reduction.

## **3. Comparison and selection of optimal segregation variant**

Company investigated the following options for cellular assets segregation and sale:

- 1) cellular communications equipment sale;
- 2) establishment of subsidiary company and transfer of cellular communications equipment, licenses and frequency permits to authorized capital;
- 3) PJSC FETEC reorganization with cellular assets segregation into a subsidiary company.

As a result conclusion on the impossibility of the two options was made for the reasons below.

The major and most valuable assets of OJSC FETEC on cellular communications market are frequency use permits and licenses for providing mobile radiotelephone services in certain territories. Valid legislation prohibits direct transfer of rights for activities under appropriate license from one person to another, including transfer by selling to any other person or share capital payment by rights vested in the founder accordance with correspondent license.

Therefore with the first option (equipment sale) Company will not be able to sell license and frequency permits, and such failure will result in sharp fall in cellular assets value for potential buyers.

The second option – establishment of a new company by OJSC FETEC and payment of the company share capital by appropriate property – will result in depriving the company of licenses for mobile radiotelephone communications provider and permits for the use of respective frequencies. In this case obtaining the permits and licenses seems almost impossible in current situation on mobile radiotelephone service market of the far East Territory.

Meanwhile, Federal Communications Law implies the possibility of license reregistration in the name of provider's successor (Clause 31). Civil legislation defines succession as transfer of all (or part of) civil rights and obligations from one person to another. Due to expressed direction in Clause 19 of Federal Law "On Joint Stock Companies" establishment of joint stock company and partial transfer of rights and obligations of establishing company to the newly formed one can be ensured by reorganization in the form of segregation only, if thee establishing company is not intending to terminate its own activities..

Therefore, cellular assets segregation from OJSC FETEC as a functioning business is possible only through OJSC FETEC reorganization in the form of a new joint stock company segregation from FETEC.

#### **4. Conditions of reorganization**

In accordance with resolution of Board of Directors dated March 3<sup>rd</sup> 2007 (Minutes No. 17) for approval of cellular business development strategy Company has performed preliminary actions to concentrate cellular business within the subsidiary company, which is suggested for establishment by certain assets segregation from OJSC FETEC.

Segregation balance sheet was prepared as of January 1<sup>st</sup> 2008, where subsidiary company is given assets and liabilities participating in the process of cellular communications service providing by OJSC FETEC in Magadanskaya and Kamchatskaya oblast, including the right to use licenses and frequencies. As of registration date final

segregation balance sheet will be prepared with regard to changes in assets and liabilities that will take place from January 1<sup>st</sup> 2008 to the registration date.

Company obtained approval from Federal Antimonopoly Service (FAS) for reorganization in the form of segregation.

Conditions of segregation and OJSC FETEC reorganization in the form of new company segregation:

1. Segregated company shall be established as a close joint stock company.
2. Shares of segregated company shall be issued by their purchase by reorganized Company so that OJSC FETEC becomes a sole shareholder in segregated company having 100% of shares of the latter.
3. Supreme management body of segregated company shall be general meeting of shareholders (sole shareholder). In accordance with OJSC FETEC Articles of Association resolutions on matters within the competence of general meeting of shareholders in companies where OJSC FETEC has 100% of votes shall be made by PJSC FETEC Board of Directors.
4. Executive bodies of segregated company shall be Executive Committee and Chief Executive Officer with the competence determined by Articles of Association of segregated company.

Conditions of OJSC FETEC reorganization guarantee rights of creditors and shareholders voting against resolution for OJSC FETEC reorganization or failing to participate in voting on agenda issues of general meeting of shareholders concerning OJSC FETEC reorganization in the form of segregation, in accordance with valid legislation of the Russian Federation.

#### **Guarantees of creditors' rights**

Quarantine for observance of OJSC FETEC creditors' rights in case of Company reorganization shall be implemented as Company obligation to notify creditors of resolution for reorganization and availability of the creditor's right to demand termination or early fulfillment of obligations.

Availability and exercising procedures for the right is determined in accordance with Russian Federation Civil Code and Federal Law "On Joint Stock Companies", namely:

- segregation balance sheet includes provisions for succession in respect of all OJSC FETEC obligations concerning all its creditors and debtors, including contested obligations, and procedures for succession determination in relation to changes in the type, contents and cost of reorganized company property and in relation to occurrence, modification and termination of reorganized

company rights and obligations, which may happen after the date of transfer deed and segregation balance sheet.

- as of the date of resolution for reorganization Company shall make a list of creditors including all Company creditors shall be made.

- within 30 days from the date of resolution for reorganization Company shall publish notice of the resolution in *Vestnik Gosudarstvennoy Registratsii* and notify its creditors in writing by registered mail. Company creditors shall be entitled, within 30 days from the date of such notices, to demand in writing early termination or exercising of company respective obligations and reimbursement of their damages.

### **Guarantees of shareholders' rights**

Shareholders voting against or failing to participate in voting may offer their shares to Company for redemption. Availability and exercising procedures for the shareholders' right is determined in accordance with Russian Federation Civil Code and Federal Law "On Joint Stock Companies".

Redemption price for ordinary and preferred shares shall be determined by OJSC FETEC Board of Directors and independent appraiser. Redemption price will be specified in materials distributed among Company shareholders prior to holding general meeting of shareholders where Company reorganization will be discussed.

OJSC FETEC ordinary and preferred shares redeemed from shareholders will be sold during a year on Moscow Interbank Currency Exchange (or in an open tender). Revenues received from the share sale will participate in formation of Company net profit as a result of fiscal year, part of the revenues will be allocated for dividends.

## **5. Analysis and evaluation of financial and tax risks**

### **Financial markets**

1. Currently considerable penetration has been achieved in the aggregate of OJSC FETEC telecommunication services (fixes telecommunications, intrazone telecommunications, traffic connection and accommodation). Average annual growth rate is expected up to 5-7% per year. Considerable growth is observed in Internet broadband access service only (about 50% from year to year).

Consequently, due to extensive penetration profitability of each service goes down. For this reason strategy of telecommunication providers is aimed at development and implementation of bundled services including all type of services like cellular, fixed communications, broadband access and various content services). With regard to this tendency in market development OJSC FETEC package of services can be reduced by one item (to the extent of service providing in

Magadanskaya and Kamchatskaya oblast) upon cellular assets sale, however, this will not necessarily lead to decrease in consumer value of OJSC FETEC package of services.

2. Delay in segregation and sale of OJSC FETEC cellular assets poses the risk of reduction in the assets value as the revenues, number of subscribers, market share and return on assets of cellular go down.

3. Early payment of Company debt at creditors' request (p. 6 Cl. 13 of Federal Law "On Joint Stock Companies". Due to growing interest rate on the market there is a great probability of calls for early debt payment. Amount of called accounts payable may reach total amount of accounts payable (including credits and loans) presented in balance sheet. In this case Company will have to raise borrowed funds for payments to creditors, associated with additional interests payable. Respectively, Company expenses in case of early payment may amount to the difference between interest rates on Company current credit portfolio and current interest rate as of the moment of reorganization. Prompt repayment of the debt is difficult under current market situation on and subject to valid antimonopoly legislation.

4. Share redemption from shareholders voting against reorganization of failing to participate in voting (Cl. 75 of Federal Law "On Joint Stock Companies"). Maximum amount of calls for share redemption may reach 10% on Company net assets or 659 mln rubles. Respectively, Company expenses may amount to the difference between redemption price and sale price for the shares on secondary market as well as interest on use of cash money allocated for share redemption.

5. Changes in debt load (debt to assets ratio) in OJSC FETEC. In accordance with segregation balance sheet new company will get part of OJSC FETEC assets, at the same time OJSC FETEC indebtedness will be transferred to new company in a less proportion than assets. Debt load will therefore increase for OJSC FETEC from 1,3747 to 1,3989 (aggregate liabilities to net assets ratio).

## **Tax risks**

### **1. Value added tax**

Bearing in mind that in accordance with subparagraph 2 of paragraph 3 of RF Tax Code Clause 39 transfer of fixed assets, intangible assets and (or) any other property from company to its successor in case of reorganization of such company shall not be recognized as sale, Company will not incur liabilities in respect of VAT accrual and payment. The newly formed corporate body will have no authorizations to deduct VAT in respect of the property received either.

### **2. Profit tax**

For the purpose of taxation, reorganization in the form of segregation does not cause and additional financial operations affecting taxpayer's taxation base.

In accordance with norms prescribed by Cl. 251 and 270 of RF Tax Code no income or expenses forming taxation base for profit tax will occur with Company.

According to p. 2.1 of RF Tax Code Cl. 252 expenses of newly established and reorganized companies shall, in particular, include cost (residual cost) of property received in a succession procedure in case of reorganization of corporate bodies, which were purchased (formed) by reorganized companies prior to completion of reorganization. Cost of property shall be determined by data and documents of taxation accounting of the transferor as of the date of title transfer for the said property.

### 3. Property tax

In accordance with separation balance sheet transferred property shall be considered charged-off company balance as of the date of segregated company registration and must be charged and taxable on newly established company balance in respect of property tax.

## **6. Reorganization effect on Company capitalization and financial results**

### **Effect on capitalization**

The process of reorganization by cellular assets segregation will not have noticeable effect on Company capitalization for the following reasons:

1. Upon reorganization by cellular assets segregation into a subsidiary company consolidated indicators of Company performance will not undergo considerable changes. Subsidiary company performance will be reflected in accounting statements according to IFRS.
2. Information about cellular assets sale off OJSC FETEC balance is currently anticipated by market (investors and analytics) and is represented in current prices for Company shares. Information about OJSC FETEC intention to withdraw from cellular business was previously welcomed by investment community because Company may focus on other services with growth rates higher than in cellular communications sector.
3. The news about completed cellular assets segregation will confirm the Company approved strategy for cellular assets sale, which may push share quotations a bit upward. Growth driver for the quotations will be the anticipated sale of cellular assets and, respectively, fastest receipt of cash funds to be invested in services with high value added.

At the same time actual sale of cellular assets will result in Company share price review by investors. This fact may influence Company capitalization from both positive and negative sides. Cost of segregated cellular assets is currently included into market prices for Company shares. In general average cost of cellular assets on the market is 250 50 US dollars per subscriber. Investors purchasing Company shares shall be oriented at this very interval.



Cost per subscriber is greatly influenced by situation with frequencies on market of particular region. For instance, in accordance with proposal received from OJSC Vypelcom for purchasing of shares of OJSC Akos owned by OJSC FETEC, value per subscriber estimated to USD 530. This was mainly due to the fact that OJSC Vypelcom has no frequencies in Primorsky krai, neither it has chances to obtain the same. However, on Magadanskaya and Kamchatskaya oblast markets all providers of the “big three” are present, ensuring lower price per subscriber on the markets. In this connection cost per subscriber of the segregated company may vary from USD 250 to USD 400, which allows for the evaluation range from USD mln to USD 40 mln for the asset. No doubt, such evaluation is of preliminary nature only, and it must be confirmed by particular proposals from potential purchasers and independent appraisal prior to the asset sale.

Therefore, effect from sale of subsidiary company on Company capitalization will depend completely on the consistency between market expectations as to the price of assets offered for sale and actual sale price. Actual price exceeding the expectation will have positive effect on Company capitalization, on the contrary, sale prices for the cellular assets inconsistent with market expectations will meet negative response of investors and contribute to reduction in Company share quotation. In quantitative terms the effect will be represented by absolute deviation of average expectations from actual sale price upward or downward.

### **Effect on financial results**

Cellular business segregation into a subsidiary company will not influence OJSC FETEC consolidated revenues, although it will result in short-term reduction in expenses due to decreasing costs of labor, miscellaneous expenses, expenses on providers and some other costs of the subsidiary company. Details of charging operational costs and reasons for their reduction are given in section 6.1 of cellular communications development business plan. Consolidated results of OJSC FETEC and segregated company performance are given in Company development program till 2012 (section 4.3).

Sale of cellular assets will not resulting consolidated revenues decrease because the withdrawn revenues will be superseded by revenues from providing Internet broadband access. Simple calculations prove that increase in revenues from DSL (1900 mln rubles in 2008) at annual surplus of 45% (855 mln rubles) can compensate revenues reduction in the amount of 411 mln rubles as soon as in the next year. Growth rates in revenues from broadband access and other services will be supported in future by new investment projects implemented with the funds received from cellular assets sale.

## 7. Financial costs of reorganization

Expected financial costs are given in Table below:

Item No.	Cost item name	Cost evaluation
1.	Evaluation of property directly transferred into share capital, by independent appraiser	300 thousand rubles
2.	Evaluation of OJSC FETEC for the purpose of determination of redemption price	500 thousand rubles
3.	Submitting an application for and obtaining FAS approval of new company establishment by OJSC FETEC reorganization	10 thousand rubles
4.	Preparation and holding of general meeting of shareholders to discuss Company reorganization by subsidiary company segregation	About 3000 thousand rubles
5.	Making list of creditors and notifying them on OJSC FETEC reorganization. Publishing announcement of Company reorganization in mass media	Up to 5000 thousand rubles
6.	Early payment of creditors' calls	This is not a cost item, but an earlier outflow of cash funds (up to accounts payable amount maximum). Company does not expect any considerable amounts of creditors' calls
7.	Share redemption from shareholders submitting claims for redemption	This is not a cost item, but an earlier outflow of cash funds up to 10% of net assets or 648 mln rubles maximum. In future the redeemed shares will be sold on open market at market price to compensate cash outflow and (providing the market situation is favorable) to receive additional income.
8.	State registration of subsidiary company	2 thousand rubles
9.	Submitting application to Ministry of Taxes and Levies for OJSC FETEC reorganization by segregation Registration of relevant amendments to constituent instruments	0.4 thousand rubles
10.	Registration of share issue by the new subsidiary company in Federal Service for Financial Markets	100 thousand rubles
11.	Reregistration of licenses and frequency permits from OJSC FETEC to the new company	360 thousand rubles
	<b>Total</b>	<b>About 9.5 mln rubles *</b>

\* excluding operations on mandatory redemption of shares and their subsequent sale on market and creditors' claims satisfaction

## 8. Reorganization schedule

Reorganization stages including events for arrangement of the established subsidiary company functioning in commercial mode are given in Table below:

Item No.	Task description	Commencement date	Completion date
1	development of OJSC FETEC cellular business development strategy	26.03.2007	30.03.2007
2	approval of OJSC FETEC cellular business development strategy	03.04.2007	03.04.2007
3	approval of reorganization plan by OJSC FETEC Executive Committee	18.04.2007	18.04.2007
4	making list of assets and liabilities to be transferred to segregated company	18.04.2007	29.06.2007
5	inventory of OJSC FETEC assets and liabilities	01.05.2007	29.06.2007
6	evaluation of property to be transferred to share capital, by independent appraiser	02.07.2007	07.09.2007
7	evaluation of share cost in order to determine redemption price	12.10.2007	14.12.2007
8	updating share cost in order to determine redemption price	26.03.2008	10.04.2008
9	preparation and submission of application to FAS	11.06.2007	21.06.2007
10	obtaining FAS approval	22.08.2007	22.08.2007
11	preparation of draft segregation balance sheet	02.07.2007	07.09.2007
12	preparation of the issue concerning implementation of cellular business development strategy for OJSC FETEC Executive Committee	17.12.2007	21.12.2007
13	meeting of OJSC FETEC Executive Committee on the issue concerning implementation of cellular business development strategy	26.12.2007	26.12.2007
14	preparation and bringing the issue concerning implementation of cellular business development strategy for Board of Directors	27.12.2007	18.01.2008
15	meeting of Board of Directors on the issue concerning implementation of cellular business development strategy	15.02.2008	15.02.2008
16	preparation of materials on segregation for OJSC FETEC Executive Committee	13.03.2008	10.04.2008
17	meeting of OJSC FETEC Executive Committee to discuss segregation	11.04.2008	11.04.2008
18	determination of candidate to the office of General Director and members of Executive Committee of subsidiary company	07.04.2008	11.04.2008
19	preparation and holding meeting of OJSC FETEC Board of Directors to discuss inclusion of segregation issue into agenda of general meeting of shareholders; plus issue concerning redemption price approval	14.04.2008	05.05.2008
20	preparation and holding of Svyazinvest Executive Committee meeting to discuss segregation	20.03.2008	03.04.2008
21	preparation and holding of Svyazinvest Board of Directors meeting to discuss segregation	04.04.2008	19.05.2008

22	preparation for holding general meeting of shareholders to discuss segregation (30 days from Board date)	06.05.2008	11.06.2008
23	holding general meeting of shareholders on segregation issue	11.06.2008	11.06.2008
24	preparation of Minutes of general meeting of shareholders	12.06.2008	16.06.2008
25	giving notice of resolution on segregation to taxation authority	17.06.2008	19.06.2008
26	making list of creditors and written notice to creditors (30 calendar days)	17.06.2008	16.07.2008
27	publishing announcement about reorganization in mass media	17.06.2008	16.07.2008
28	collection of creditors' claims (30 calendar days)	17.07.2008	18.08.2008
29	payment of creditors' claims (60 calendar days)	19.08.2008	17.10.2008
30	collection of shareholders' calls for share redemption (45 calendar days from the moment of general meeting of shareholders)	12.06.2008	28.07.2008
31	share redemption from shareholders submitting calls for redemption (30 days from calls collection deadline)	29.07.2008	27.08.2008
32	state registration of subsidiary company	17.07.2008	23.07.2008
33	preparation of transfer deed	24.07.2008	24.07.2008
34	registration of issue and report on issue results prepared by company, by Ministry of Taxes and Levies	24.07.2008	20.08.2008
35	actual transfer of fixed assets	24.07.2008	24.07.2008
36	execution of fixed assets lease agreement with subsidiary company (for the period of licenses and frequencies reregistration)	25.07.2008	21.08.2008
37	reregistration of licenses and frequencies in the name of subsidiary company	24.07.2008	29.04.2009
38	subscribers transfer to subsidiary company	30.04.2009	29.05.2009
39	employees transfer to subsidiary company	30.04.2009	30.04.2009
40	commencement of subsidiary company operation in commercial mode	29.05.2009	29.05.2009

Upon implementation of the above actions shares of the segregated company can be sold off OJSC FETEC balance. Therefore cash funds from OJSC FETEC cellular assets will be available not earlier than in the 2<sup>nd</sup> half of 2009. Subject to valid tax legislation it is reasonable to register assets transfer in the 4<sup>th</sup> quarter of 2009.