

**COMMERCIAL LAWS OF
LITHUANIA
December 2012
AN ASSESSMENT BY THE EBRD**

Office of the General Counsel



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for Reconstruction and Development

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Basis of Assessment: This document draws on legal assessment work conducted by the Bank (see www.ebrd.com/law) and was last updated during the preparation of the 2012 EBRD Strategy for Lithuania, reflecting the situation at that time. The assessment is also grounded on the experience of the Office of the General Counsel in working on legal reform and EBRD investment activities in Lithuania and does not constitute legal advice. For further information please contact ltt@ebrd.com.

1. Overall Assessment

Lithuania has generally achieved a quite high level of compliance with international standards in relation to commercial laws. Notwithstanding, certain improvements are desirable on a number of specific issues to further advance Lithuania's legal framework.

In the recent EBRD PPP Legislative Framework Assessment, Lithuania's legal framework scored as being in "high compliance" with international standards. However, several weaknesses have been identified, such as a lack of regulation of unsolicited proposals or a lack of centralised dedicated PPP capacity, both at central and local levels.

EBRD's recent assessment of corporate governance legislation has found that Lithuania achieved a good level of compliance in its corporate governance legislation with international standards and its corporate governance framework is generally sound. Certain minor shortcomings exist nevertheless, in particular, in the regulation of the responsibilities of the board.

In the energy efficiency and renewable energy sectors, Lithuania has overall introduced solid programmes regarding both energy efficiency and renewable energy, though further consistent efforts aimed at liberalising the energy market, introducing more guarantees for renewable energy investments and increasing the energy efficiency of buildings are required.

The EBRD Insolvency Sector Assessment completed in late 2009 has found Lithuanian insolvency legislation to be in "low compliance" with international standards, concluding that Lithuanian insolvency law contained some significant shortcomings, such as with respect to the reorganisation processes, treatment of estate assets or terminal/liquidation processes. Steps should be taken in parallel to address recognised shortcomings in Lithuania's institutional insolvency framework, particularly with respect to lack of capacity and skills and qualifications of judges and insolvency office holders.

In the judicial capacity sector, Lithuania's statute book is in accordance with the EU's *acquis communautaire* and the country is considered to be one of the most effective EU states in implementing directives, however, problems persist in relation to the implementation and enforcement of laws. Public trust in the judiciary is uneven, and there are concerns about corruption in the court system, despite efforts undertaken to address these issues, including introduction of a new National Anticorruption Programme aiming to improve judicial transparency by digitising the court system and initiation of an intensive judicial training programme has been initiated in order to make judges more familiar with recently adopted commercial legislation.

In the public procurement sector, Lithuania's legislation sets forth a modern, highly competitive and transparent legal framework, based on the sound principles of the EU public procurement policies and is quite well implemented. In the 2010 EBRD Public Procurement Assessment Lithuania was found to be in high compliance with international standards both in terms of public procurement legislation and practice. Certain shortcomings were found nevertheless, e.g. the Lithuanian public procurement procedures are not open to international trade; tender documents are, in most cases, formulated in the official language and hardly ever made available in other languages. Not all of the contracting entities have implemented internal policies to monitor changes in a procurement procedure, nor do they provide for public contract management. Also, mandatory use of eProcurement procedures could be increased.

In the secured transactions sector, generally, the system for taking, perfecting and enforcing security over movable and immovable property in Lithuania is working well, and overall, the country is an example of an advanced EBRD country of operations where the secured transactions regime does not require a general overhaul but rather specific sophisticated changes in order to further develop into a system that would fully cater for the needs of modern finance transactions. In particular, changes could facilitate using a fluctuating pool of assets, general description of debt and allow charging enterprise as a going concern.

In EBRD's Securities Markets Sector Assessment completed in 2007, Lithuania was found to be in "high compliance" with international standards as to the quality of its securities markets legislation. However, the financial instruments dimension has been identified as a weakness of the system and would benefit from reform efforts.

The electronic communications sector in Lithuania has been formally liberalised since 2003 and is considered to be an advanced environment with respect to deployment of fibre-optic broadband infrastructure, one of today's main sector drivers. In the EBRD Telecommunications Regulatory Assessment 2008, the telecommunications regulatory framework of Lithuania scored very well, showing full compliance with international standards. In common with other EU member states, Lithuania is subject to the on-going legal and regulatory reforms necessary to remain part of the evolving Europe-wide market for electronic communications.

2. The Legal and investment climate

2.1 Constitution and courts

The Constitution of the Republic of Lithuania was adopted by a referendum in 1992 and most recently amended in 2006. According to the Constitution, the legislative body is the unicameral Seimas (Parliament) having 141 members elected for a four-year term. The right of legislative initiative belongs to members of the Seimas, the President, the Government and the citizens of Lithuania, if a draft is submitted by 50,000 citizens.

The President of Lithuania is the Head of State, directly elected by the citizens. The President is empowered, *inter alia*, to: implement foreign policy, appoint and remove the Prime Minister upon approval by the Seimas, appoint and dismiss ministers upon the recommendation of the Prime Minister, dissolve the Seimas, contingent upon certain circumstances, and return legislation to the Seimas for review. The Seimas can remove the President by impeachment, subject to a three-fifths majority vote by the members of the Seimas. The Government of Lithuania holds executive power in the country.

The Constitution and the Law on Courts established a four-tier court system of general jurisdiction: the Supreme Court, the Court of Appeals, district courts and local (trial) courts. The local courts try in the first instance most civil, criminal and administrative cases. The district courts hear in the first instance civil, criminal and administrative cases attributed to its competence and appeals against the decisions of the local courts.

The Court of Appeals serves as a further appellate court for the decisions in first instance by the district courts. The Supreme Court is the cassation instance for the effective decisions of the district courts and decisions of the Court of Appeals. The Supreme Court can also provide guidance to ensure uniform application of the law. Recently, the decisions of the Supreme Court have played an increasing role in the proper application and interpretation of provisions and are published on a regular basis.

The Constitution allows for the establishment of specialised courts, such as administrative, labour, family and other. A two-tier system of administrative courts has been established in Lithuania, comprising regional administrative courts (first instance courts) and the Supreme Administrative Court (appellate court). Administrative courts hear cases concerning complaints against administrative acts and actions of the state agencies and state officials.

The Constitutional Court of Lithuania has a separate status from the judicial system and supervises the compliance of laws and other regulatory acts issued by state officials with the provisions of the Constitution.

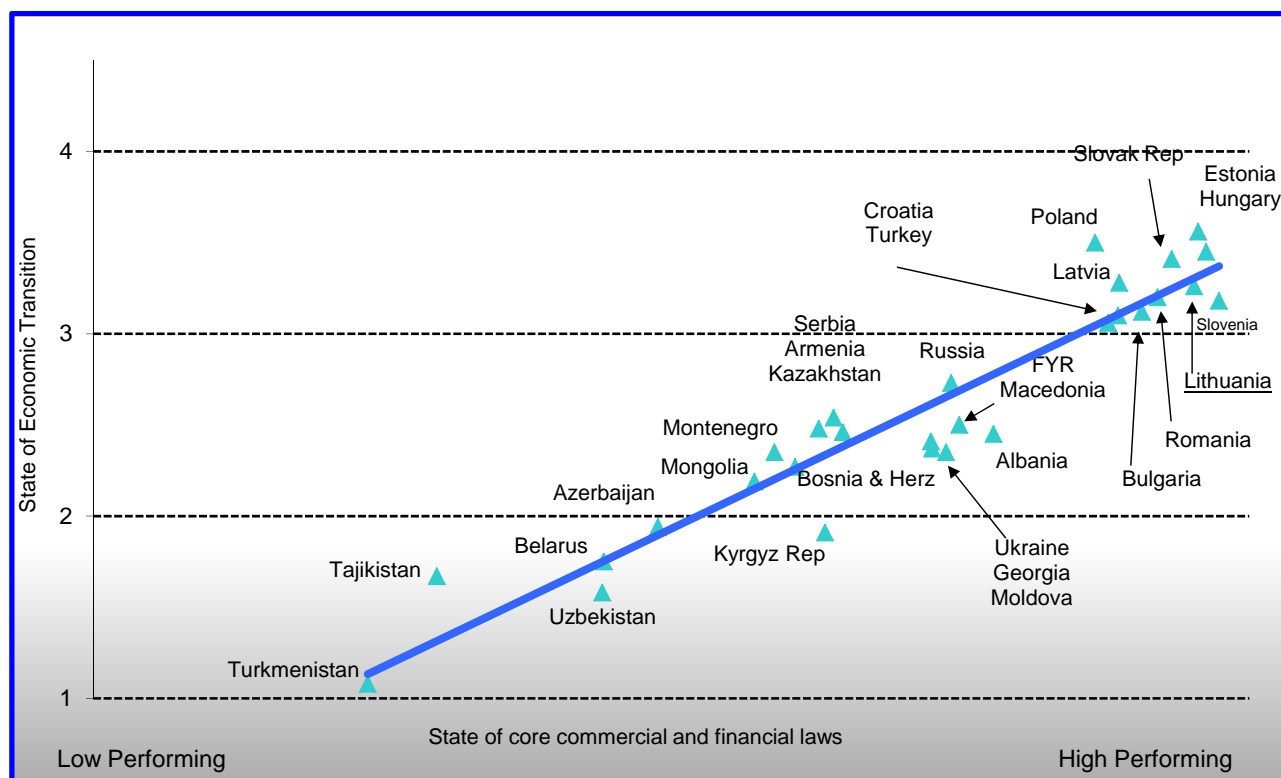
The autonomy of the courts and judges is ensured by the General Meeting of Judges, a self-governing body. Judges of the local, district courts and specialised courts are appointed by the President. Judges of the Court of Appeals are also appointed by the President but with the approval of the Seimas. Judges of the Supreme Court are appointed by the Seimas.

The judicial process has seen substantial improvements in recent years due to Lithuania's continuing effort to streamline and speed up procedures. In addition, Lithuanian judges have benefited from comprehensive training to facilitate understanding and implementation of the new provisions, laws and regulations aligned with EU law. However, there is still room for improvement with regard to the effectiveness of the courts and enforcement procedures.

2.2 Relationship between legal transition and economic progress

Experience in transition countries suggests that advances in law reform and economic development progress or regress hand in hand. Since the start of the economic reforms, Lithuania has progressed considerably with respect to developing a stable and functioning market economy, and is now regarded as one of the most advanced transition countries in Central and Eastern Europe. The country has made significant progress in establishing the rule of law and democratic institutions. As a result, Lithuania's good performance as demonstrated in the following comparative chart on combined legal and economic indicators is not surprising (see Chart 1).

Chart 1 – Rule of law and progress in transition in the EBRD countries of operations



Source: EBRD Transition Report 2010 Table 1.1; EBRD Composite Country Law Index, July 2011

Note: The **horizontal axis** measures the performance of commercial and financial laws. The **vertical axis** displays the EBRD transition index as an average of transition indicators between 1997 and 2011 with 1 referring to very early transition stages, and 4 referring to an advanced transition level.

2.3 Recent developments in the investment climate

Lithuania has recorded the EU's second highest growth in 2011, having benefited from good diversification of its exports across markets and products, as well as from relatively low household debt and a reviving labour market supporting private consumption. However, the country's general government deficit remained quite high in both 2010 and 2011, reflected in rapid deterioration of the country's public debt indicators. The government has been attempting to meet the Maastricht deficit criteria during the last few years, including through a 4% across-the-board spending cut introduced in 2011. In line therewith, the 2013 budget envisages a 2.5% GDP equivalent cut in the general government deficit, compared to the 3% GDP equivalent target for 2012. At the same time, the government remains committed to complying with the timeline of accession to the European Monetary Union in 2014.

The recently adopted National Reform Programme, reviewed by the EU Counsel, identifies key obstacles to the country's economy growth – such as imbalances in public finances, insufficient productivity and competitiveness – and reform proposals. The government realises the long-term nature of most of the identified reform efforts, including increase in technology-intensive production through stimulating research and development, raising participation in the labour market or improving standards in education.

The government has been taking measures to increase transparency and improve strategic planning of state-owned companies in energy, transportation and postal services sector, in response to on-going concerns of private investors over governance issues in those companies. However, a full

separation of ministries' regulatory functions from authorities to manage state-owned stakes still remains to be the government's ambition.

The failure of a mid-sized local bank (Bank Snoras) in November 2011 motivated greater government attention to the governance and business models of locally owned banks. Even though the failure in question was due to an isolated case of fraud, it briefly eroded depositor confidence in viability of the few remaining locally owned banks, witnessed by the deposit flight from such institutions immediately following the incident. Within the failure case itself; all retail deposits were honoured, however, as a result of the failure, the public sector has assumed a liability of at least 2.5% of GDP in excess of the assets in the deposit insurance fund. Overall, in the financial sector, the authorities are keen to put in place a regulatory framework that will prevent the excesses of the previous lending boom. The measures taken to that effect include streamlining of the personal bankruptcy law as well as the adoption of regulation for responsible lending aiming to prevent the re-emergence of unsustainable credit and house price developments.

2.4 Freedom of Information

The legal framework for freedom of information ("FOI") is primarily governed by two laws in Lithuania – The Law on the provision of information to the public (1996) as amended in 2002 and the Law on the Right to receive information from State and Municipal Institutions and Bodies, 2000. In addition to these laws Lithuania was also an early adopter in the region of an Ombudsman's Office (1994) to investigate and oversee complaints. Despite seemingly having well drafted laws and appropriate government institutions in place to deal with FOI issues the Council of Europe noted during an assessment conducted in 2002 that both the public and media had problems accessing public information, partly due to onerous legal obstacles and a rather discretionary approach to the enforcement of the laws by public officials.

This negative assessment has been recently confirmed by the RTI Rating (Right to Information) carried out by the Centre for Law and Democracy and Access Info Europe (2012). In the RTI rating Lithuania was ranked 83rd out of 93 countries. A particular aspect of the rating was that of some concerns relating to the appeals process, where Lithuania only scored 6 out of a possible 30 in the rating. In particular FOI appeals incur a cost, the oversight body does not appear to be independent of the executive and the appeal process does not appear to have clear procedures.

3. Evaluation of selected commercial laws

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: concessions, corporate governance, energy, insolvency, judicial capacity, public procurement, secured transactions, securities markets and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of such laws (also referred to as "effectiveness"). This section presents a summary of the results accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

All available results of these assessments can be found at www.ebrd.com/law.

3.1. Concessions

Since the EBRD Concessions Sector Assessment 2007/08, Lithuania has further improved its PPP legal framework, having created a system which now regulates both concessions and general government and private entities' partnership ("GGPEP") similar to the PFI model used in the United Kingdom, which brings the Lithuanian legal framework in the PPP/concessions sector even closer to the PFI Guide recommendations as it was a few years ago. In the recent EBRD PPP Legislative Framework Assessment, Lithuania's legal framework scored as being in "high compliance" with international standards (see Chart 2), with the dimensions of the PPP legal framework and definitions and scope of the law having been identified as the main strengths of the country's concessions legislation, while the project agreement as well as security and support issues have been identified as its main weaknesses (see Chart 3). According to the Assessment, implementation of the PPP/concessions laws has been scored "medium effectiveness" as compared to international standards, with the PPP law enforcement being a stronger pillar and the institutional framework being the weaker pillar (see Chart 4).

Significant amendments were introduced to the Law on Investments recently as well as the Rules on Preparation and Implementation of the Public – Private Partnerships were adopted, even though the Law on Concession have not had any significant amendments since 2006.

As part of recent amendments, the Law on Investments introduced definitions of a public-private partnership ("PPP") and a GGPEP. The Law has further set forth the concepts, principles and peculiarities of GGPEP project agreement, as well as its contents (which are similar to those set in the Law on Concessions with respect to concession agreements) and defined who can be the "general government entities". The Law on Investments has also introduced a requirement that the GGPEP agreement be concluded in accordance with the Law on Public Procurement and that its term shall be more than 3 but not more than 25 years. In addition, the Law on Investments has set forth the legal basis for establishment of the Central PPP Unit, which is responsible for the methodological help and consultations regarding preparation and implementation of PPP projects.

The recently adopted Rules on Preparation and Implementation of the Public – Private Partnerships have introduced the definition of a partnership agreement and specified the process of preparation and implementation of a PPP project. The Rules have further clarified which institutions are responsible for preparation, approval, implementation and control over PPP projects, as well as relevant processes. Additionally, the Rules have defined main PPP risks and principles of risk allocation between public and private parties, as well as its impact on the ratios of public sector deficit and debt.

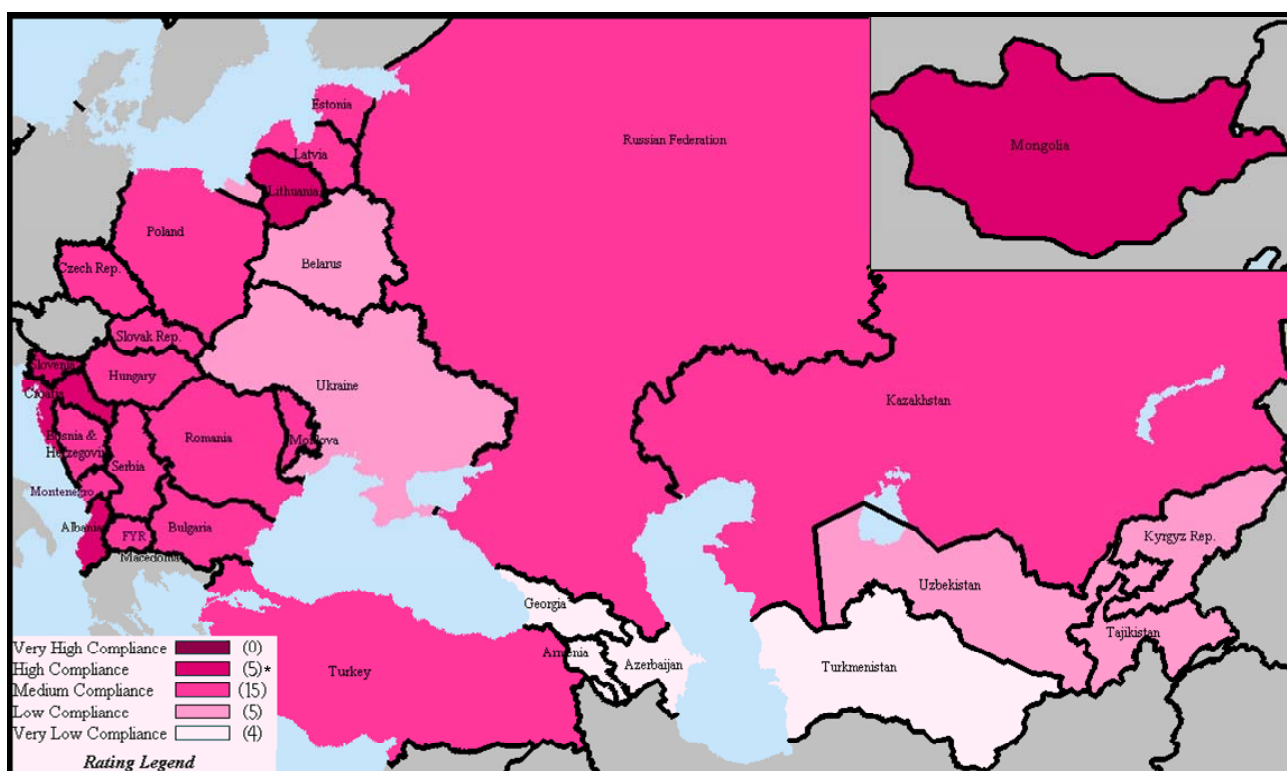
Overall, the legal framework established by the Law on Investments, the Law on Concessions, the Rules on Preparation and Implementation of the Public – Private Partnerships, and the Law on Public Procurement provides for a comprehensive and clear regulation and guidance as to what is a PPP, who can prepare, approve and implement PPP projects, what shall be included into the partnership agreements and how the risks between public and private sectors should be allocated. At the same time, even though these rules are comprehensive, they still provide sufficient flexibility to allow the parties to negotiate the terms of a private partnership agreement.

However, Lithuanian laws still do not regulate or even refer to unsolicited proposals and regulate creating records of key information regarding selection and award of a partnership agreement in a concession type of PPP.

Overall, the Lithuanian environment is favourable for PPP project implementation. Specifically, there are no current political or social obstacles for implementation of PPP projects – to the contrary, due to the current financial situation and lack of funds to improve or expand the public infrastructure, the government is favouring the development of PPP structures. Concessions have been in use by municipalities for approximately 10 years and now 40 concession agreements are in operation in various sectors such as energy, health care, transport and waste treatment. At the same time, the government is also actively promoting the recently introduced GGPEP model. Specifically, one project in the transport sector is being currently implemented, with five more pilot projects in the pipeline and about to be implemented. Promotion of PPP structures is supported by the availability of the protection of bidders' rights and legitimate interests. Specifically, when a GGPEP or PPP project is awarded as a works concession, remedies under the Law on Public Procurement are applicable, which are in conformity with Directive 2007/66/EC (the so-called "remedies" directive). When a PPP project is awarded as a services concession, the same principles are being applied by the courts. The courts themselves have sufficient experience in disputes with respect to acts or decisions by the contracting authorities and follow the precedents by the General Court (Court of Justice of the EU).

One obstacle for a wider use of PPP structures in Lithuania could be the relatively small size of the projects, which currently do not exceed LTL 200 million (approx. EUR million) and thus are not particularly appealing for large foreign investors / financial institutions. Another obstacle for a wider use of PPP structures in the country is the lack of a “task force” that would provide all requisite assistance to the development of the PPP projects, with the Central Unit currently focusing its efforts on the promotion of PPP projects rather than whilst providing methodological assistance for the implementation of PPP projects. Furthermore, there are no PPP units, or agencies or departments of the Central PPP Unit at the municipal level; therefore, smaller municipalities lack the competence and assistance to prepare and implement a PPP project, even if they have a need for it.

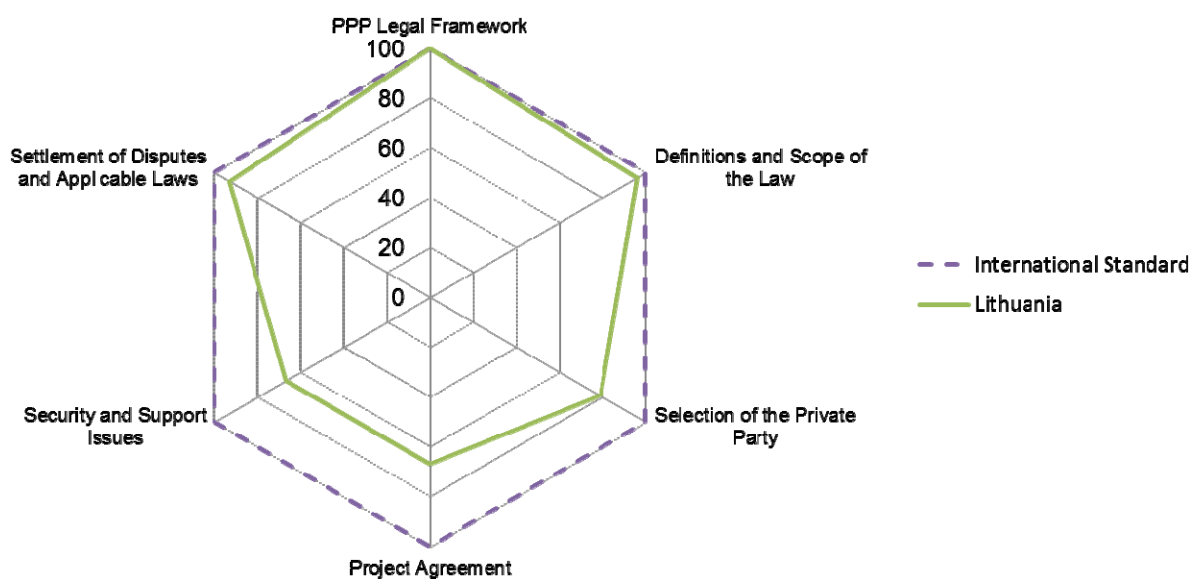
Chart 2 – Quality of concessions legislation in the EBRD countries of operations (2011/12)



Source: EBRD Concession / PPP Legislative Framework Assessment (LFA)

Note: The various categories represent the level of compliance of a given country’s legislation (“the laws on the books”) with international standards such as the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects. The asterisk indicates in which category Lithuania ranks.

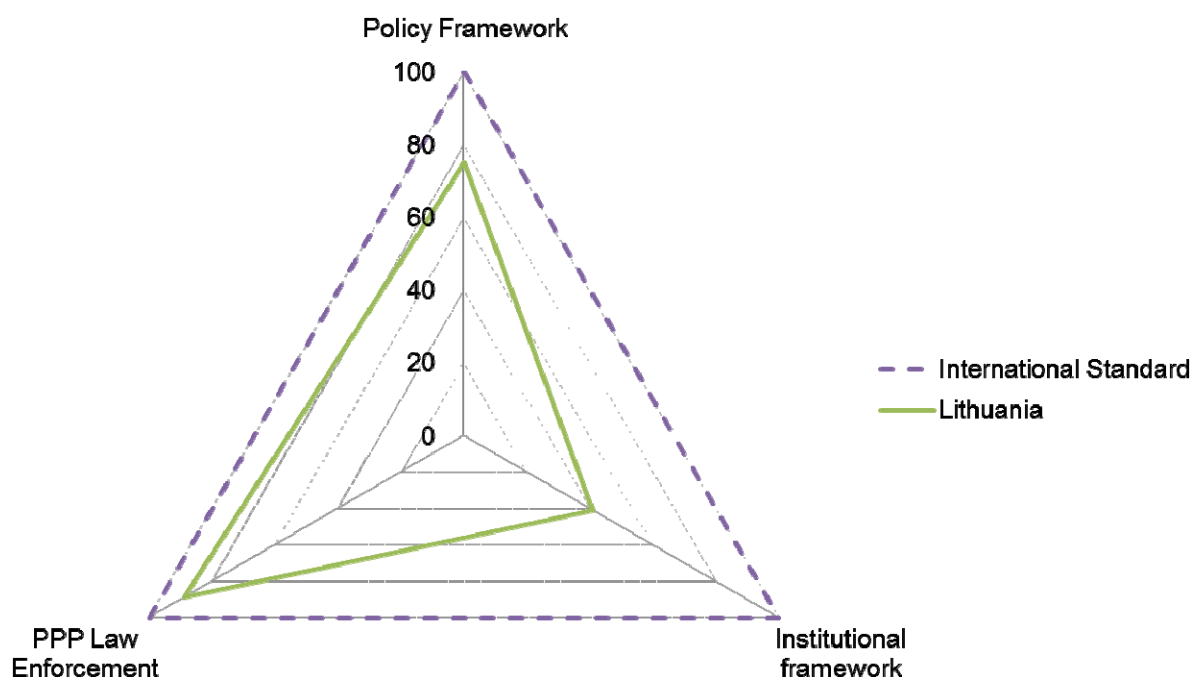
Chart 3 – Quality of the PPP/concessions legislative framework in Lithuania (20112)



Source: EBRD Concession / PPP Legislative Framework Assessment (LFA)

Note: The extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Chart 4 – How the PPP/concession law is implemented in practice in Lithuania (2012)



Source: EBRD Concession / PPP Legislative Framework Assessment (LFA)

Note: The extremity of each axis represents an ideal score, that is, a fully effective legal framework for concession / PPP.

3.2 Corporate governance

The principal corporate governance framework in Lithuania comprises the Civil Code effective from 1 July 2001, as amended; the Law on Companies, effective from 1 July 2001, as amended; the Law on Securities, effective from 8 February 2007, as amended; and the Law on Markets in Financial Instruments, effective from 8 February 2007, as amended.

In addition, in 2006 the Vilnius Stock Exchange and the Lithuanian Securities Commissions developed a voluntary corporate governance code for listed companies. Companies listed on the stock exchange are required to state their compliance with the code according to the so-called “comply-or-explain” rule.

In early 2008, the EBRD benchmarked the Lithuanian corporate governance legislation against the relevant international standards (*i.e.*, the OECD Principles of Corporate Governance). The results indicated that Lithuania achieved a good level of compliance (see Chart 5), with certain minor shortcomings in the regulation on the responsibilities of the board, while ensuring the basis for an effective corporate governance framework has been identified as the main strength of the Lithuanian corporate governance legislation (see Chart 6).

Overall, the corporate governance framework in Lithuania is relatively sound and there are no particular issues likely to affect the Bank’s operations. No investee companies’ corporate governance related suits have been reported.

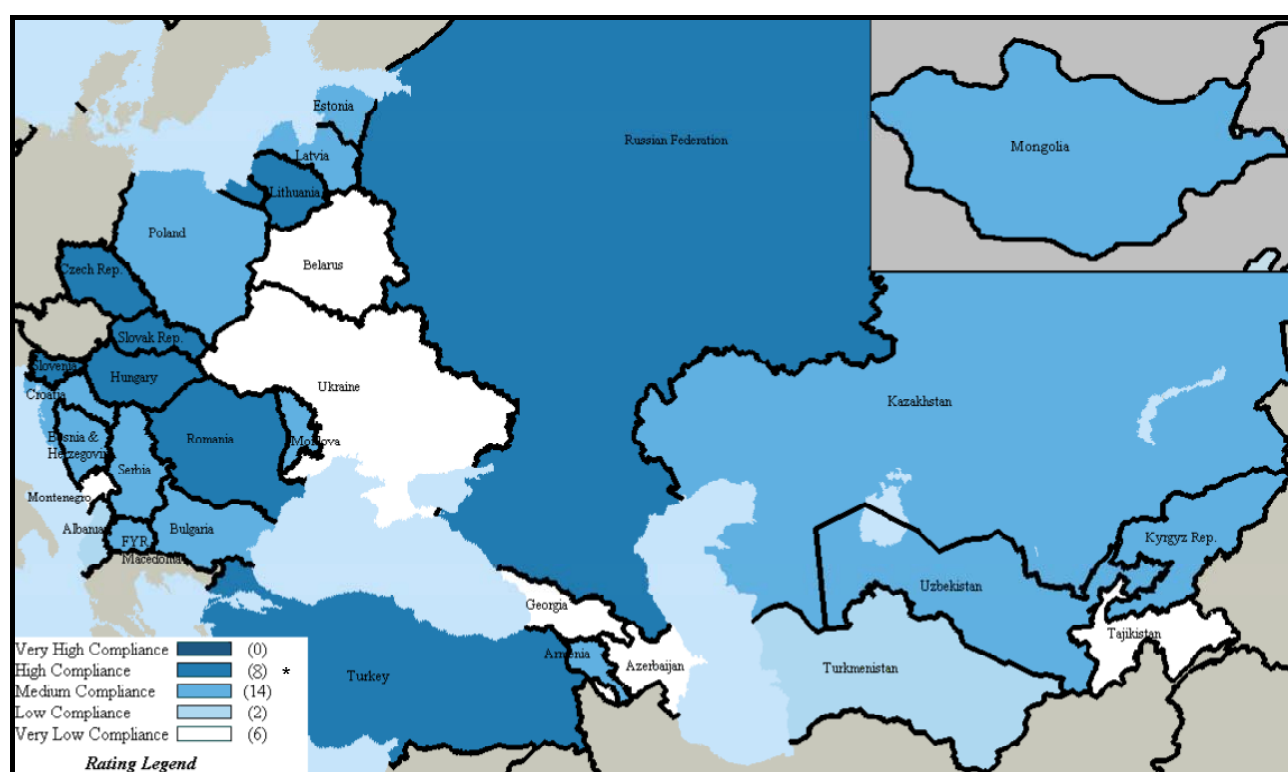
Since 2010, the government of Lithuania has been undertaking an ambitious reform of state-owned enterprises, aiming at restructuring their corporate governance, increasing transparency and separating ownerships and regulatory functions, and increasing competition and efficiency. The reform is relevant, involving legislative as well as organisational changes.

The Baltic Institute of Corporate Governance is very active in promoting corporate governance. In 2012, it launched a publication entitled “Governance of State-owned Enterprises in the Baltic States,” which ranks the governance practices of state-owned enterprises in the Baltic States.

There are no on-going or proposed EBRD corporate governance projects in Lithuania.

Overall, Lithuania has generally achieved a fairly high level of compliance with international standards and its corporate governance framework is generally sound. In 2012, the Supervision Service, a new unit of the Bank of Lithuania started supervising commercial banks and other credit and payment institutions, securities and insurance markets, and investigating disputes between consumers and financial institutions, replacing the functions of the Securities Commission, Insurance Supervisory Commission and Credit Institutions Supervision Department of the Bank of Lithuania. This structural reform is aimed at allowing the Bank of Lithuania to achieve higher operating efficiency and to play an important role in ensuring that Lithuanian listed companies comply with corporate governance requirements.

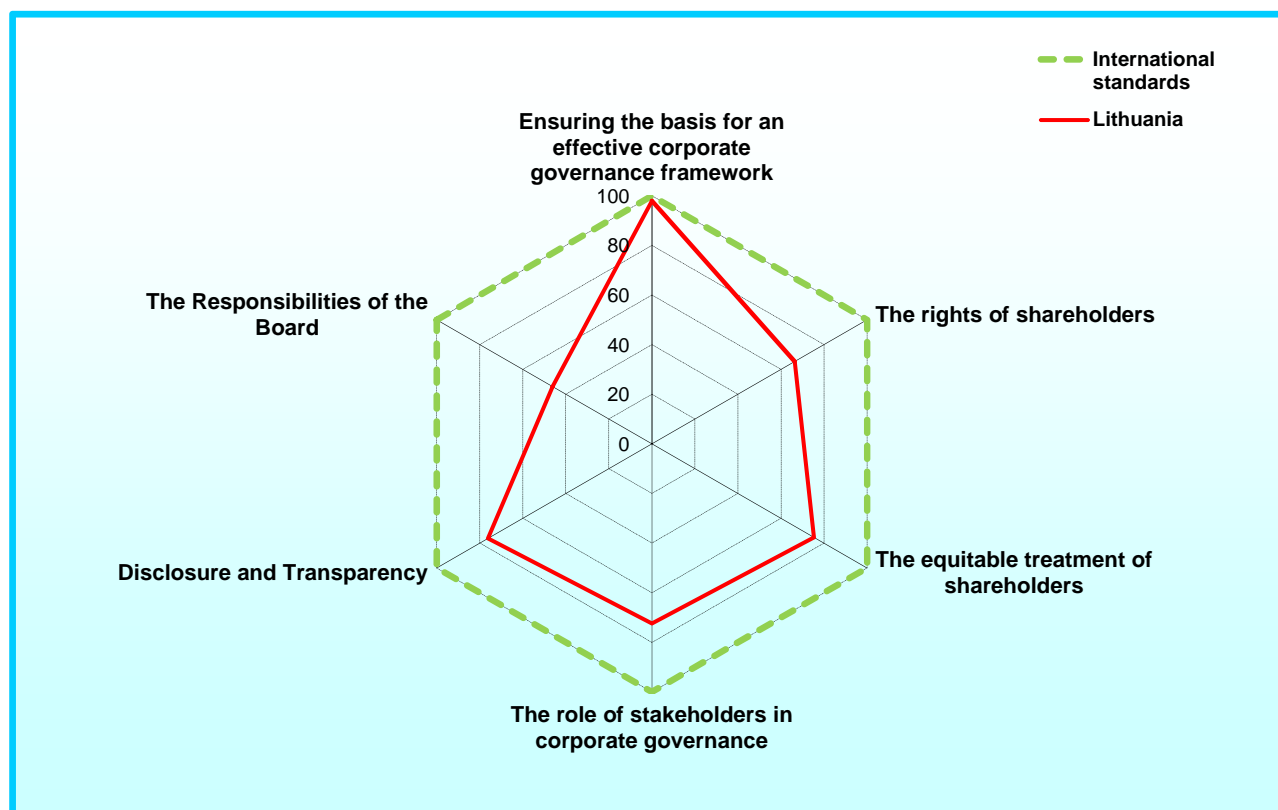
Chart 5 – Quality of corporate governance legislation in the EBRD countries of operations (2007)



Source: EBRD Corporate Governance Sector Assessment 2007

Note: The various categories represent the level of compliance of a country’s legislation (the “laws on the books”) with international standards as set out in the OECD Principles of Corporate Governance. The asterisk indicates in which category Lithuania ranks.

Chart 6 – Quality of corporate governance legislation in Lithuania (2007)



Source: EBRD Corporate Governance Sector Assessment 2007

Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles.

3.3 Energy regulation (electricity and gas)

Lithuania performs reasonably well overall in terms of the quality of its energy (electricity and natural gas) sector. The recent EBRD energy law reform dimensions assessment project has shown that public service obligations and market framework are key weaknesses of the country's electricity and gas legislation as compared to international best standards (see Charts 6 and 7).

Within the electricity sector, Lithuania's regulatory framework is relatively advanced; as a practical matter development of competition has been constrained by the availability of low priced power from the state-owned nuclear plant, Ignalina, and will now be dominated by the shutdown of that plant and the need to find alternative resources, providing further impetus to expand network connections to other countries, to facilitate imports, near-term development of new combined-cycle plants using imported natural gas and, in the longer term, potential construction of new nuclear generation. The gas sector is dominated by Gazprom, with the lack of alternative resources and, until 2008, below market pricing, stunting market development. There remains no grid code and dramatic market changes are not envisaged on the near-term horizon.

Since January 2007, all customers in the electricity market have been eligible to choose their suppliers. The market participants are the generators, the Transmission System Operator (TSO), the market operator, distributors, Distribution System Operators (DSOs), traders and retail suppliers (both public and independent) and customers. The Ministry of Energy, the major policy making

governmental body in the electricity sector, and the market operator, a division within the TSO, are responsible for facilitating and organising electricity trade.

Aside from network prices, prices are unregulated, except as to generation and supply serving more than 25% of the market. National Control Commission for Prices and Energy (“NCCPE”), the autonomous entity responsible for regulatory implementation and covering electricity, natural gas, heating and water supply, uses a 50/50 revenue/price cap approach for network services, with a binary tariff at all voltage levels introduced in 2007 to disaggregate network tariffs from supply to harmonise the network prices for eligible and public supply customers. The caps are set for a three-year period with annual adjustments based on consumer price index fluctuation, an efficiency factor, allowed unpredicted changes, the impact of electricity volume and corrections based on the revenue requirements of the regulated entity if justified by that entity. Tariffs are not uniform throughout the country, but divided into two regions. Household prices are lower than the EU average, but rose in 2008 due to rising gas prices.

Access rules and charges are applied ex-ante and details are published. Non-discriminatory Third Party Access (TPA) to the network is required in accordance with EU directives and implemented through a grid code. NCCPE approves connection charges and may exempt new investment from allowing TPA, which exemption is a means to encourage investment, and is permissible under EU rules and best practices as long as appropriately constrained to encourage needed investment. The Lithuanian electricity system as well as the Baltic energy system does not experience any congestion because of sufficient transmission capacity of electricity networks. Intersystem electricity flows, interconnection capacities, generation, consumption, export/import, the influence of transmission network outages on transmission capacities between neighbouring countries can be followed on-line on the website of the Lithuanian transmission system operator (www.le.lt).

The regulator licenses sector participants. It does not, however, issue production permits or authorisations for new generating capacity, which are handled and issued entirely by the Ministry of Energy. In 2007, bankruptcy proceedings were initiated against one local distribution network operator (Ekranas AB). The right to manage the electricity distribution grids of Ekranas AB was then granted under an agreement to Prekybos Namai Giro UAB, thereby ensuring the continuity of the licensed activity and electricity. The Law on Electricity of 2000 provides for two types of electricity supply licence: a public electricity supplier and an independent electricity supplier. The number of licensed traders or suppliers has not increased appreciably recently, with a total of 18 independent supply licences and six public supply licences issued in 2007, and eight undertakings actually engaged in independent supply.

With respect to security of supply and public service obligations, as noted, the two DSOs perform public supply, and few customers have chosen to leave public supply because of its relatively low pricing. With the looming closure of the Ignalina facility, security of supply is a concern, resulting in promotion of greater physical connections to the west and north, and pursuit of domestic production from renewable energy and, potentially, a new nuclear plant.

NCCPE monitors quality of service pursuant to a 2005 order approved by the Ministry of Energy, and the benchmarked baseline conditions are now used to adjust price caps for transmission and distribution services. Since 2004, NCCPE annually inspects major electricity companies, and analyses and evaluates how they register data on reliability of electricity supply and service quality. If violations are discovered during inspections, the companies must eliminate them within the NCCPE-specified time; failure to perform can be reflected in the price cap formula. The number and length of interruptions on the transmission grid is comparatively low when compared with other European countries and is similar to other European countries on the distribution level.

In 2007, NCCPE considered about 300 various types of residential complaints and requests, most of which were rejected. There have been no complaints about access to the network.

NCCPE files an annual report, available on its website (www.regula.lt). Decisions are published and also available on the website, and NCCPE must present a report annually to Parliament.

Foreign capital investment in energy companies is permitted and changes of ownership are regulated through licence conditions. Incentives for new generating investments are primarily directed at encouraging renewable energy development.

In the natural gas market, market participants are primarily the transmission company and distributor-suppliers. The market has been fully open since 1 July 2007, but there is no wholesale natural gas market as a practical matter because natural gas comes largely from Russian Gazprom AAB, pursuant to long-term purchase agreements. In 2008, there were five retail gas suppliers, but Lithuanian customers were supplied by two main companies: Lietuvos Dujos AB and Dujotekana UAB, with Lietuvos Dujos AB being the main natural gas supplier to household customers. Switching is hampered by quota limitations imposed by Gazprom. A large chemical manufacturer (Achema AB) and a combined heat and power plant (Kauno Termofikacijos Elektrin UAB) buy directly off the transmission line for their own needs.

There is only one natural gas supplier, Gazprom AAB, and as of 1 January 2008, Lithuanian customers began paying prices equivalent to other western countries. In the spring of 2007, the Law on Natural Gas was amended to have NCCPE regulate natural gas supply prices for all customers, including eligible customers. According to that Law, transmission, distribution, storage, supply and liquefaction prices are all regulated, although as a practical matter there is no storage or liquefaction.

Tariffs are published and calculated in accordance with published price cap methodologies with separate tariffs established for storage and trade in 2007. A five-year regulatory period is used, with annual price adjustments based on inflation, operational efficiency coefficients, changes in gas consumption volumes and other factors external to the provider. Both household and commercial tariffs are low as compared to other EU countries.

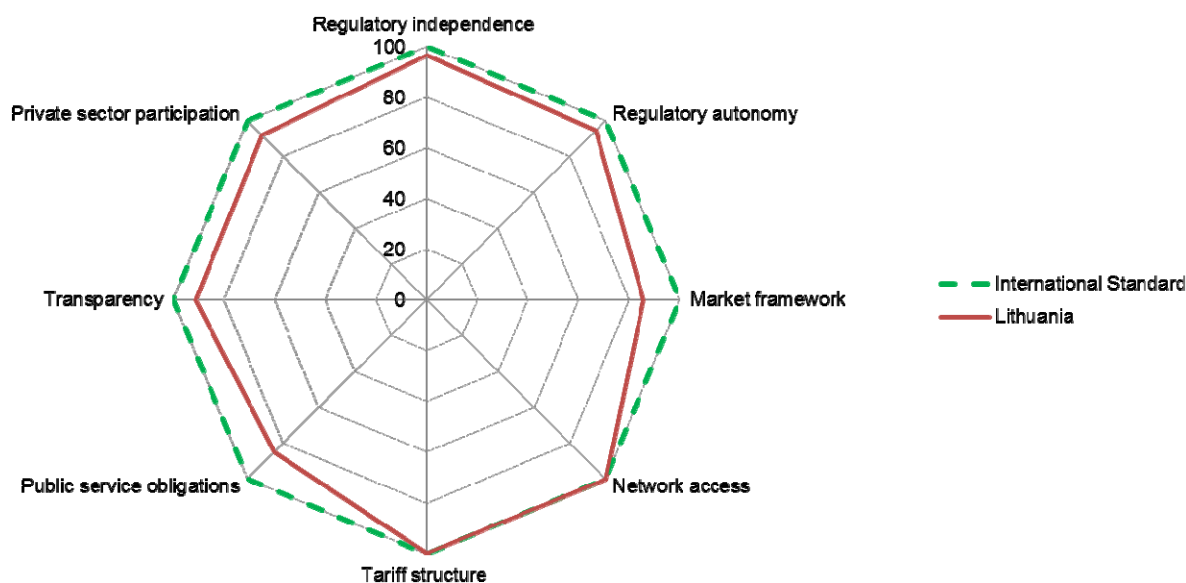
There is no grid code. The key requirements for the natural gas transmission system balancing are set forth in published rules set by the transmission or distribution system operators, upon agreement with NCCPE which, per the 2002 Law on Natural Gas and the Rules for Natural Gas Transmission, Distribution, Storage and Supply, must be objective, transparent and non-discriminatory. These balancing rules are mandatory for customers and system users, except for domestic customers. Lithuania applies a daily (24-hour) transmission system balancing interval.

With respect to public service obligations, the Government or its delegate may impose such obligations pursuant to the Law on Energy. Article 16.3 of the Law on Natural Gas provides that supply of last resort may be provided to domestic customers and users with an energy generation capacity of less than 5 MW and having no fuel reserve stocks. Under Article 10 of the Law, the Government of Lithuania approved Licensing Rules on Natural Gas Transmission, Distribution, Storage, Liquefying and Supply, in which the scope of supply of last resort is narrower than in the Law, providing only for domestic customers. These Licensing Rules prescribe that NCCPE shall require a company with a supply licence to act as the supplier of last resort; Lietuvos Dujos AB is that supplier.

Gas reserves are being increased to ensure security of supply, although dependence on Russia in the gas sector is enlarged further by the fact that Lithuania does not have depots for natural gas, and cannot import gas by sea, as it does not have liquefied natural gas (LNG) terminals, and demand for natural gas will increase in 2010. Lietuvos Dujos AB is charged with implementing measures to address gas shortage problems due to the fault of an external supplier.

There are as of yet no quality of service standards, although the Ministry of Energy is in the process of drafting them, and Lietuvos Dujos AB provides NCCPE with annual data regarding interruptions and other quality factors.

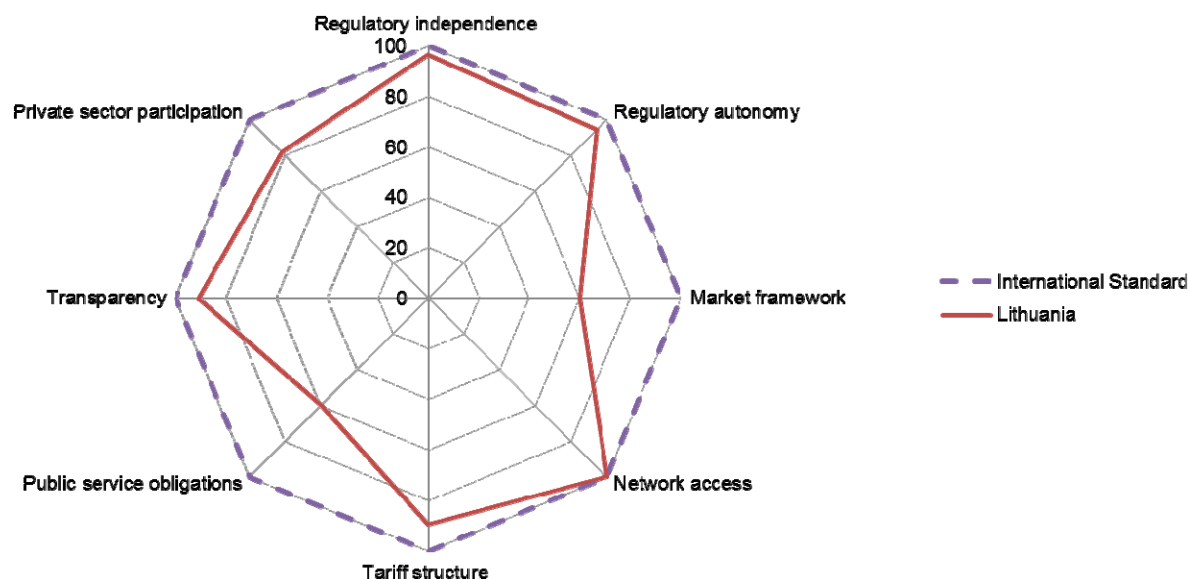
Chart 7 – Quality of energy (electricity) legislation in Lithuania (2009)



Source: EBRD Energy, law reform dimensions assessment project, 2009

Note: The extremity of each axis represents an ideal score i.e., corresponding to the benchmarks and indicators identified in the assessment model. The fuller the ‘web’, the more closely the energy laws of the country approximate these principles.

Chart 8 – Quality of energy (gas) legislation in Lithuania (2009)



Source: EBRD Energy, law reform dimensions assessment project, 2009

Note: The extremity of each axis represents an ideal score i.e., corresponding to the benchmarks and indicators identified in the assessment model. The fuller the ‘web’, the more closely the energy laws of the country approximate these principles.

3.4 Energy efficiency / renewable energy

The renewable energy and energy efficiency sectors in Lithuania are primarily regulated by the Law on Energy of 16 May 2002 (as amended), the Law on Renewable Energy of 24 June 2011 (as amended), the Law on Heat Sector No. IX-1565 of 20 May 2003 (as amended), the Law on Biofuel, Biofuels for Transport and Bio-oil No. VIII-1875 of 18 July 2000 (as amended).

In the energy efficiency sector, Lithuania’s Second Energy Efficiency Action Plan (the “Plan”) was presented to the European Commission in 2011. The Plan presents an overview of energy efficiency measures and programmes which are currently being planned or implemented in the residential, services, industrial, energy, and transport sectors, as well as programs which cut across sectors. The Plan also outlines the leading role of the public sector in promoting energy efficiency improvements, as well as provisions for concluding voluntary agreements with energy companies to improve energy efficiency, both in accordance with Directive 2006/32/EC. The Plan introduces a high energy savings target for the 2008-2016 period, amounting to 9.4% of average final energy consumption for 2001-2005 as a result of planned measures in the energy sector, industry, the household sector, transport and the service sector.

The government has made some progress in improving the energy efficiency of buildings, including by adopting the Multi-Apartment Building Modernisation Programme in December 2011. This programme provides financial incentives by the state (supported by EU funds) for residents of multi-apartment buildings to invest in energy efficiency improvements. The state provides support for improvements such as: major renovation/upgrading of the heating and hot water systems,

improvements to thermal characteristics, installation of renewable energy source (“RES”) using equipment (*e.g.*, solar panels on the for water heating), and reorganisation of communal building services. The Programme, however, is weakened by counteracting subsidies available in other policy areas that reduce incentives for inhabitants of residential buildings to improve energy efficiency. Such measures include provision of subsidies to low-income households to cover increased energy costs as well as the application of a 9% reduced VAT rate for residential heating through the end of 2012. Further substantial and accelerated efforts are needed to improve energy efficiency of buildings.

In the renewable energy sector, Lithuania’s EU 2020 targets for energy produced from RES are 23% of total energy consumption and 10% of consumption in the transport sector. The official statistics reveal that the percentage of RES energy amounts to approximately 19.7% of the final energy consumption in Lithuania for 2010, which surpasses its 2011/2012 interim target. The majority of RES energy is produced from biomass. However, while adequate financial incentives are in place to overcome cost barriers to market entry, there has been little progress towards eliminating non-cost barriers to large-scale RES development.

The main support for energy produced from renewable energy sources is a feed-in tariff (“FiT”) system with purchase obligation at the national level introduced in 2002. On 24 June 2011, a new Law on Renewable Sources of Energy (‘The Law’) was adopted, which revises the subsidies regime available to electricity producers from renewable energy sources. The supporting legal framework is still being developed and some procedures remain unclear. The law envisions that producers of energy from renewable sources will receive the difference between a fixed (feed-in) tariff and the price of electricity actually sold at the energy market. Fixed tariffs and incentive quotas will be allocated at an auction independently in every geographic region. This regime will apply only to power plants with 30 kW of power and more. Renewable energy power plants with smaller capacity will receive fixed feed-in tariffs, which are set centrally by the National Control Commission for Prices and Energy. Newly commissioned plants are entitled to receive FiT for 12 years after the commissioning of the plant. Renewable energy has priority over other kinds of energy in the transmission and distribution of electricity.

Presently, the electricity power grid operator LITGRID has not indicated the maximum potential technical limits in the power grid. Since a number of producers have received permits or preliminary planning terms for 1,600 MW of power in the wind energy sector, LITGRID may exercise its authority to postpone connection to the power grid or regulate the amount of electricity received from energy providers. The main challenges for investment in the sector remain the poor status of the energy infrastructure in some areas (which have a high potential for wind energy), overall insufficient grid development, complex connection procedure, and other.

The country’s energy system infrastructure lacks competition and interconnections and this is a factor that hinders growth. The country is exclusively connected with the two other Baltic States, as well as with Belarus and Russia. Grid development (especially in the Western coastal region) is one of the biggest issues in Lithuanian energy policy. Concentration remains high (above 90 %) in both the gas and electricity markets.

The Ministry of Energy has prepared a new National Energy Independence Strategy ('the strategy') to replace the 2007 National Energy Strategy. Currently, Lithuania relies primarily on oil and gas in its energy mix, and these fuels come from a single supplier, Russia. The goal of the strategy is for Lithuania to diversify its energy supply by 2020 by increasing interconnectedness with European electricity networks and liberalising its energy markets.

The Lithuanian parliament approved the Electrical Grid Synchronisation Law on 12 June 2012. The law complies with the EU's third energy package and will allow the country to connect to the Western European power network by 2020. Currently, Lithuania is building LitPol Link 1, a 1,000 MW electrical power link to Polish power grids, which is expected to become operational in 2015. In addition, a 700 MW Lithuanian-Swedish power link, Nordbalt, currently under construction, will connect Lithuania to the Nordic electricity market (Nord Pool), in 2015. Current cooperation and future integration with the Nord Pool market provides an interesting perspective for the further market development, in terms of increasing market size, participation in a well-established market and the introduction of an intraday market, which is likely to decrease the end-user energy price.

The strategy also calls for improvements in energy efficiency and increased reliance on renewables, especially in the heating sector. Currently, over 70% of heat is produced by natural gas. Under this strategy, Lithuania would support initiatives to increase the use of biomass in heat production (both by installing bio boilers and constructing bio combined heat and power (CHP) facilities) and promote the use of waste for heat production. The goal is to enable renewable energy to account for 60% of centralized heat production by 2020. In addition, Lithuania would support the initiative to increase efficiency in production, transmission, and consumption of heating energy. A preliminary reading of the resolution to approve the strategy was held before the Seimas (the Lithuanian parliament) on 7 June 2012 but it was returned for further discussion.

Lithuania needs to promote competition in energy networks by improving interconnectivity with EU countries for both electricity and gas. The legal framework for RES should be improved in order to reduce non-cost barriers to market entry. Disincentives to EE improvement in residential buildings should be examined and reduced to the extent possible. Taxation should be shifted towards energy use in order to reduce the energy intensity of the Lithuanian economy.

Although Lithuania has overall introduced solid programmes regarding both energy efficiency and renewable energy, further consistent efforts aimed at liberalising the energy market, introducing more guarantees for renewable energy investments and increasing the energy efficiency of buildings are required. The recently approved integration with the European grid and construction of power links with Poland and Sweden will enable the country to diversify its energy supply from Russian electricity imports.

3.5 *Insolvency*

Lithuania's current insolvency regime contains two sets of commercial insolvency legislation: the Enterprises Bankruptcy Act (Law No. IX-216, as amended) ("EBA"), and the Enterprises Restructuring Act (Law No. IX-218, as amended) ("ERA", and together with the EBA, the "Insolvency Legislation"). The Insolvency Legislation applies to all enterprises registered in Lithuania with certain exceptions. For instance, credit institutions, insurance companies, investment companies, pension funds and intermediaries of public trading in securities are not subject to the ERA. No personal insolvency laws currently exist for individuals; although draft personal insolvency legislation was recently approved by the government.

The EBA is available for entities which are insolvent or which have defaulted in paying employee wages or where the entity has made a public announcement or otherwise notified its creditors of its inability to discharge its liabilities. Proceedings under the EBA may result in a compromise / settlement between the debtor and its creditors, a reorganisation or rehabilitation of the debtor (by transfer of its assets (or any part thereof) to another economic entity or alteration of the nature of the debtor's business) or in liquidation of the debtor. A decision concerning the compulsory liquidation of an enterprise may be adopted no earlier than three months following the commencement of bankruptcy proceedings. By contrast, the ERA is a pre-insolvency procedure available for entities experiencing financial difficulties or which are expected to experience financial difficulties within the next three months. The ERA is focused upon the preparation of a reorganisation plan and the restoration of solvency of the debtor.

The EBRD Insolvency Sector Assessment completed in late 2009 (the "Assessment") has found Lithuanian insolvency legislation to be in "low compliance" with international standards (see Chart 9), having in addition concluded that Lithuanian insolvency law contained some significant shortcomings, such as with respect to the reorganisation processes, treatment of estate assets or termination/liquidation processes (see Chart 10). Overall, while the Insolvency Legislation has provisions that are aimed to facilitate rehabilitation of viable enterprises and liquidation of other non-viable enterprises, Lithuania's insolvency law regime and institutional framework require improvement.

The EBA defines insolvency as the state of an enterprise when it fails to settle payment with creditors within three months following expiry of the statutory or contractual deadline or upon the expiry of such period by creditors demanding discharge of payment liabilities, provided they are able to demonstrate that the debtor's liabilities exceed its assets. This definition is not particularly clear or comprehensive. Furthermore it sets the threshold for "insolvency" unnecessarily high. A shorter period of approximately one month for non-payment by the debtor would be more in keeping with international best practice.

Bankruptcy proceedings under the EBA may be formal or informal, unlike restructuring proceedings under the ERA, which may only be formal. The EBA foresees the possibility of an "extra judicial bankruptcy process" run out of court by the creditors' committee. Such process requires a decision by creditors (supported by creditors whose claims in terms of value amount to four fifths of the total amount of the company's liabilities) and follows the same rules as the ordinary "court driven" process. The extra judicial process is, however, rarely used in practice and it is not clear that it provides any real added value.

The EBA provides for a composition with creditors in bankruptcy. To be binding, such composition requires the consent of all of the creditors present and voting at the creditors' meeting and the subsequent approval of the court. Without a mechanism to enable the support of a qualified majority of creditors to make the compromise binding on a minority of dissenting creditors, the compromise procedure is unlikely to be successful. The EBA is not clear on the treatment of secured creditors in the compromise procedure. If the bankruptcy court enters no ruling regarding the approval of the composition agreement between the enterprise and its creditors (*i.e.*, if no settlement is reached) within three months from the approval of creditors' claims by the court and no extension of this term is requested by the creditors' meeting, the court will adjudge the enterprise bankrupt and issue a decision instituting liquidation proceedings.

While the EBA allows for continuation of the company's business during bankruptcy proceeding or a transfer of the business of the debtor as a going concern, it does not provide all the necessary tools to facilitate such continuation. For instance, the EBA does not contain any provisions to protect the debtor's business from termination of contracts by key suppliers following the entry of the debtor into bankruptcy.

Under the EBA, secured creditors cannot enforce their security against the debtor and the power to realise pledged or mortgaged assets is vested exclusively with the liquidator. This may prejudice the position of secured creditors in liquidation, where the assets of the debtor are no longer needed for the continuation of the debtor's business and secured creditors are unable to enforce their security directly. Lithuanian law further provides that immovable property shall be sold by "auction" in accordance with procedures established by the government. In this regard, it would be useful to allow for private sale of immovable property (with or without court supervision) to preserve and maximise sale value. Procedures for selling assets other than immovables may be established by creditors.

The ERA permits a fast-track restructuring proceeding in the event that a pre-packaged restructuring plan is drawn up prior to the filing of the petition. The restructuring plan must be accepted by creditors representing at least two-thirds by value of the aggregate amount of certified claims. The ERA prescribes in detail the contents of any restructuring plan and consequently may not give sufficient flexibility to the parties to determine the final content of such plan.

There are no provisions in the ERA governing protection of secured assets and outlining what the enterprise is permitted to do with respect to any secured assets. Secured creditors are not able to request for the lifting of the moratorium on security enforcement on the grounds that the assets are not necessary for the continuation of the enterprise's activities or are being used to the detriment of creditors' security interest.

The ERA briefly states that the enterprise in restructuring shall bear the costs of the administrator's remuneration, which is approved by the meeting of creditors. In practice, the administrator in Lithuania receives a "monthly remuneration" from the enterprise, which may create the incentive for the administrator to unduly delay the procedure to secure such monthly remuneration. It is also the practice to establish a specific fee the covers all administrator's expenses throughout the bankruptcy proceedings. Accordingly, a new mechanism for determining administrators' fees may be advisable to ensure an efficient restructuring process.

Finally, there are a number of areas which could be improved across the Insolvency Legislation generally. Avoidance rules do not provide for sufficient guidance for parties and should be clarified in order to provide greater legal certainty. Rules for determining the personal and criminal liability of owners, directors and officials are also unclear. For example, related parties are allowed to vote and participate in creditors' committees as any other creditors. There are no provisions with respect

to new financing and allowing for limited set off in insolvency. All set-off is prohibited under the EBA from the date of the decision to institute such proceedings and under the ERA from the date the restructuring order is effective up until the court decision to approve the restructuring plan. More stringent and clear qualification requirements for the licensing of insolvency office holders are needed, including specific procedures and grounds for removal. Furthermore, there is currently no specific agency charged with overseeing and controlling the performance of insolvency office holders.

EBRD's support to Lithuania is extensive, with a particular emphasis on the energy and infrastructure sectors. Insolvency laws may potentially affect all sectors where the EBRD has either equity or a debt stake. They provide an important framework for dealing with distressed investments. Insolvency laws complement other financial and commercial laws. Where reliable and efficient, they may contribute to the creation of a legal environment which is attractive for private investors.

The International Monetary Fund ("IMF") has advised the Lithuanian authorities recently on their proposed reforms to the commercial and personal insolvency regime. The IMF conducted a technical assistance mission to Lithuania in May 2010, publishing a report in November 2011. The Bank's Legal Transition Team understands that the government of Lithuania is aiming to introduce a major reform of the insolvency regime through the adoption of a new and comprehensive Enterprises Bankruptcy Act by end 2012. Proposed changes to the Enterprises Bankruptcy Act include designing an effective legal framework for addressing fraudulent bankruptcies (widely perceived to be an issue in Lithuania yet not addressed properly under the existing Insolvency Legislation), improving the commencement of bankruptcy proceedings in order, amongst other matters, to make the process more efficient and introducing further professional qualification requirements for insolvency office holders.

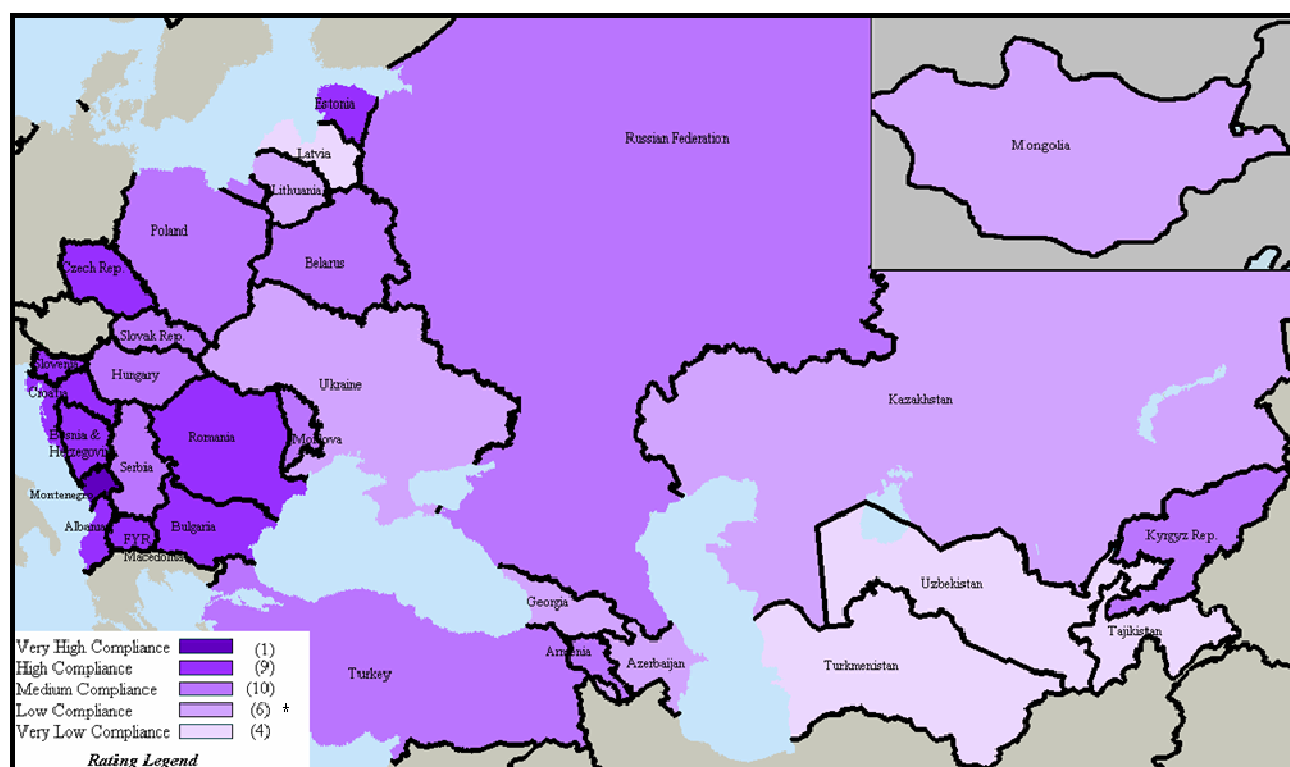
Lithuania's existing insolvency regime only governs the bankruptcy of 'enterprises' and not individuals, a gap in the legal framework which became more apparent with the effect of the global financial crisis on Lithuania's household sector. In March 2012, the government of Lithuania approved a new draft Personal Bankruptcy Act to enable a person facing financial difficulties restore his solvency by releasing him from his financial difficulties following expiry of a defined period.

It is not clear how far the Lithuanian government will go in adopting the IMF proposals for reforming the insolvency law regime. Nevertheless, widespread insolvency law reform is expected. In terms of main policy recommendations, the EBA could be improved to clarify the existing triggers for commencement of bankruptcy proceedings and to make the compromise procedure in bankruptcy viable by allowing it to be approved by a qualified majority of creditors. An expedited liquidation process could also be introduced to deal with circumstances where no compromise with creditors is likely.

With respect to the ERA, provisions governing the restructuring plan should be reviewed to ensure these are workable. Further consideration should be given to the rights of secured creditors under the restructuring plan, particularly to the extent the plan purports to affect any secured assets. Steps should be taken in parallel to address recognised shortcomings in Lithuania's institutional insolvency framework, particularly with respect to lack of capacity and skills and qualifications of judges and insolvency office holders.

Overall, Lithuania's insolvency regime provides for both liquidation and restructuring; however, it would benefit from targeted reform aimed at aligning its insolvency laws with international best practice.

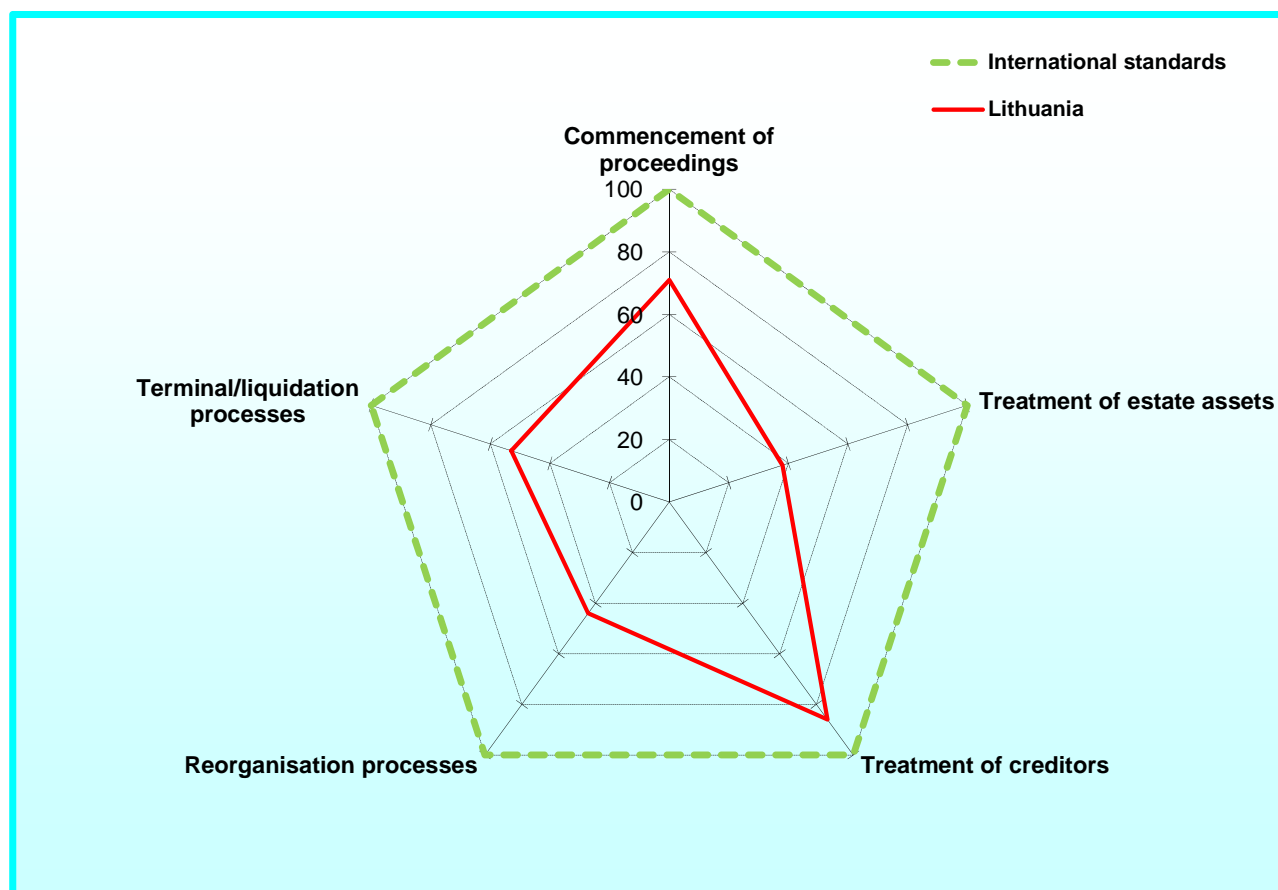
Chart 9 – Quality of insolvency legislation in the EBRD countries of operations (2009)



Source: EBRD Insolvency Sector Assessment 2009

Note: The various categories indicate the level of compliance of each country's legislation (the "laws on the books") with international standards, such as the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on Legislative Guidelines for Insolvency Law, and others.

Chart 10 – Quality of insolvency legislation in Lithuania (2009)



Source: EBRD Insolvency Sector Assessment 2009

Note: The extremity of each axis represents an ideal score, i.e. corresponding to international standards such as the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group's "Legislative Guidelines for Insolvency Law", and others.

3.6 Judicial Capacity

Lithuania has a four-tiered court system comprising the Supreme Court, the Court of Appeals, district courts and local courts. The local courts are of general jurisdiction and try most civil, commercial and criminal cases. District courts are the first appellate instance, the Court of Appeals the second, with the Supreme Court functioning as a court of cassation. The Supreme Court can also provide guidance to courts below on points of law and practice to ensure uniform application of the law.

The Constitution allows for the establishment of specialised courts. A two-tier system of administrative courts has been created, comprising regional administrative courts (first instance courts) and the Supreme Administrative Court (appellate court). Administrative courts hear cases concerning complaints against administrative acts and actions of state agencies and state officials. No specialist commercial courts have been established.

Judges of the local, district and administrative courts are appointed by the President. Judges of the Court of Appeals are also appointed by the President but with the approval of the Seimas (parliament). Judges of the Supreme Court are appointed by the Seimas. The autonomy and independence of courts and judges is ensured by the General Meeting of Judges and the Judicial Council. The latter body consists of 21 members, among which are the Chairmen of the Supreme

Court, Court of Appeal and Supreme Administrative Court, as well as other judges who are elected by their peers. The Judicial Council advises the President of the Republic on judicial appointments, promotion, transfer and removal from office.

Judicial independence is protected by law, and Lithuania statute book is in accordance with the EU's *acquis communautaire*. The country is considered to be one of the most effective EU states in implementing directives. Problems persist in relation to the implementation and enforcement of laws. Public trust in the judiciary is uneven, and there are concerns about corruption in the court system. In order to tackle these issues, a new National Anticorruption Programme aims to improve judicial transparency by digitising the court system. In particular, the programme foresees randomly allocating lawsuits to judges and publishing all county and appeal court verdicts, as well as all relevant information and documentation regarding court proceedings on the internet. Moreover, an intensive judicial training programme has been initiated in order to make judges more familiar with recently adopted commercial legislation.

3.7 *Public procurement*

Public procurement in the Republic of Lithuania is governed by the Law on Public Procurement of 6 September 1997, No. I-1491, as amended by law No. X-471 of 22 December 2005 (the "PPL"). In addition, a number of laws govern operational aspects of public procurement, including application of the eProcurement tools in conducting public procurement procedures.

The PPL sets forth a modern, highly competitive and transparent legal framework, in compliance with the EU public procurement directives. eProcurement and modern purchasing techniques are employed to improve the economy and efficiency of procurement processes. The PPL provides for uniform regulation for public tenders, including procurement in the utilities sector. Tenders, open and restricted, are the default procurement methods; the contracting entity may apply negotiated procedures only when permitted by law. In addition, procurement capacity is well developed and the public procurement regulatory authority is obliged to provide training for contracting entity procurement staff; procurement officers have to be professional, of high integrity and follow a code of ethics. The public procurement review system is well regulated, and the dedicated independent body is in charge of remedies for public procurement procedures.

Under the Bank's operation, the EBRD Procurement Policies and Rules shall be imposed, as there is a low procurement risk in conducting procurement under the local system.

At present, there are reform initiatives undertaken by the government, in order to fully implement the eProcurement instruments and tools in the national legal framework.

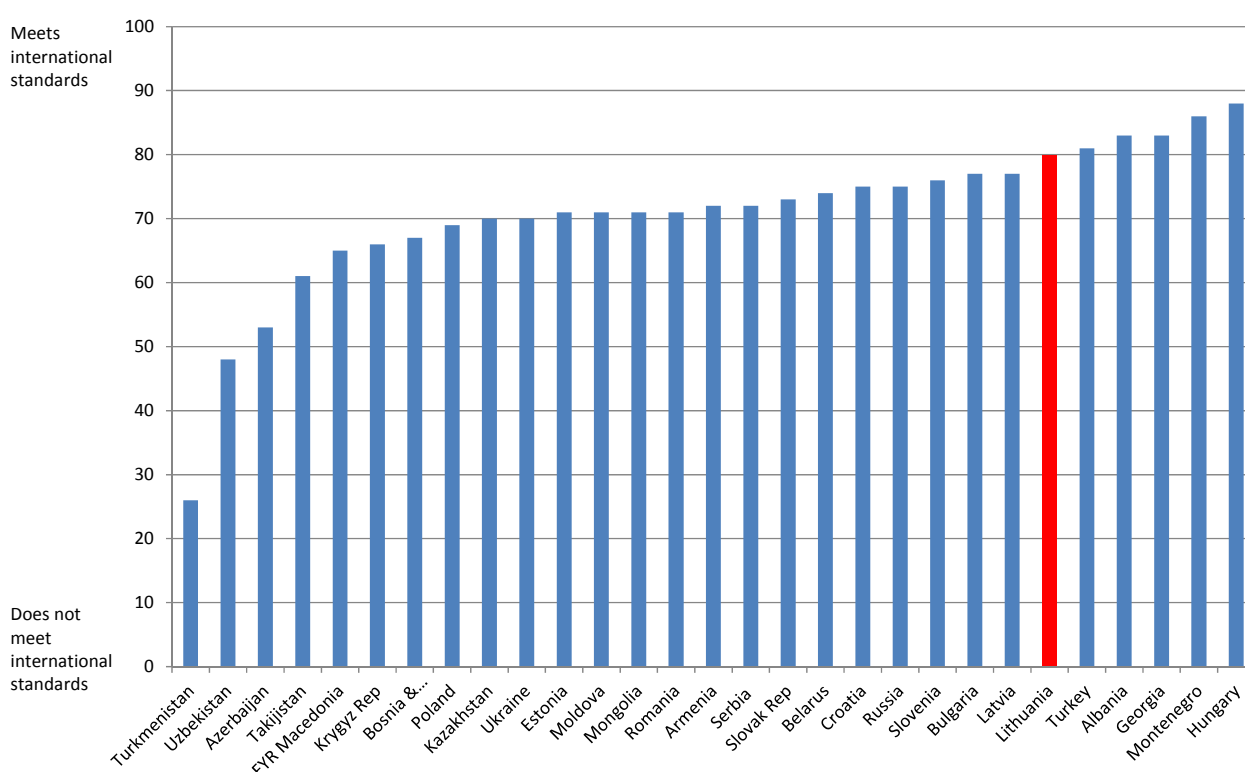
The public procurement legal and regulatory framework in Lithuania is based on the sound principles of the EU public procurement policies and well implemented. In the 2010 EBRD Public Procurement Assessment Lithuania scored to be in high compliance with international standards both in terms of public procurement legislation and practice (see Chart 11). The Assessment has further shown that competition and uniformity are strongest, and efficiency of the public contract and enforceability are the weakest features of the regulatory framework in the public procurement sector (see Chart 12). In addition, local public procurement practice has proved to be regular and compliant with international standards (see Chart 13).

No major regulatory or implementation problems were reported. Still, Lithuanian public procurement procedures are not open to international trade; tender documents are, in most cases, formulated in the official language and hardly ever available in other languages. Not all of the contracting entities have implemented internal policies to monitor changes in a procurement procedure, nor do they provide for public contract management. Thus, Lithuanian PPL could be

improved in terms of introducing a mandatory detailed and unbiased assessment of the contracting entity's needs before procurement is launched and implementing contract management procedures for public procurement contracts. Also, a mandatory use of eProcurement procedures could be increased - currently 50 per cent of procurement is required to be conducted electronically.

With further development of eProcurement policies and full implementation of the new instruments in the PPL, Lithuanian procurement practice could be considered exemplary in the EBRD region, in terms of the contracting entities' efforts to achieve the best value for money.

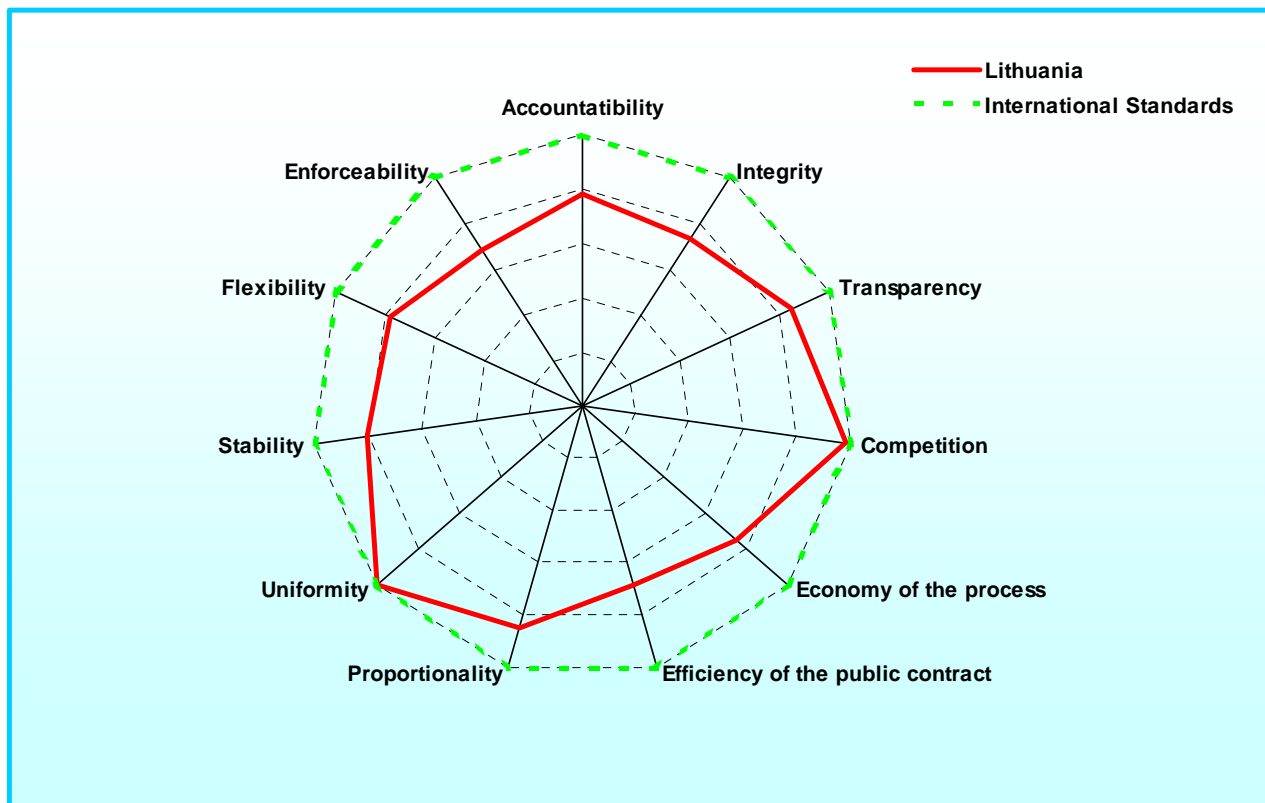
Chart 11 - Quality of Public Procurement legal framework in Lithuania as compared to other EBRD countries of operation (2010)



Source: EBRD Public Procurement Assessment 2010

Note: The score represents the level of compliance of the country's legal framework with international standards such as the revised UNCITRAL Model Law on Public Procurements. Lithuania is highlighted in comparison with other countries.

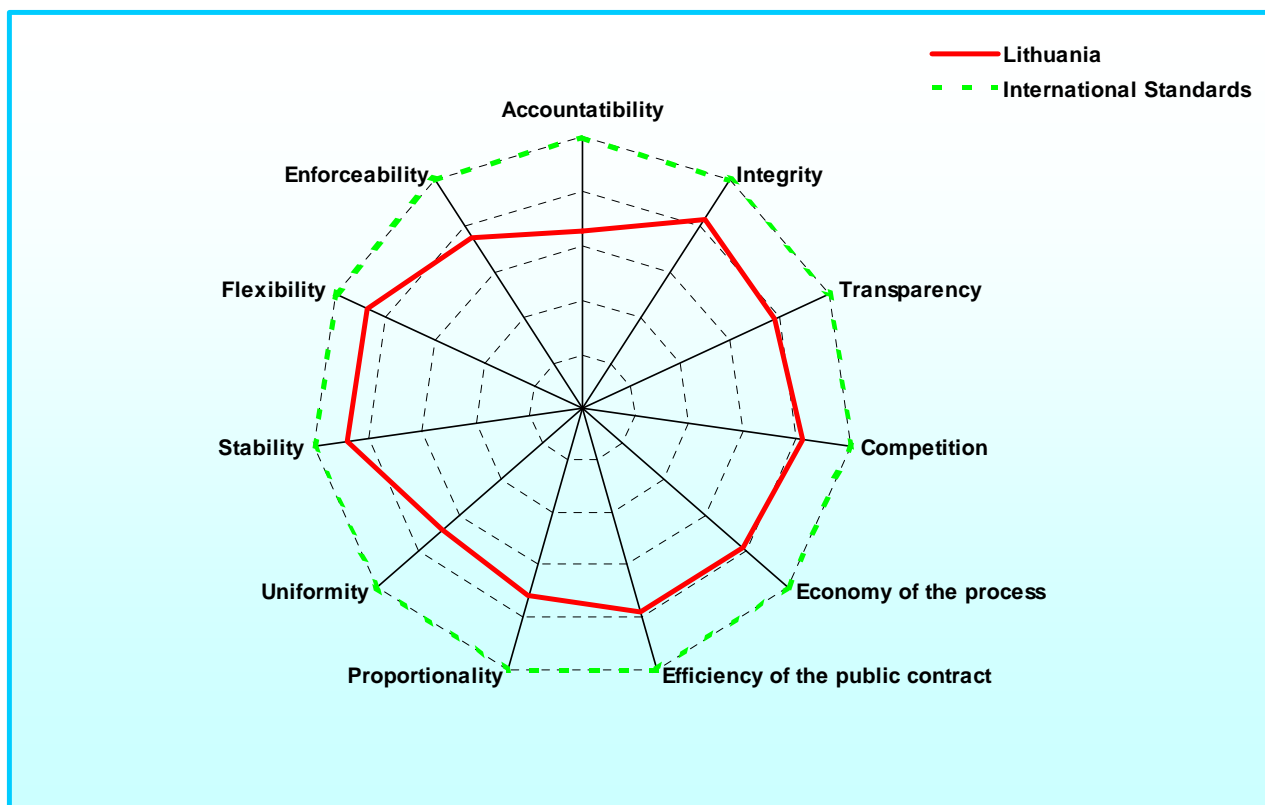
Chart 12 - Quality of Public Procurement legislation – Lithuania (2010)



Source: EBRD Public Procurement Assessment 2010

Note: The extremity of each axis represents an ideal score in line with international standards such as the revised UNCITRAL Model Law on Public Procurement. The fuller the 'web', the more closely the public procurement laws of the country approximate these standards.

Chart 13 – Lithuania - Quality of local procurement practice (2010)



Source: EBRD Public Procurement Assessment 2010

Note: The extremity of each axis represents an ideal score in line with international standards such as the revised UNCITRAL Model Law on Public Procurement. The fuller the 'web', the more closely the public procurement practices of the country approximate these standards.

3.8 Secured transactions

Lithuania's legal framework in the secured transactions sector comprises the Civil Code of 2000, the Law on Establishment of the Hypothec Register of 1997, the Instruction on Filling in the Mortgage, Compulsory Mortgage, Pledge and Compulsory Pledge Bonds introduced by Order No. 46 of the Minister of Justice of 20 February 2002, and Regulations of the Hypothec Register introduced by Resolution No. 1246 of the Government of 18 October 2001.

The Civil Code, which came into effect in July 2001, regulates taking mortgages over immovable property (Sec. 4.170 – 4.197) and pledges over movable property and rights (Sec. 4.198- 4.228). Generally, the system for taking, perfecting and enforcing security over movable and immovable property in Lithuania is working well.

Through a number of reforms in the late 90s and early 2000, the country has equipped itself with an efficient and user-friendly legal and institutional framework.

A mortgage can be created by contract between the creditor and the debtor or unilaterally by the owner of the immovable asset and has to be evidenced in a notarised mortgage bond (contents specified in the Civil Code). Subsequent mortgages over same property are allowed and the priority is achieved on registration.

A security interest can be created over wide range of tangible and intangible property as well. However, further improvements could be made to strengthen the existing regime. For example, a creditor cannot obtain a security interest in the universality of a debtor's assets since every single item pledged has to be specifically described, a general description of debts and obligations is not possible in the pledge (and mortgage) agreement and creating security over business as going concern is problematic due to the fact that floating charges are not recognised in practice (although arguably Sec. 4.202 of the Civil Code allows pledge over fluctuating pool of assets).

Non-possessory security interests (pledges) and a number of “quasi” security interests (sales with the right of redemption, leasing agreements, and sales with reservation of title), as well as mortgages must be registered with the Hypothec Register in order to be valid. The Hypothec Register is operated by the Central Hypothec Agency that has 15 local offices at district courts. The registrars are supervised by the Ministry of Justice. The system is centralised, fully computerised and easily accessible through the Internet. All interested persons can search the data electronically, including the particulars of a charge. Records on mortgages over land and buildings are immediately transferred to the Real Estate Register, which database is interconnected with the Hypothec Register.

Enforcement of pledges is done out of court in accordance to the existing agreement between the pledgor and the pledgee (direct sale, appropriation for value, public auction), or if the parties did not agree, the pledged assets are sold by the pledgee at a public auction. Enforcement of mortgages, in contrast, takes place via public auction led by bailiffs or by mandatory administration. In both cases, enforcement is reported to work efficiently unless the debtor challenges the procedure.

Limitations on taking security over a fluctuating pool of assets or the ability to use the general description of debt hinders modern financing operations. The local legal practice tries to overcome these limitations by setting up rather complicated combinations of various security instruments. This can lower legal certainty and rise costs of transactions which can be burdensome for businesses; particularly SMEs. Hence, modifications of the present regime aimed at removing these hurdles would lower the costs of transactions, increase the legal certainty of financing operations and thus help the Bank in its support to the SME sector in the country.

There are no current or proposed reported reforms in the secured transactions sector in Lithuania. At the same time, although a general secured transactions system is functioning well, some modifications of the Civil Code would be welcome in order to reflect the needs of modern business transactions. In particular, changes could facilitate using fluctuating pool of assets, general description of debt and allow charging enterprise as a going concern.

Overall, Lithuania is an example of an advanced EBRD country of operations where the secured transactions regime does not require a general overhaul but rather specific sophisticated changes in order to further develop into a system that would fully cater for the needs of modern finance transactions.

3.9 Securities markets

The primary legislation regulating securities markets in Lithuania is the Law on Securities of 18 January 2007. Other applicable legislation includes, in particular, the Law on Markets in Financial Instruments of 18 January 2007, the Law on Financial Institutions of 10 September 2002, the Law on Collective Investments Undertakings of 4 July 2003, the Law on Pension Funds of 3 July 1999, and the Law Amending the Law on Financial Collateral Arrangement, in force as of 30 June 2011, implementing Directive 2009/44/EC (the “Financial Collateral Law”).

As to the regulatory authority, by virtue of adoption of the Law on Banks of 22 December 2011, the Securities Commission was dissolved on 31 December 2011 and its functions were transferred to the Bank of Lithuania (the “BoL”), which has become an integrated supervisor (like the FSA in the United Kingdom). A new supervision service at the BoL established on 1 January 2012 is charged with supervising commercial banks, other credit and payment institutions, securities and the insurance markets.

NASDAQ OMX Vilnius remains the only regulated secondary securities market in Lithuania, offering trading, listing and information services. Vilnius stock exchange, via NASDAQ OMX platform, is integrated with Tallinn and Helsinki stock exchanges, providing direct access to securities traded at these exchanges.

The Lithuanian capital market is very young and of relatively small size. The applicable legal framework seems to be of high quality and it implements various EU directives. In EBRD’s Securities Markets Sector Assessment completed in 2007, Lithuania was rated in “high compliance” with international standards as to the quality of its securities markets regulation (see Chart 14). The Assessment has indicated that a number of features of Lithuania’s securities markets regulation is quite strong, including those with respect to the regulator, self-regulatory organisations, issues and disclosure, collective investment schemes, and accounting; at the same time, financial instruments have been identified as the major weakness of the system (see Chart 15).

The over-the-counter (“OTC”) market, including the derivatives market, is still not active, and foreign exchange derivative (forwards, swaps, and options) has become more popular, but not yet widely used, mostly due to the size of the Lithuanian capital market. The Financial Collateral Law not only implements Directive 2009/44/EC but also, following the International Swaps and Derivatives Association (ISDA) Model Netting Act, decreases systemic risk and creates more certainty in derivatives contracts by including provisions enabling close-out netting on insolvency under qualified financial agreements.

However, the application of the Financial Collateral Law is narrowed to qualified financial agreements on financial instruments and foreign exchange which may be concluded between specific counterparties only. Also, the Law does not provide criteria or enumerates the derivative transactions covered by the definition of financial instruments included in the Law. Thus, some clarifications may be needed.

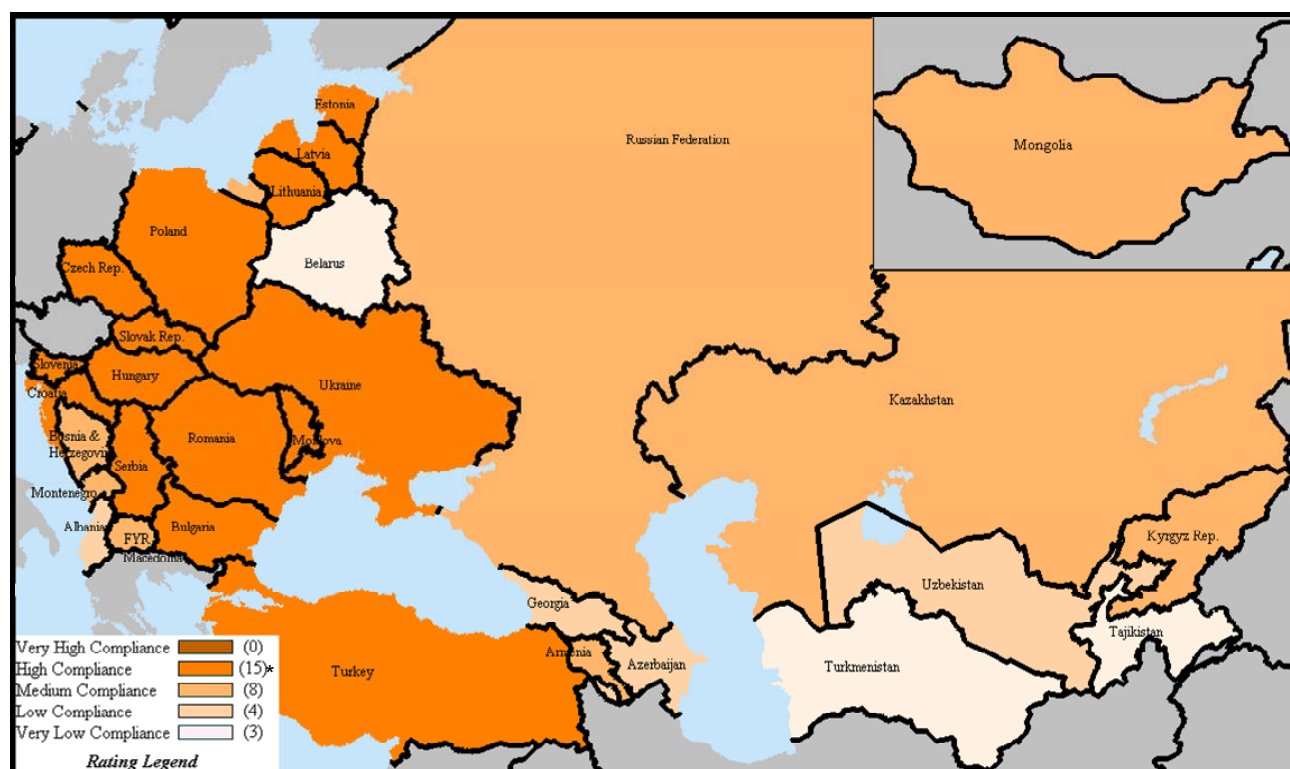
Overall, Lithuania’s financial system is stable and remained resilient despite the late 2011 bankruptcy of a domestically owned, medium-sized bank, Snoras. The financial sector is however dominated by the banking sector.

In Lithuania, the EBRD fosters commercial banks’ continued lending to the corporate sector, particularly to SMEs. There are currently no EBRD (including Treasury) capital markets projects or activities.

There are no current or proposed EBRD projects on capital markets development in Lithuania. However, the Financial Collateral Law could be clarified in terms of what types of derivative transactions are covered by it. Financial agreements executed in derivative contracts which do not fall within the scope of Directive 2009/44/EC and the Law on Markets in Financial Instruments will risk being re-categorised and thus close-out netting provisions specified in the Financial Collateral Law would not apply to them. This is an important risk for investors willing to trade derivatives instruments as close-out netting provisions with respect to financial claims under such financial agreements may therefore be regarded as invalid and unenforceable. Furthermore, the limited scope of eligible counterparties should be reconsidered as such limitation is contrary to practice in other European countries.

In conclusion, the Lithuanian financial sector was impacted by the 2008 Global crisis; recently however, this sector has seen some improvement. Furthermore, the new model of supervision by the BoL is expected to be more effective as well as cost-efficient and should lead to reinforced stability of the financial system. In terms of the legal framework, the scope of application of the Financial Collateral Directive could be widened in terms of eligible counterparties and eligible transactions.

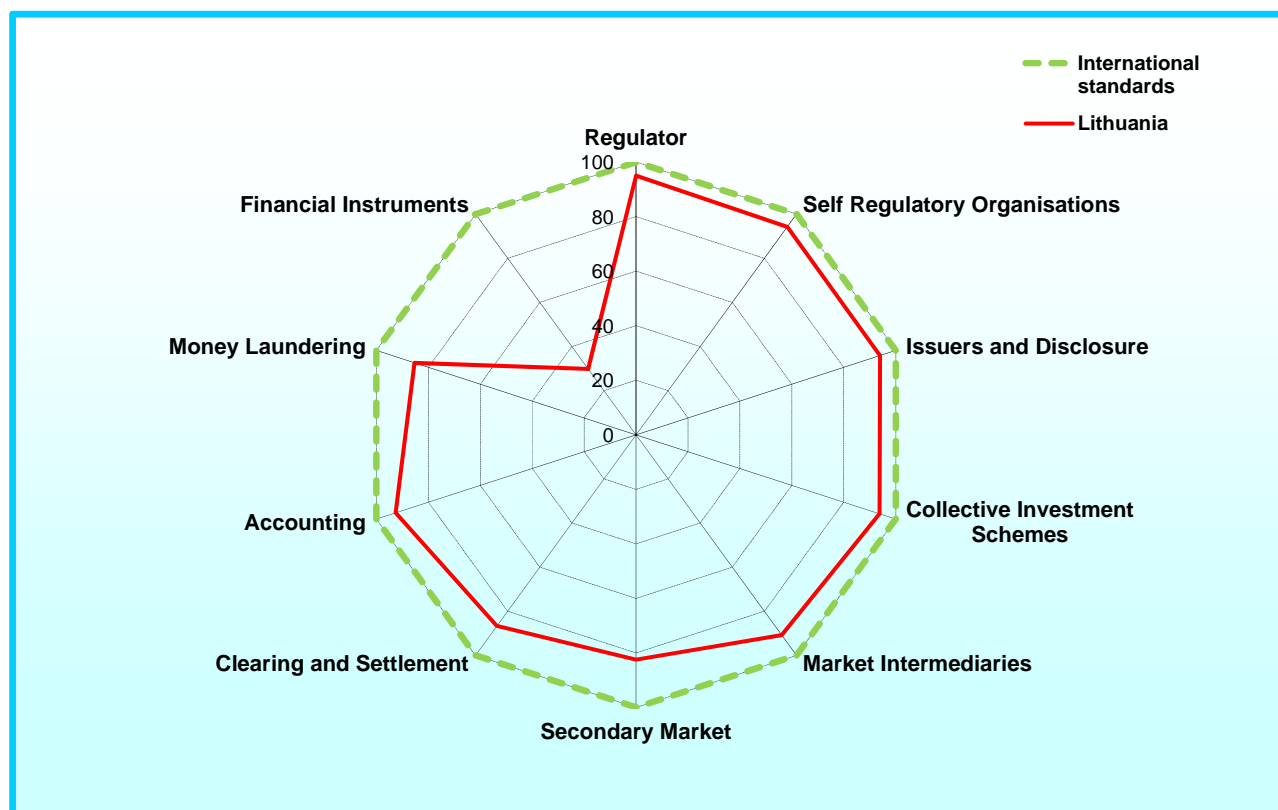
Chart 14 – Quality of securities market legislation in the EBRD countries of operations (2007)



Source: EBRD Securities Markets Sector Assessment 2007

*Note: The various categories represent the level of compliance of a given country's legislation (the "laws on the books") with international standards such as the IOSCO Principles. *The asterisk indicates in which category Lithuania ranks.*

Chart 15 – Quality of securities markets legislation in Lithuania (2007)



Source: EBRD Securities Markets Sector Assessment 2007

Note: The extremity of each axis represents an ideal score in line with international standards such as the IOSCO Principles. The fuller the 'web,' the more closely the country's securities markets laws approximate these standards.

3.10 Telecommunications / Electronic Communications

Lithuania's electronic communications sector is governed mainly by the Law on Electronic Communications of 2004 (the "2004 Law"), as amended, most notably in 2007 and 2011, together with relevant subordinate legislation. The 2004 Law harmonised Lithuania's legislation with that of the European Union (EU) as part of the accession process whereby Lithuania became a member state of the EU. Lithuania transposed the revised (2009) EU regulatory framework through the 2011 amendment of the 2004 law and through a number of decisions by Ryšiu Reguliavimo Tarnyba ("RRT"), the sector regulator. The Ministry of Transport and Communications oversees communications policy in Lithuania.

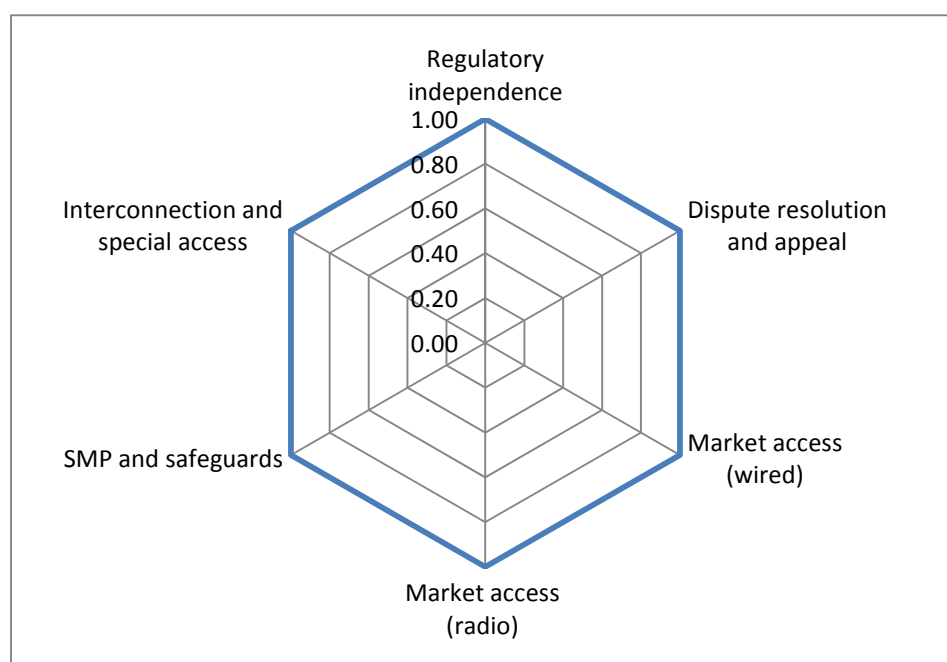
The electronic communications sector in Lithuania was formally liberalised since 2003 and is considered an advanced environment with respect to deployment of fibre-optic broadband infrastructure, one of today's main sector drivers. In the EBRD Telecommunications Regulatory Assessment 2008, the telecommunications regulatory framework of Lithuania scored very well, achieving full compliance with international standards in all six comparison dimensions (see Chart 16). The main fixed-line player is Teo (formerly Lithuania Telecom), former state-owned incumbent operator, now majority (68.08%) owned by TeliaSonera. A total of 26 alternative fixed operators currently offer a service, though with control of less than 10% of the market, reflecting strong remaining dominance of Teo in this area. Although growing, fixed line penetration is still below the EU average, standing at 22% at the end of 2011 (see Chart 17(a)). Local Loop Unbundling has been available for some time, though there has been very low take up (less than 1%), likely reflecting the strong development of own infrastructure by alternative operators. The

mobile market is shared by three operators (Omnitel, Tele2 and Bite) holding approximately 39%, 37% and 24% of the market, respectively, with a number of Mobile Virtual Network Operators also providing service. Penetration rates for mobile were at 150% in 2011, above the EU average of 127% (see Chart 17(b)). Mobile broadband is also making significant inroads in the marketplace, with 88% of the Lithuanian territory currently covered by a 3.5G mobile network and LTE/4G deployment being undertaken by one mobile operator, and prepared by a second. Broadband penetration is still below the EU average; standing at approximately 14% at the end of 2011 (see Chart 17(c)).

The Bank does not currently have investments in the sector in Lithuania; however (at a technical and business level) the continuing presence of an EU-compliant legal and regulatory framework makes the overall environment for the sector attractive for investment, promotes broader competitiveness across the economy and aids social development.

In common with other EU member states, Lithuania is subject to the on-going legal and regulatory reforms necessary to remain part of the evolving Europe-wide market for electronic communications. In common with most EU partners, among Lithuania's future challenges is keeping pace with the evolving EU framework and its effective implementation, in particular, ensuring effective regulation of local loop unbundling and sufficient incentive for competing operators to access the incumbent fixed network as an appropriate balance to the current trend of infrastructure based competition.

Chart 16 – Quality of telecommunications regulatory framework in Lithuania (2008)

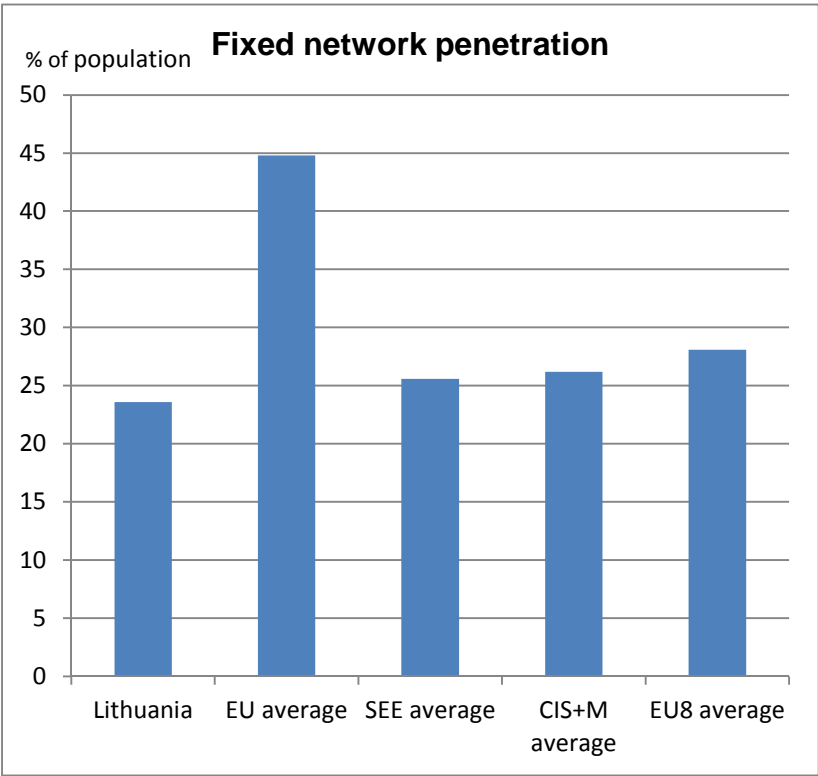


Source: EBRD Telecommunications Regulatory Assessment 2008

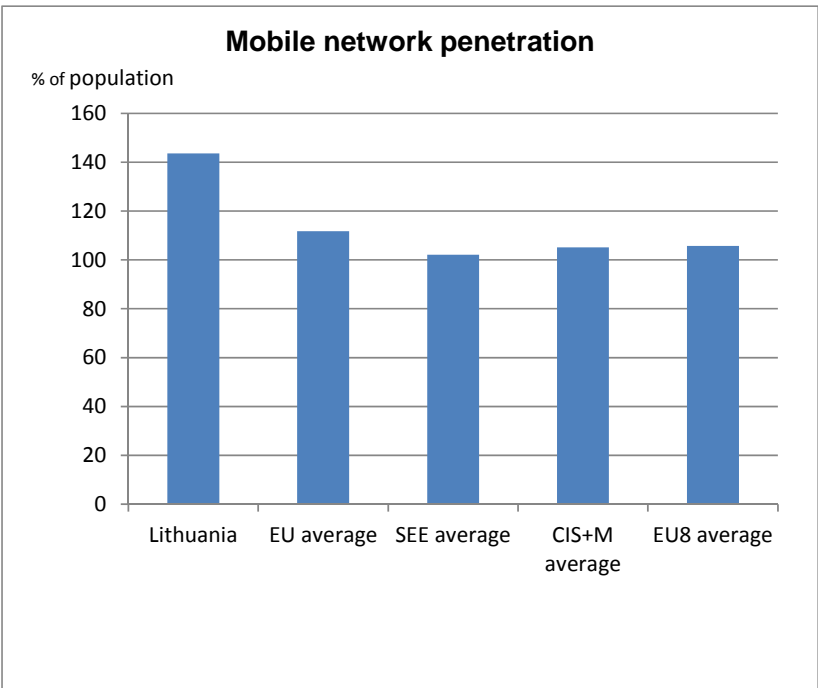
Note: The diagram shows the combined quality of institutional framework, market access and operational environment when benchmarked against international standards issued by the WTO and the European Union. The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the “web”, the closer the overall telecommunications regulatory framework of the country approximates these standards.

Chart 17 – Key indicators for Lithuania (2008)

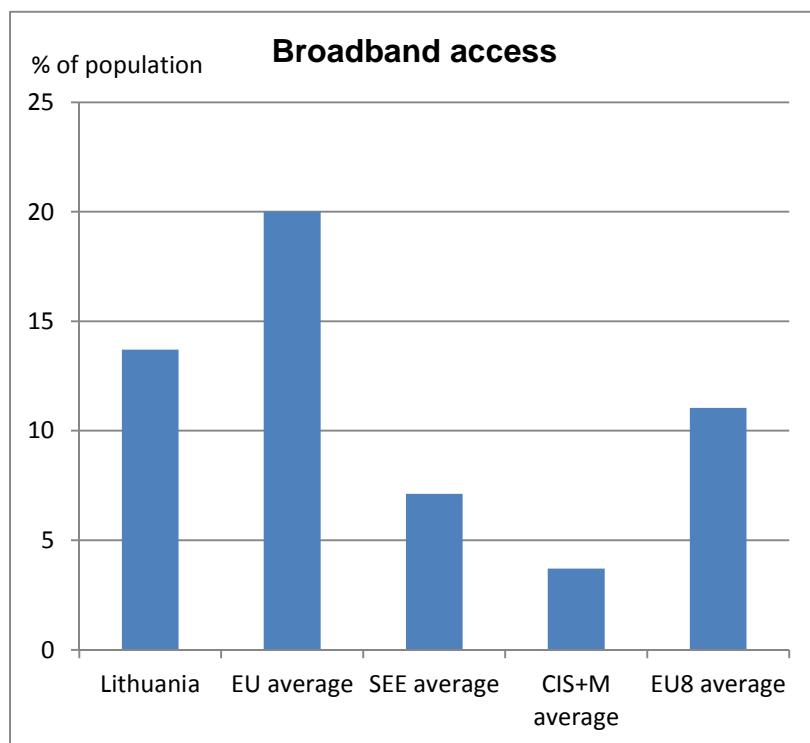
17(a) Fixed Network Penetration



17(b) Mobile Network Penetration



17(c) Broadband Network Penetration



Source: EBRD Telecommunications Regulatory Assessment 2008

Note: Key indicators for Lithuania provide the fixed network penetration defined as active subscriber lines as a percentage of population, mobile network penetration defined as active pre- and post-paid subscribers as a percentage of population and the broadband network penetration defined as the number of access subscribers with speeds of 144k/bits or more as a percentage of population (broadband Network Penetration less than 1% is not shown on this chart).