

Corruption and borders: Corruption in Russia; Reiman's Telecommunication Empire (a case study)

Introduction:

Corruption in Russia is a phenomenon that became a way of living rather than a crime. Corruption existed yet in the Soviet Russia, and it was well controlled by the state. However, after the collapse of the Soviet Union, corruption went out of control: in contemporary Russia, almost all ordinary citizens engage in corruption activities at some point of their lives. The higher the position one holds in Russia, the larger amounts of bribes are. The laundered money originated from high-scale corruption cases are usually further transferred through the borders to foreign banks. The current research paper analyzes corruption among high officials using a case study of Leonid Reiman, a former Minister of Telecommunications in Russia, who was reportedly involved in the large-scale offshore telecom corruption case.

Corruption in the Post-Soviet Russia

There are two broad categories of corruption: "petty" and "high-level". "Petty" corruption involves low-ranking officials accepting bribes that supplement their poor salaries. For example, road police falls under this category. The second category of "high-level" corruption includes large-scale appropriation of state resources, usually, by the politicians, businessmen and government officials. In Russia, the appropriation of large amounts from the budget was made possible right after the collapse of the Soviet Union through complex tax and customs systems, vague capital controls and wide-ranging and opaque regulations on businesses, including privatization (Roaf, J. 2000).

Therefore, as a result of the weak state and lack of the rule of law, a combination of opportunities and incentives arose after the collapse of the Soviet Union. In the post-Soviet Russia, it meant that some state officials benefited from their position developing multi-billion businesses for self-gain. According to EBRD, a system controlled by self-interests, as in Russia, "fostered a culture of corruption and regulation that stifled competition instead of rules designed to provide fair conditions for all market participants" (EBRD, 1999).

Furthermore, the international cases of corruption involving Russian officials are hard to prosecute or follow due to unwillingness of the Russian side to cooperate. Thus, many international corruption cases involving Russia as the main source for the laundered money are

stopped due to Russia's inactivity. A case of Leonid Reiman is interesting because it crossed the international borders and was proven in the foreign courts, but denied by the Russian side as a wrong-doing.

“Petersburg operator”

A case of Leonid Reiman is unique (or not so unique in terms of Russia) because it combines corruption and cronyism/nepotism. Today Reiman is a successful businessman, whereas in past he held positions of the Minister of Communications and an advisor to President Medvedev, respectively.

Leonid Dododzhonovich Reiman (Леонид Дододжонович Рейман), a native of Leningrad, graduated from the Leningrad Electro-Technical Institute of Communications (LEIC) named after Bonch-Bruевич. Before 1999, he occupied different mid- to high-level positions in St.-Petersburg telecommunication agencies: the Leningrad city international telephone station, the Leningrad City Telephone Network and OAO PTS (former LGTS). His accession to the post of the state official, the First Deputy Chairman of the Russian State Committee for Telecommunications (Gostelekom), in July 1999, might look like a timely flow of events, if it was not for a small but important detail that creates the controversy in his career – that is the friendship with Putin.

A reasonable question one might ask is how, unknown outside of the Petersburg region, Reiman got appointed to a federal-level position. The answer is quite simple. Mr.Reiman is known to belong to the Putin's Saint Petersburg “team”. Furthermore, as a senior fellow at the Hoover Institution Richard Starr wrote it in the “KGB & Other Buddies in Putin Apparatus” paper, Reiman is “Putin's friend and travelling companion” (Starr, 2000).

To be precise, in the beginning, it was Stepashin who drew Reiman to the federal level. Putin-Reiman-Stepashin “acquaintance-friendship” emerged back in 1990s in Saint Petersburg. In the early 1990s (1991-92), Stepashin was a Chief of the St. Petersburg and Leningrad Region Directorate at Federal Security Service, while Reiman was the Deputy Head of Development of the Leningrad City Telephone Network (LGTS).

Political analyst Boris Vishnevsky writes: “Communications and state security have always been closely interrelated government agencies: The latter invariably needed the services of the former, while the former could never take a step without a nod from the latter” (*Moscow News*, 2004). At approximately the same time, after retiring from the active state security

services, Putin became the First Deputy of the St. Petersburg Mayor Anatoly Sobchak and became in charge of foreign investments with the right to grant permissions to establish joint ventures with foreign investors (*Grani.Ru* 2005). Reportedly Putin and Stepashin worked closely during 1990s (*Lenta.Ru* 2012). Putin's role in this position will play its role in the Reiman's case in 1993.

Stepashin, who occupied the position of Prime Minister very shortly in 1999, appointed Reiman as the First Deputy Chairman of the Russian State Committee for Telecommunications (Gostelekom). Already in August 1999, Putin, who had just become prime minister, appointed Reiman as a Gostelekom Chairman (*Moscow News* 2005). This shows that despite who was at the power, Reiman was a very useful and trusted person, whom both Stepashin and Putin thought of when assigning the positions in the capital. Since then, Mr. Reiman moved up the career hierarchy in the federal government: in 1999 – 2008, he was a Minister of Information and Communication, and in 2008-2010, an Advisor to the President.

Out of the blue, as it may seem to an outside observer, in October 2006, *The Wall Street Journal* published an article uncovering a laundering scheme used by Mr. Reiman and co. The allegation came from the German prosecutors and the Swiss commercial tribunal, both of which said that “a vast international money-laundering scheme has been used to conceal a diversion of state assets by the Russian minister, Leonid Reiman.” The investigators were working from a trail of documents and witnesses unearthed in court cases and police inquiries ranging in various European jurisdictions and the British Virgin Islands.

The German prosecutors and the Swiss tribunal claimed that “right after the collapse of the USSR, Reiman used his position of an executive of a state-controlled company to shift control of the businesses to foreign holding companies he owned”. The Swiss tribunal further claimed that later, after becoming the Minister of Telecommunications, he made the decisions that yielded millions of dollars in profits for these businesses (*Wall Street Journal* October 17, 2006).

Telecommunications market - Beginning:

To understand a laundering business scheme, it is necessary to look at the telecommunications market after the USSR collapse. LGTS was founded in 1950 as a telecommunications service provider in Leningrad region. After the collapse of the Soviet Union, anyone seeking to provide modern phone services to private enterprises had to connect to their

equipment, despite LGTS' old technology and low regulated rates; it resulted in the LGTS's ownership of much share in the market. When working for the government, Mr. Reiman created a network of companies that offered a wide range of services from billing to paging. An interesting example goes back to 1992 when a newly founded St.Petersburg's "Peter-Service" telecommunications company immediately became the only Russian producer of information and billing systems for telecommunication companies. Its' founders were people unrelated to telecommunications: Leonid Reiman's ex-wife Julia Poltavskaya, Valery Yashin's (current CEO of OJSC "Svyazinvest") wife Irina and Sergei Soldatenkov's wife (current CEO of OJSC "MegaFon") Natalia (Rospres 2004).

KGB links and personal acquaintances played a major role in the post-soviet Saint Petersburg. Therefore, it is easy to believe that the creation of the city's first joint venture in the field of mobile communication "Delta Telecom" with American and Danish capital in 1991 happened with the direct consent of the security services, the same goes for the establishment of the mobile phone operator "North-West GSM" (Severo-Zapadny GSM) in 1993 - the basic structure of the future MegaFon.

In 1993, the LGTS was privatized – the privatization of the Leningrad city telephone network was supervised by Putin. After privatization, LGTS was renamed to PTS. A year later, in 1994, PTS created Telekominvest Holding (the registration of the company was also done by Putin, the Committee of the External Relations of Sobchak). OAO PTS transferred the stakes of all its subsidiaries to the holding. In 1994, 95 per cent of the Telekominvest was owned by Reiman's employer PTS, while 5 per cent were owned by a Danish lawyer Jeffrey Galmond. Reiman and Galmond knew each other since early 1990s, when the latter visited St.Peterburg with his client, while Reiman worked for the LGTS. Reportedly, Galmond worked closely with Reiman providing legal help and introductions to potential foreign partners. (*The WSJ*, October 2006)

And already "two years later, the state effectively lost its control over the PTS's subsidiaries", as Boris Vishnevsky wrote in *The Moscow Times*. The controlling stake (51 per cent) in Telekominvest was sold to the Luxembourg company FNH (First National Holding), which was a subsidiary of German Commerzbank and the Swedish telecoms operator Telia. As a result of this transaction, the interest held by Mr. Reiman's employer and another state company shrunk to 49 per cent. The owner of FNH was thought to be German Commerzbank, and

Telekominvest also portrayed it this way.¹ However, after the case started gaining momentum, Commerzbank denied its ownership. And Mr. Reiman reported that his Danish friend Galmond was the owner and he himself had nothing to do with it.

The WSJ reported that the German police found a long internal report from the Commerzbank's Moscow office warning that the bank was improperly helping Mr. Reiman conceal ownership of state assets. The article also said that the employee, who prepared the internal report, told investigators that in 2001 he tried to give the report to Commerzbank Chief Executive Klaus-Peter Muller at the bank's headquarters in Frankfurt, who reportedly turned his back on this issue. Mr. Muller, who first was mentioned as one of the suspects in money-laundering scheme, was later removed from the list due to the lack of evidence.

The former Telecommunications Minister Vladimir Bulgak commented on the FNH ownership, "We didn't make a scandal. We thought the Petersburgers found a good partner who would invest" (*The WSJ*). Furthermore, Reiman commented on the purchase that his state-controlled employer did not actually suffer when its interest in the businesses drastically decreased, because it later grew so much in value.

Thus, Telekominvest, which was linked to PTS, became a monopoly in the region's market. Competitors were given a squeeze and crowded out: "they were refused the lease of cable networks, offered discriminatory linkup terms, denied the required throughput capacity" (*The Moscow Times* 2005). An interesting fact is that Lyudmila Putina served as a Telekominvest representative in Moscow under Reiman in late 1998-99.

In 2001, Commerzbank ended its trust arrangement with telecom business. As a new repository for them, Mr. Galmond created several Bermuda entities, including one called IPOC, International Growth Fund Ltd., registered as a mutual fund. Several Commerzbank executives who used to work in these telecom enterprises quit and moved to the firm Mr. Galmond had set up in Frankfurt to manage IPOC. That was the time when Reiman moved up on the career hierarchy and moved to Moscow.

Megafon ("Lenya-Megafon"):

¹ Telekominvest issued new shares. Though the state-controlled companies, represented by Mr. Reiman, had a right to invest in these shares and maintain their dominant stake, they didn't. Instead, First National Holding put up a modest \$1.8 million for the new shares and wound up with the majority stake. Later its stake rose to 85% through the same process.

However, the main part of the laundering scheme starts with the creation of a federal mobile telecom operator Megafon. The decision to create MegaFon with the assets of the Severo-Zapadny (North-West) GSM company, was made in 1999, with its' official launch to follow in 2001. It was an interesting timing: in 1999, the North-West GSM was the first Russian operator that signed roaming agreements with all countries in Europe (Megafon webpage). MegaFon was divided among three entities: "Telecominvest", IPOC International Growth Fund and LV Finance Group.

LV Finance Group was owned by Leonid Rozhetskin, who in 2000 co-founded the Moscow Sonic-Duo operator. He later exchanged the company's controlling share for 25.1 per cent of the Russian MegaFon. This MegaFon share later became a reason for a long-lasting and expensive commercial fight with Alfa-group that announced buying it from Rozhetskin (CNews 2007).

Nobody knew how much Reiman was involved in Megafon or other telecommunication companies, i.e. how much share he possessed, until *The Wall Street Journal* published its article. But one thing is clear, at that time MegaFon and its other subsidiary companies were given the most favored treatment: Megafon was the only provider holding a GSM standard operations license throughout Russia (BeeLine and MTS are the other two major cellular companies operating in Russia at that time). Reiman's ministry brought much chaos to the Russian telecommunication market with protecting several companies' interests at the expense of others, usually exerting influence through the licensing. The cases of Reiman's influence on the businesses were known long before the Court hearings in Switzerland and Germany and were discussed in yet free Russian Media.

For example, in 2000 the Association of GSM standard operators sent a letter to Reiman expressing their dissatisfaction with the Reimans' licensing committee. The problem was that a number of Moscow mobile operators, Vypelkom (BeeLine) and Telekom XXI (MTS), with regional licenses to provide GSM-1800 services received a clause to their licenses to work in the GSM-900 standard, which was annulled by Reiman after the public complaint (Kommersant November 24, 2001). Reportedly, the denial of the radio frequency was done due to the emergence of the third Moscow mobile operator (Rozhtskin's) Sonic Duo, which only proves Rozhetskin's words that there was an agreement between him and the Minister (KM September 13, 2000).

Another good example is RosBuisnessConsulting report of the 2001 Telecommunication market, which mentions an unprecedented expansion of Telekominvest's Megafon right after its emergence: "The project "MegaFon" has the largest Russian license coverage, covering all 89 Russia's regions with a population 147 million people, representing 100% of the population". In December 2001, the number of "MegaFon" users increased by \$249 thousand in a single month, and at the end of January 2002, the number of customers already grew to 1 million. The report also writes that Megafon is the only operator that at that time provided the largest international roaming in the country (RosBuisnessConsulting report, 2001).

Lastly, the example of Reiman's influence found by The Swiss Tribunal was the case of Telecom XXI. A small Russian company, Telecom XXI was acquired for \$3 million in late 1999 by the company Mr. Galmond said he owned. About a year later, Telecom XXI was sold for \$30 million, and this money was promptly invested in IPOC. According to The Zurich Tribunal, due to Mr. Reiman's ministry, "in the short time the Galmond's businesses controlled Telecom XXI won a much-sought-after license to offer cellular service in and around St. Petersburg". At the time, Russia's biggest cell-phone company OAO Mobile TeleSystems, or MTS, license applications were repeatedly rejected by the branch of Mr. Reiman's ministry. To get the license, MTS agreed to the pricey purchase of Telecom XXI to expand to the area (*The WSJ* 2006).

The Fight over Megafon:

The Reiman's case would have not become known to the public if it was not for the commercial fight. The Alfa-group owner, Mikhail Fridman, one of Russia's richest men, announced in 2003 that his business had acquired Megafon stakes through a purchase of the LV Finance, the owner of a blocking stake in MegaFon (*Kommersant* June16, 2006). Rozhetskin, the LV Finance owner, as claimed, did not have any right to sell Megafon stakes to Alfa as he already signed transfer agreement with IPOC. Rozhetskin did not deny signing the agreements, saying that Reiman forced him to do so.

The Bermuda entity filed several lawsuits to challenge Alfa Group. One of Fridman's strategies was to argue that the Bermuda entity couldn't make valid contracts because it was a money-laundering vehicle for Mr. Reiman. Alfa Group deployed many lawyers and private investigators. The Swiss Commercial tribunal got involved because one of IPOC's option agreements called for arbitration of any dispute in Zurich (*The WSJ* 2006).

To defeat the allegation that it was a money-laundering tool for Mr. Reiman, IPOC provided financial records to several courts that, in fact, raised more questions. IPOC said to earn income by lending to, or consulting for a second set of companies. IPOC listed several companies as shareholders, all of which, according to Mr. Galmond, belonged to him. He said that he also was the owner of other companies that held the rest of the Russian telecom empire. However, according to *the WSJ*, various documents that emerged in the investigation and court proceedings, pointed to Mr. Reiman as the owner. For example, there was a 2002 letter to the Liechtenstein Bank claiming Mr. Reiman's ownership of the telecom empire. According to an affidavit filed in a court, the letter had Mr. Galmond's signature. Mr. Galmond later rejected Mr. Reiman's involvement as the owner and claimed that his staff made a mistake (*The WSJ* 2006).

In May 2006, after more than two weeks of testimony and the review of the bank records and other documents, The Zurich Commercial Tribunal "found that Minister Reiman of the Russian Government was the beneficial owner of IPOC [International Growth Fund Limited (Bermuda)] and that he committed criminal acts under Russian law" (World Bank, Stolen Asset Recovery Initiative).

In 2007, according to the Bermuda court ruling, Alfa Group and IPOC, a Bermuda-based fund, agreed to drop all the proceedings against each other in a \$2bn-plus legal dispute stretching across Switzerland, Bermuda, the British Virgin Islands and New York. The Court validated Mikhail Fridman's Alfa Group's rights to a 25.1 per cent stake in Megafon, thus, bringing an end to one of Russia's most bitter corporate feuds (*The Financial Times*, November 30, 2007).

In 2008, the General Director of "Gazprom Invest" and co-owner of Metallinvest Holding Alisher Usmanov bought the main asset of Telecominvest Holding along with the blocking stake in "Megafon". Usmanov also bought a minority stake in "MegaFon", owned by IPOC. It is believed that Usmanov was the third party that ended the fight. At the same time, Leonid Reiman resigned as the Minister of Communications (CNews August 5, 2009).

It was reported that in August, 2012, after missing for 4 years Leonid Rozhetskin, who sold Megafon stakes to Alfa Group, was found dead in Latvia. Although the DNA test of the blood found in the crime scene matched the blood found in his villa, the police are waiting for the DNA results of his close family to confirm the finding. Furthermore, at his absence, the Moscow Prosecutor's office ruled that Rozhetskin, a US citizen of Russian descent, was guilty of large-scale fraud of allegedly stealing the money that Bermuda-based IPOC International Growth

Fund planned to use to buy 25 per cent in Russia's phone operator Megafon (DailyMail August 18, 2012).

Reaction in Russia and Europe:

After the article appeared in *The WSJ*, Reiman told to reporters that the facts laid out in the article were false. According to *The Moscow Times*, the Minister suggested that the article was sponsored by special interest groups to "exert pressure on" the ministry and besmirch President Vladimir Putin's reputation (*Moscow Times* June 12, 2005).

Besides a few comments by Reiman, Russian authorities showed little interest in this case. St.Petersburg prosecutors found no significant violations in the 1994 formation of Telecominvest. No senior Russian official other than Mr. Reiman has publicly commented on the allegations against him. Russian prosecutors, when asked by legislators to respond to the Zurich Tribunal's ruling, said they saw no evidence that IPOC had engaged in suspicious financial operations.

In January 2008, Commerzbank accepted the Frankfurt civil-court verdict that ordered the bank to pay €7.3 million, including a €1 million fine and the confiscation of €6.3 million of profits derived from illegal activity (*The WSJ* April 11, 2012).

In December 2010, the German Prosecutors' office accused Galmond and four former employees of Commerzbank of money laundering for Reiman (*RIA Novosti* April 6, 2012). In 2012, the Frankfurt Court ruled that four of the defendants would pay amounts from €5,000 to €40,000 as part of the settlement in return for dropping the charges. Charges against the fifth defendant, an employer of the Commerzbank, were dropped because the statute of limitations had expired in January, 2012. Under terms of the settlement, the five continued to maintain their innocence.

According to *The WSJ*, during the six-year investigation, German justice officials asked their Russian counterparts for legal assistance in tracing the source of about \$150 million at their regular meetings. The Russian officials told their German counterparts to delay the sending of a formal written request for assistance, suggesting that "help would be easier later". Under the German law, a conviction for money-laundering in this case would be possible only if prosecutors proved that the illicit funds resulted from a crime committed in Russia (*The WSJ* April 11, 2012).

Mr.Reiman commented on the Frankfurt Prosecution decision to *Vedomosti* newspaper:

“I am satisfied with the removal of all these baseless allegations. I am pleased that the opinion of Russian law enforcement agencies, which long expressed the lack of wrongdoing, coincided with the opinion of the German colleagues. Finally, the truth won and this dirty story was put to its logical end" (*Vedomosti* April 6, 2012).

According to *Kommersant*, after the final departure from the public service in 2010, Reiman became a shareholder of Angstrom, a company that deals with the introduction of new technologies, and a co-investor of another IT company Prostor Capital Foundation. He also has interest in the NGI and Alternative Capital Investments funds, investing in telecommunications and IT-projects (*Kommersant* Profile March 2012).

Conclusion:

The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, adopted in 1997, requires each signatory country to make foreign bribery a crime. Russia acceded to the Convention only in 2011 with the Convention coming into force in April 2012 (Exporting Corruption, 2012 TC). Furthermore, Russia is a signatory of the UN Convention against Corruption. However, despite Russia’s announcements of adherence to the international anti-corruption standards and recent show-off high-scale corruption cases, Russia still does poorly in corruption rankings. According to the Transparency International’s Corruption Perception Index 2011, Russia is currently ranked 143rd out of 182 countries and is placed between Nigeria and Timor-Leste (TI Corruption Perception index).

Russia will not make any progress in the fight against corruption, if the government officials proceed with corruption as a routine and a part of their work. As Vladimir Putin's campaign manager Stanislav Govorukhin unwittingly noted in his interview with the *Trud newspaper*, "Under Putin Russia has developed a normal, civilized corruption." (Institute of Modern Russia August 29, 2012). As long as high officials in the famous corruption cases are not punished for their wrongdoing and Russia’s citizens do not see a true government’s intention in corruption prosecution, Russia will stay at the same place in the corruption rankings.

The international community alone will not be able to do anything to combat corruption in Russia – if anything at all. As the head of the German branch of the *Transparency International* commented on the Reiman case, "Convictions are difficult in international corruption cases unless justice officials in all the affected countries cooperate"; and so far Russia

has not shown any slight desire to cooperate on a series of important high level cross-border criminal and corruption cases (The WSJ April 11, 2012).

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