Russia

Baker & McKenzie

Doing Business in Russia

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Table of Contents

PREFACE

Baker & McKenzie provides sophisticated legal advice to the world's most dynamic global enterprises, and has done so for 60 years.

With a network of more than 3,900 locally qualified, internationally experienced lawyers in 69 offices across 39 countries, we have the knowledge and resources to deliver the broad scope of quality services required to respond effectively to both international and local needs - consistently, with confidence and with sensitivity to cultural, social and legal differences.

Active in the USSR and the Commonwealth of Independent States for over 40 years, with offices in Almaty, Baku, Kyiv, Moscow, St. Petersburg and project office in Tashkent we now have one of the largest legal practices in the region, offering expertise (in close cooperation with our offices worldwide) on all aspects of investment in the region including corporate law, banking and finance, securities and capital markets, venture capital, competition law, tax and customs, real estate and construction, labor and migration, intellectual property, and dispute resolution.

The first western law firm to be registered with the then Soviet authorities, our Moscow office was opened in 1989, followed by the opening of our St. Petersburg office in 1992.

Since the dissolution of the Soviet Union in 1991, the Russian Federation has adopted new legislation at a rapid pace. It remains a country in transition and its legal system in continued development. *Doing Business in Russia* has been prepared as a general guide for companies operating in or considering investment into the Russian Federation. It is intended to present an overview of the key aspects of the Russian legal system and regulation of business activities in this country.

The information contained in this guide is current as of the date below. Three chapters in this issue *Climate Change*, *Insurance* and *Derivatives* are brand new: they reflect our growing involvement in these areas. We will be happy to provide you with updates on the material contained in this guide, or to provide you with further information regarding a specific industry or area of Russian law in which you may have a particular interest.

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1. RUSSIA - AN OVERVIEW

1.1 Geography

The Russian Federation stretches across Eurasia from Eastern Europe to the Pacific coast. After the collapse of the Soviet Union, Russia became the largest country in the world in terms of territory.

1.2 Population

The population of the Russian Federation is approximately 143 million. Although approximately 80% of the country's population is ethnically Russian, the Russian Federation is a multinational state and is home to numerous ethnic minority groups, including sizeable Tatar (3.8%) and Ukrainian (2%) populations. Roughly 73% of the population lives in urban areas, and 13 cities have a population of over one million. The largest city in the Russia is Moscow, with a population of approximately 10.4 million, followed by St. Petersburg, with a population of approximately 4.5 million.

1.3 Political System

The Russian Federation is a federal republic consisting of 83 constituent entities. There are six categories of federal constituent entity which, while subtly different in classification, are constitutionally defined as equal members of the federation. The 21 republics (corresponding to the homelands of various ethnic groups) enjoy a certain degree of regional autonomy. The federation is further divided into 47 oblasts (regions), one autonomous oblast (autonomous region), and nine krais (territories) in which four autonomous okrugs (autonomous districts, also delineated for various ethnic groups) are located. Moscow and St. Petersburg are classified as cities of federal significance. In 2000, Russia was further delimited into seven federal super-districts (circuits) with the aim of ensuring federal supervision over regional affairs.

Each constituent entity of the federation possesses its own charter, political institutions and local legislation. Approximately half the constituent entities have signed bilateral treaties regulating the relationship between the regional and federal governments. Significant progress has been made towards greater consistency between the regional and federal legal systems. However, when conducting business transactions at the regional level treaty stipulations should be carefully reviewed as they may assign slightly different rights and privileges to the constituent entity in question.

Constitutionally, the President of the Russian Federation is elected for a four year term (limited to two terms in succession) and is vested with extensive powers, serving as the head of state, the commander-in-chief of the armed forces, and the highest executive authority of the federation. The office of the President also includes the powers of decree and legislative veto, and the power to appoint and dissolve the Government. The President is primarily responsible for domestic and foreign policy and represents Russia in international relations. Furthermore, as of December 2004 the President was granted the authority to directly appoint Russia's regional leaders, subject to confirmation from the regional legislature. The procedure was amended in December 2008: according to the new law, the political party that obtains the majority of mandates in the regional legislature submits three candidatures for the President's consideration.

The Prime Minister oversees the activities of the government and serves as the acting President if the President becomes ill and is unable to carry out the functions of that office. The Prime Minister's authority as acting President expires upon the election of a new President, which would normally be three months after the former President's authority expires.

Since the election of Vladimir Putin to the Russian presidency in May 2000, the country has undergone a number of sweeping political reforms aimed at centralizing power within the federal executive. Mr. Putin was re-elected in March 2004. In March 2008 Putin's designated successor, Dmitry Medvedev, won the general election with an overwhelming majority. In May 2008 Vladimir Putin was appointed Prime Minister.

Legislative power is exercised by a bicameral Federal Assembly, which consists of the Federation Council (upper house) and the State Duma (lower house). Since January 2002, the Federation Council has consisted of two representatives from each federal constituent entity, one from the executive branch appointed by the regional governor, and one from the legislature nominated by the regional assembly. This is different to the previous system, where leaders of the regional legislative and executive branches served on the council *ex officio*. The State Duma consists of 450 members elected nationwide by proportional representation though party lists. Previously 225 of the 450 members were elected in single member constituencies; however, in December 2004 these seats were abolished. The first election under the new rules was held in December 2007. In addition, new rules were introduced governing national political parties, increasing both the minimum number of party members required for registration (from 10,000 to 50,000) and the threshold to secure Duma seats (from 5% to 7% of the national vote).

The lowest governmental level in the Russian Federation is local self-government. Reformed in September 2003, bodies at this level remain relatively new and untested. Current law distinguishes between community-level government and the governments of towns and villages, reforming the roles and responsibilities of each level. However, the overall influence of local self-government depends on how much authority has been delegated to the local level by the regional government. Foreign investors should be aware of the position of local bodies in regions where they conduct business since these bodies may possess limited powers of taxation.

At the top of the Russian judicial system are three high courts: the Constitutional Court, Supreme Court and Supreme Arbitrazh (Commercial) Court. The 19 justices of the Constitutional Court review all constitutional disputes. The Supreme Court reviews civil, criminal, and administrative disputes involving private individuals, while the Supreme Arbitrazh Court reviews commercial disputes and administrative disputes involving legal entities and individual entrepreneurs. Judges for all these courts are appointed for life by the Federation Council on the recommendation of the President.

1.4 International Relations

Russia is still in the process of defining its position in the post-Cold War world. One of the primary accomplishments of Russian foreign policy has been an improved relationship with Western Europe and the United States, although this bond has been severely tested on several occasions. In the past few years Russia has been re-evaluating its foreign policy agenda in response to increased Western involvement in both Eastern Europe and Central Asia.

One of the key pillars of Russian foreign policy has been the Commonwealth of Independent States (CIS), whose membership is comprised of most of the former Soviet republics. Since 1991 the CIS has struggled to establish itself as an effective and integrated body. In August 2008, following the escalation of hostilities between Russia and Georgia over the separatist region of South Ossetia, Georgia announced its intention to withdraw from the CIS.

Recently, Russia has been very active in various Western programs, including the strengthening of the International Non-proliferation Initiative as well the formation of a joint Russia-NATO action plan on international terrorism, which envisages the exchange of confidential information, joint exercises and anti-terrorism training. Internationally, Russia continues to be an active member of all bodies of the United Nations, and retains a permanent seat on the Security Council with veto rights.

Russia has always had close ties with its neighbour and major trading partner, Belarus. In 1997 a supranational entity, the Union of the Russian Federation and the Republic of Belarus, was formed. However, since then the initial enthusiasm for integration has waned and a Union with a single currency remains at the planning stage.

1.5 Economy

The eight years of Vladimir Putin's presidency from 2000 to 2008 coincided with an era of rapid economic growth fuelled by sky-high commodity prices and accompanied by a significant increase in living standards. The government's devaluation of the rouble during the 1998 financial crisis gave local producers significant advantages over their foreign competitors. Local consumption was boosted by the introduction of consumer loans and mortgages. Among the other drivers of economic growth was an increase in the utilization of industrial capacity constructed in the Soviet period. Between 1999 and 2007 GDP rose by an average of 6.8% annually. Real fixed capital investments increased by an annual average of 10% between 2000 and 2007, while real personal incomes rose at an average annual rate of 12%.

Over these years Russia successfully paid off a substantial portion of its foreign debt. In March 2008 the country's gold and foreign currency reserves surpassed US$500 billion, giving Russia the third largest reserves in the world after China and India. These achievements, in conjunction with prudent macroeconomic policies and renewed government efforts to advance structural reforms, raised business and investor confidence, with new business opportunities emerging in such sectors as telecommunications, retail, pharmaceuticals and the power industry in particular.

However, shortly after Vladimir Putin was appointed Prime Minister, the country's economic fortunes changed. Russia has been badly hit by the international financial crisis in 2008-2009. A slump in commodity prices, collapse of the financial markets, restricted access to external financing, rising unemployment and a consequent drop in internal consumption have shaken the foundations of the Russian economy. Among the industries most seriously affected were the financial services, B2B, IT, real estate & construction, mining & metals and automotive sectors. Experts have voiced concerns as to the soundness of the Russian banking sector given the apparent growth in the percentage of non-performing loans. In 1Q 2009 GDP fell by 9.5 % year on year. The IMF forecasts that Russian GDP will contract in 2009 by 6%.

Since the outbreak of the crisis the government has increased its efforts to safeguard the economy. By April 2009 approximately a third of Russia's foreign currency reserves had been spent on implementing a step-by-step rouble devaluation, which prevented panic and an inevitable run on the banks. The Central Bank has provided commercial banks with liquidity through REPO mechanisms in an attempt to unfreeze the credit market. However, as of April 2009 short-term financing at reasonable rates was still unavailable for most small and medium-sized enterprises. The government has proposed bail-out initiatives for the economy's largest companies with a view to limiting the negative social impact of massive lay-offs. Some banks and financial services companies have been acquired by government-controlled organizations. The authorities have come up with a multi-billion dollar rescue plan for the automotive sector and are subsidizing rates on car-loans for cars produced or assembled domestically. A package of tax initiatives encouraging economic activity has been adopted.

The Economist Intelligence Unit mentions that among the strong points of the Russian economy are comfortable savings levels, very limited exposure to the stock market (less than one million Russians own shares) and low exposure to the mortgage market compared to the US, the UK and the Central and Eastern European counties. On the downside are the drops in real income, real wages, disposable income and retail sales, and the increasing unemployment, which currently stands at between 7 and 8%.

The prospects for an upturn in the Russian economy remain unclear and largely depend on how long the recessions in the US and world economy last. According to the Economist Intelligence Unit, if global demand shrinks and oil prices in 2009 fall below 45-53 USD per barrel (seen as the critical level for the state budget), the rouble will come under more pressure and the recession in the Russian economy may last until Autumn 2010 or beyond.

2. PROMOTING FOREIGN INVESTMENT IN RUSSIA

2.1 The Foreign Investment Law

2.1.1. General Provisions Regarding Foreign Investments.

The *Constitution of the Russian Federation* (the *Constitution*), the *Civil Code of the Russian Federation* (the *Civil Code*), and other legislation on joint stock and limited liability companies and their insolvency provide the general legal framework for trade and

investment in Russia. Foreign investments are regulated by the Federal Law *On Foreign Investments in the Russian Federation*, dated 9 July 1999 (the *Law on Foreign Investments*). However, the *Law on Foreign Investments* does not apply to the investment of foreign capital in banks, credit organizations, insurance companies or non-commercial organizations; foreign investments in such entities are regulated under different Russian legislation.

The *Law on Foreign Investments* guarantees foreign investors the right to invest and to receive revenues and profits from such investments, and sets forth the terms for foreign investors' business activity on the territory of the Russian Federation.

The objective of the *Law on Foreign Investments* is to attract foreign materials, financial resources, and technology and management skills to improve the Russian economy, while providing stability for foreign investors. The *Law on Foreign Investments* is aimed at the Government of the Russian Federation conforming to standards of international law and to international standards of investment cooperation.

The *Law on Foreign Investments* emphasizes the role of both federal and regional legislation, and stipulates that foreign investors and investments must be treated no less favorably than domestic investments, with some exceptions. Such exceptions may be introduced to protect the Russian constitutional system, the morality, health and rights of persons, or in order to ensure state security and defense.

The *Law on Foreign Investments* permits foreign investment in most sectors of the Russian economy: portfolios of government securities, stocks and bonds, direct investment in new businesses, the acquisition of existing Russian-owned enterprises, joint ventures, *etc.* Foreign investors are protected against nationalization or expropriation unless such action is mandated by a federal law. In such cases, foreign investors are entitled to receive compensation for any investment and other losses.

One of the most important features of the *Law on Foreign Investments* is the tax stabilization clause set forth in Article 9. Under Article 9.1, the Law's tax stabilization clause, also known as "the Grandfather Clause", applies to i) foreign investors that are implementing "priority investment projects", ii) Russian companies with more than 25% foreign equity ownership, or iii) Russian companies with some foreign participation that are implementing "priority investment projects."

Article 2 defines a priority investment project as a project with foreign investment of at least one billion rubles (about USD 41 million at current exchange rates), or

where a foreign investor has purchased an equity interest of at least 100 million rubles (about USD 4.1 million at current exchange rates); in either case, the investment project must also be included in a list of projects approved by the Russian Government.

For qualifying companies and projects, the Grandfather Clause prohibits increases in the rates of certain import duties and federal taxes until initial investments have been recouped (up to a maximum of seven years, unless this period is extended by the Russian Government under certain conditions). Key exceptions to the Grandfather Clause are established for protective customs tariffs on commodities, excise tax, VAT on domestic goods, and Pension Fund payments. Article 9.4 provides a further and potentially broad exception for laws protecting certain public or state interests. Article 9.5 contemplates the adoption of regulations to implement the Grandfather Clause. Given all of these exceptions and qualifications, it remains arguable whether the tax stabilization clause is of real benefit to foreign investors.

2.1.2. Restrictions on Strategic Companies

Certain restrictions for foreign investments are imposed by *Russian Law No. 57-FZ of April 29, 2008 "On the Procedures for Foreign Investments in Companies of Strategic Significance for National Defense and Security"* (the "*Law on Strategic Companies*"). The Law on Strategic Companies is designed to regulate *the acquisition of control* over Russian strategic companies by foreign investors or "groups of persons" that include a foreign investor. Acquisitions by such entities of control, including through acquisitions of shares, in strategic companies require the *preliminary consent of the Russian Government and/or a post-transaction notification*.

The Law on Strategic Companies provides a list of more than 40 activities that constitute strategic activities in Russia. Accordingly, any company engaged in such activities is viewed as a strategic company. The strategic activities include, among other activities, the following:

1. Works having an active impact on geophysical processes;
2. Works related to hydro-meteorological processes and events;
3. Activities related to the use of infectious agents;
4. Activities related to the nuclear industry and the storage of nuclear and radioactive materials;
5. Activities related to encryption and licensed encryption techniques;

6. Activities related to the secret obtaining of information in premises and equipment (excluding the activities performed for the purposes of security of legal entities);

7. Activities related to the production, trade, repair and utilization of weapons and military equipment, and their spare parts and ammunition (excluding cold arms, civil and service weapons) and explosive materials for industrial purposes;

8. Activities related to aviation equipment and security;

9. Space activities;

10. Activities related to telecasting or radiocasting on territory, where half or more of the population of the constituent of Russia resides;

11. Services provided by a company included in the register of natural monopolies, (excluding natural monopolies in public telephone and wireless communication and postal communications fields, and services for the supply of heat energy and electrical energy through the distribution grid);

12. Activities performed by a company included in the register of companies having more than a 35% market share in a particular market of goods and occupying a dominant position in the following fields:

    - The market of communication services on the territory of Russia (excluding services for providing access to the Internet);
    - The market of fixed telephonic communication on the territory of five or more constituent territories of Russia;
    - The market of fixed telephonic communication on the territory of Moscow and St. Petersburg.

13. Activities related to geological research of the subsoil and/or mineral exploration and extraction on federal subsoil;

14. Procurement of water biological resources (fishing);

15. Performance of printing by a commercial entity, if such commercial entity is capable of printing no less than two hundred million impression prints a month; and

16. Performance of editorial office activities and/or activities of a periodical publisher, publishing editions with individual circulations of no less than one million.

Therefore, from the standpoint of foreign investment, it is important to verify all activities the investor's company is engaged in to properly assess whether it may be viewed as strategic and therefore subject to certain restrictions.

2.1.3 Controlled Transactions

Transactions involving acquisition of control over strategic companies that require the preliminary consent of the Russian Government include the following:

(i) transactions with shares (participatory interests) of such a company if as a result of such transactions a foreign investor or group of persons acquires:

- the right to direct or indirect disposal of ten or more percent of the total number of votes at shareholder level - *for companies using federal subsoil plots*;
- the right to direct or indirect disposal of more than 50 percent of the total number of votes at shareholder level - *for companies engaged in strategic activities other than the use of federal subsoil plots*;.
- the right to appoint (a) the chief executive officer, and/or (b) more than 50 percent of the members of a collective executive body of such a company;
- the unconditional ability to elect more than 50 percent of the members of the board of directors (supervisory council) or another collective governing body of such company;

(ii) for companies using federal subsoil plots - transactions aimed at the acquisition by a foreign investor/group of persons of shares (participatory interests) if the foreign investor or group of persons already has (a) the right to direct or indirect disposal of ten or more percent of the total number of votes at shareholder level (that is, any increase in a shareholding in a strategic company), the right to appoint (b) the chief executive officer, and/or (c) ten or more percent of the members of a collective executive body of such a company (d) the unconditional ability to elect more than ten or more percent of the members of the board of directors (supervisory council) or another collective governing body of such company;

(iii) agreements resulting in the acquisition by a foreign investor or by a group of persons of rights to perform the functions of a management company;

(iv) other transactions aimed at the acquisition by a foreign investor or group of persons of the right to determine the decisions of the governing bodies of such a company, including the rights to determine its business activities; and/or

(v) transactions aimed at the acquisition by a *foreign state, international organization or organization controlled by them*, of the right to dispose *directly or indirectly* of more than

- five percent of the total number of votes at shareholder level - *for companies using federal subsoil plots*; or
- more than 25 percent of the total number of votes at shareholder level - *for companies engaged in strategic activities other than the use of federal subsoil plots*.

Similar criteria are employed by the Law on Strategic Companies when defining the notion of '*control*'. "Control" denotes not only a certain minimum shareholding level, but also rights to appoint management bodies and otherwise determine the company's business activity.

Acquisition of five percent or more of the shares (whether voting or not) in any strategic company requires providing a post transaction notification to the Government.

2.1.4 Special Restrictions for Foreign States, International Organizations and Organizations Under Their Control

A foreign state, international organization or organization controlled by them are explicitly prohibited from acquiring control, as defined by the Law on Strategic Companies, over strategic companies. Namely, they are not allowed to acquire:

(i) ten or more percent of the total number of votes at shareholder level - *for companies using federal subsoil plots*;

(ii) 50 or more percent of the total number of votes at shareholder level - f*or companies engaged in strategic activities other than the use of federal subsoil plots*; or

(iii) other rights mentioned in items (iii) and (iv) of the above section "controlled transactions".

2.1.5 Consequences of Violation of the Law on Strategic Companies

Transactions executed in breach of the Law on Strategic Companies are deemed void. The parties to a void transaction may be ordered to return everything received under such transaction in a court action. If it is impossible to reverse a deal, a court may

rule to deprive the foreign investor of voting rights at general shareholders meetings of a strategic company if the foreign investor has not complied with the requirements of the Law on Strategic Companies.

2.3 Special Economic Zones

In 2005, the Federal Law On Special Economic Zones in the Russian Federation No. 116-FZ dated July 22, 2005 (the Law on Special Economic Zones) was passed, which introduced new methods for the provision of investment benefits. Under the Law on Special Economic Zones, a special economic zone ("SEZ") is a territory in Russia selected by the government on a tender basis from proposals submitted by regional authorities. A special preferential regime for conducting business activities is to be provided for 20 years to encourage development of high technology industrial areas and health and recreational resorts, and for 49 years to develop transport infrastructure (international cargo sea and river ports and airports).

In December 2005 six geographic locations in various parts of Russia were selected by the government for the creation of SEZs of two types - High Technology Incubation Zones ("TIZs") and Industrial Production Zones ("IPZs").

TIZs will be located in the Moscow Region (Dubna and Zelenograd), St. Petersburg, and Tomsk - four in total. Each zone will have its own specialization: The TIZ in Dubna will specialize in nuclear technology, energy saving, aerospace and civil engineering; the TIZ in Zelenograd will specialize in microelectronics, nanotechnologies and medical studies; St. Petersburg will specialize in the development and testing of computer programs, databases, and complex equipment; while Tomsk will specialize in the development of new technologies and production of new types of materials, micro- and nanoelectronics.

Two selected territories have been chosen to accommodate IPZs - in the Lipetsk Region and in Yelabuga (Tatarstan). The IPZ in Lipetsk will produce consumer appliances, electronics, machinery and construction materials, while the IPZ in Yelabuga will specialize in components for the automotive and petrochemicals industries.

Another type of SEZ, introduced in late 2006/early 2007 is the Zone of Tourism and Recreation ("ZTR"), which will provide for the development of tourism, and health and recreational resorts. Currently seven projects have been selected for ZTRs, to be located in Altai and Buriatia, the Krasnodarskiy, Stavropolskiy and Altaiskiy Territories, and the Kaliningrad and Irkutsk Regions. They are expected to start operating by 2012 and receive over one million visitors annually.

The Port Zone ("PZ") type of SEZ was introduced in late 2007. The exact number of PZs to be created has not been decided yet, but three projects were selected in 2008: the port in the Khabarovskiy Territory, and two airports - in the Krasnoyarskiy Territory and the Ulianovskiy Region. It is expected that several other territories also will be selected for international cargo sea/river-port and airport infrastructure development. Residents will engage in load discharging, warehouse services, transportation and forwarding, ship chandler services, ship maintenance and technical support, wholesale trade, simple assembling, packaging and marking, processing of fish and other sea products, and operation and maintenance of the PZ.

The Federal SEZ Management Agency was created by the Russian Government within the Ministry of Economic Development and Trade (more information on SEZ development is available at www.rosoez and www.rosez.ru). Russian legal entities interested in participating in an SEZ (note - benefits apply to foreign investors only upon the creation of a Russian subsidiary) should obtain the status of an SEZ resident by entering into an agreement on technology implementation activities with an SEZ Administration. The application should be supported by a business plan. A Special SEZ Expert Council (including the SEZ Management Agency, regional and local administration officials, and other SEZ residents and experts) decides on whether the applicant qualifies to be an SEZ resident based on a score evaluation system, taking into account the prior expertise of the applicant (or the founder of the applicant) in the selected industry, calculation of the investment recoupment period, the markets for the developed products, competition and other business risk analysis, intellectual property rights issues, etc. Residents of an IPZ have to invest at least one million euros during the first year of their project and at least ten million overall during the project. PZ residents have to invest 100 million euros if developing new international cargo port infrastructure, 50 million euros if developing a new river-port or airport, and no less than three million euro if reconstructing the infrastructure of existing ports, river-ports or airports.

Residents of SEZs will be provided with the following major tax benefits:

- exemption from Corporate Property Tax, Transport Tax and Land Tax (the latter applicable only to the owners of land plots) for the first five years after a property is acquired;
- a reduced regional portion (13.5%) of the Corporate Profits Tax rate upon the introduction of this benefit in the corresponding Regional Law, resulting in a total Corporate Profits Tax rate of 20% down from the usual 24%; also,

the amended provisions of the Russian Tax Code now allow residents of TIZs, IPZs and even ZTRs to immediately write-off expenditure on scientific research and development works; in addition to that IPZ and ZTR residents will be able to use accelerated amortization for fixed assets, and be able to write-off any losses without limitations, otherwise resulting in a need to carry-forward.

- a Unified Social Tax (UST) on employees' salaries on a regressive scale ranging from 14% down to 2% (usually 26% down to 2%) for TIZs;
- a special "free customs zone" regime for residents of TIZs, IPZs and PZs incorporating the ability to import goods and equipment for the resident company's use with neither import customs duties nor VAT, and the possibility to acquire Russian goods under a 0% export rate of VAT. Services (works) performed by PZ residents will be exempt from VAT. Goods brought into PZs or produced within PZs and exported will be also exempt from excise tax, if it generally may be applicable.

In addition to Special Economic Zones discussed above, ad-hoc legislation on specific free economic zones ("FEZs") was adopted for several regions and is currently still in force. One example of such legislation is the Federal Law On the Special Economic Zone in the Kaliningrad Region of January 10, 2006 (which recently replaced previous legislation of January 22, 1996) and the Federal Law On the Special Economic Zone in the Magadan Region of May 31, 1999.

It is also of note that all gambling businesses will be transferred to four territories (zones) in the Primorskiy, Altaiskiy, and Krasnodarskiy Territories, and the Kaliningrad Region, by July 1, 2009; however, these zones will not provide any special tax benefits.

2.4 Regional Legislation

Prior to investing in a region, and in addition to reviewing the applicable federal legislation, potential investors should also examine regional laws. One of the most distinctive features of the investment climate in Russia has been the competition among various regions of Russia to attract investment, both foreign and Russian. Striving to attract as many investors as possible to their respective territories, and thus improve the social and economic conditions of their regions, the constituent entities of the Russian Federation have passed a large number of laws, regulations, and other legal measures to encourage and regulate investment. Some regions have made special efforts to introduce favorable conditions for foreign investment, while others have enjoyed no success in improving their investment climate.

One of the most progressive regional investment laws was approved in the Leningrad Oblast (region) in 1997. The goal of this law was to develop investment activity in the Leningrad Oblast. To achieve this goal, the law created a "most favorable treatment regime", and provided additional guarantees of state support to investors involved in investment projects having major economic and social importance for the region. Similarly positive, the city of St. Petersburg recently adopted a number of tax incentives aimed at attracting investment into the production sphere there.

Other pro-investment regions include the Samara, Saratov, Nizhnii Novgorod, Sverdlovsk, Novgorod Oblasts (regions), and the Krasnodar, Perm and Khabarovsk Krai (territories), all of which have attracted significant amounts of foreign capital. Laws providing for certain measures aimed at attracting foreign investors, in particular, reduction of taxation rates for investors, have been adopted in Tyumen, Kaluga, Voronezh, Lipetsk, Kemerovo, Orenburg Oblasts (regions) and in the Republic of Mordovia.

Creation of Special Economic Zones in the Russian Federation may also become a new means of attracting investors. The regulatory framework for these territories is established at both federal and regional levels. Laws providing for tax incentives for residents of Special Economic Zones have already been adopted in the Lipetsk, Moscow, Kaliningrad and Tomsk Oblasts (regions), in the Republic of Tatarstan and in St. Petersburg.

3. ESTABLISHING A LEGAL PRESENCE

In Russia, foreign investors may:

- Establish a representative office or a branch of a foreign legal entity;
- Establish a Russian legal entity in the form of an enterprise with foreign investment, which is either (a) entirely foreign-owned, or (b) co-owned with a Russian partner(s); and
- Act directly as a pure foreign investor.

3.1 Representative Office and Branch of a Foreign Legal Entity

3.1.1 Legal Status

A representative office or a branch of a foreign legal entity is not considered to be a Russian legal entity, but rather a body representing the interests of a foreign legal entity in Russia.

A representative office is entitled to carry out liaison and ancillary functions in order to promote the business of its foreign founder. Representative offices are not expected to engage in commercial activities in Russia. Consequently, most representative offices are not subject to profits tax, unless their activities give rise to a "permanent establishment" for tax purposes, *i.e.* when a foreign legal entity engages in regular commercial activity through its representative office (for example, the sale of goods or the provision of services).

A branch is a subdivision of a foreign legal entity, which may fulfill all or part of the functions of its foreign founder. These functions include contracting with Russian entities with payments in foreign currency and rubles, sales and marketing and other business activities.

The obligations imposed on a branch may include the same obligations as those imposed on a representative office. However, a branch has less flexibility in selecting an accrediting authority in Russia compared to a representative office. This can sometimes affect certain areas such as the effectiveness of visa support.

3.1.2 Registration

There are several bodies authorized to grant accreditation to representative bodies, including those responsible for the accreditation of representative offices in a particular industry - representative offices of foreign banks, for example, are accredited by the Central Bank of the Russian Federation. The bodies most frequently charged with the accreditation of foreign entities are the Chamber of Commerce and Industry of the Russian Federation (the "CCI") and the State Registration Chamber at the Ministry of Justice of the Russian Federation (the "SRC").

All documents from a foreign legal entity must be notarized and apostilled/legalized in the country of execution, and any document supplied in a language other than Russian must be accompanied by a translation which has a notarized certification. Accreditation is usually granted for a period of up to three years, with the right to extension.

Branch offices must be accredited by the SRC in accordance with the 1999 Federal Law *On Foreign Investments*.

Following accreditation, the representative office or branch office must carry out a number of post-accreditation procedures before it becomes fully operative, including registration with the State Statistics Committee, with the tax authorities, and with the Russian social benefits funds.

3.2 Forming a Russian Legal Entity

The *Civil Code of the Russian Federation* recognizes, among others, the following types of commercial legal entities:

- General partnerships;
- Limited partnerships;
- Limited liability companies;
- Additional liability companies; and
- Joint stock companies.

The establishment and operations of limited liability companies ("LLC") and joint stock companies ("JSC") are governed respectively by the Federal Law No. 14-FZ *On Limited Liability Companies* dated 8 February 1998 (as amended), (the LLC Law) and the Federal Law No. 208-FZ *On Joint Stock Companies* dated 26 December 1995 (as amended), (the *JSC Law*).

The two most popular forms of corporate structure are LLCs and JSCs.

Choosing Between an LLC and a JSC

In choosing between an LLC and a JSC in establishing a wholly-owned subsidiary, LLCs appear to be more popular than JSCs, because they are easier to establish and finance, since there is no legal requirement that an LLC must register its shares.

A JSC is often a preferred corporate form for joint ventures in Russia for the following reasons. In LLCs a participant is entitled to leave the company in certain circumstances and receive his proportionate share of the value of the LLC's assets and this right may not be waived. In addition, participants in an LLC who either individually or collectively hold at least a 10% interest in the company's charter capital can apply to a court seeking the expulsion of another participant. In order to actually exclude a participant from the LLC, the other participant(s) must prove that the participant substantially hindered the company's operations or materially breached its obligations.

Further, in contrast to the JSC law, the LLC Law contemplates a large number of issues which require a unanimous voting decision of all of the LLC participants.

Starting from July 1, 2009 when the amendments in the LLC Law enter into force, the participants in an LLC will be allowed to regulate their relations by concluding shareholders agreements similar to Western jurisdictions.

3.3 Limited Liability Companies

3.3.1 Number of Participants

An LLC may be established by one or more persons or legal entities (the "participants"). However, if the number of participants exceeds 50, the LLC must be reorganized into an open joint stock company or a production cooperative within one year. An LLC may not have as its sole participant another business entity consisting of a single person.

3.3.2 Rights of Participants

The participants in an LLC have the right to:

- Participate in the management of the LLC in accordance with procedures established by the *LLC Law* and the company's charter;

- Obtain information concerning the activities of the LLC and have access to its accounting and other documents in accordance with the procedures established by the LLC charter;
- Participate in the distribution of profits;
- Sell or otherwise assign their participation interests in the LLC charter capital, or a part thereof, to one or more of the participants in the LLC in accordance with the procedure established by the *LLC Law* and LLC charter; and
- Receive a portion of the assets left after settlement with creditors in the case of the liquidation of the LLC.

The participants in an LLC also have other rights as provided by the *LLC Law*, and may have additional rights set forth in the LLC charter during the establishment of the LLC, or which are granted at a later date by a decision of the LLC's general participants' meeting. The following points should be noted with regard to granting of additional rights to LLC participants:

- Where additional rights are granted by the decision of the LLC's general participants' meeting, this decision must be unanimous; and
- Additional rights granted to a particular participant in the LLC do not transfer to any party acquiring all (or a part) of such participant's ownership interest if it is transferred.

3.3.3 Obligations of Participants

The participants in an LLC are required to:

- Make contributions to the charter capital as specified in the *LLC Law* and the LLC charter (or in the decision on the establishment of the LLC, if there is only one participant in the LLC) and within the time periods specified in the *LLC Law*; and
- Keep confidential all information concerning the activities of the LLC.

Participants in an LLC also have other obligations as provided for by the *LLC Law*, and may have additional obligations set forth during the establishment of the LLC in the LLC charter, or which are imposed on them at a later time by a decision of the LLC's general participants' meeting.

The following issues should be considered when imposing additional obligations on participants of an LLC:

- When additional obligations are imposed by the decision of the LLC's general participants' meeting on all LLC participants, this decision must be made unanimously;
- If additional obligations are imposed by the decision of the LLC general participants' meeting on a particular LLC participant, such decision must be made by a two-thirds majority vote of the total number of votes held by the LLC participants, provided that the LLC participant on whom such additional obligations are imposed voted in favor of such decision or consented to them in writing; and
- Additional obligations imposed on a particular participant(s) in the LLC do not pass to any party acquiring all (or part) of such participant's ownership interest in case it is transferred.

3.3.4 Charter Capital

The charter capital of an LLC consists of contributions made by its participants. The initial charter capital may not be less than RUR 10.000 (approximately USD 280 applying the exchange rate of 36 rubles to one US dollar).

At least 50% of the charter capital amount must be paid by the date of the LLC's registration, and the balance must be paid in full within the first year of its operation. Contributions may be made in cash or in kind, and certain customs benefits may be available for in-kind contributions made by foreign investors. The charter capital may be increased only after the original charter capital has been paid in full.

3.3.5 Participation Interests

A participation interest (*i.e.* an ownership share) in an LLC is not considered a security under current Russian legislation. Therefore, in contrast to the shares of a joint stock company, LLC participation interests do not need to be registered.

Participation interests in an LLC may be sold to third parties if allowed by the LLC charter, but they are subject to the right of first refusal of other participants to purchase the participation interests at the price offered to the third parties. The participants in an LLC if allowed by the LLC charter may have a unilateral right to withdraw from the LLC and to be compensated for their participation interests.

3.3.6 Management Structure

The general participants' meeting is the highest governing body of the LLC. The LLC participants may choose to create a board of directors to govern the operations of the LLC.

The General Participants' Meeting has the right to:

- Amend the charter;
- Define the basic goals and directions of the LLC;
- Delegate to a commercial organization or to an individual entrepreneur the authority reserved to the LLC executive and approve the conditions of the agreements with such organizations or persons, if such decision does not fall into the competence of the Board of Directors in accordance with the LLC charter;
- Assign supplemental rights and duties to the participants in the LLC;
- Approve the annual financial report and the distribution of profits;
- Alter the amount of the charter capital of the LLC;
- Approve regulations governing the internal activities of the LLC; and
- Reorganize or liquidate the LLC, appoint a liquidation commission, and approve the liquidation balance sheet of the LLC.

The daily management of the LLC is the responsibility of the executive body, which may be comprised of one person (the general director) or may consist of both the general Director and the management council. The executive body is responsible for all matters which do not fall within the authority of either the board of directors or the general participants' meeting. The general participants' meeting or (if provided by the LLC charter) the board of directors may choose to delegate the powers of the executive body to an external commercial organization or to an individual manager on a contractual basis.

3.3.7 Registration

With effect from 1 July 2002, the Federal Law *On State Registration of Legal Entities* (the *Registration Law*) transferred the authority for registration of legal entities in Russia to the local bodies of the Federal Tax Service of the Russian Federation. As a result, activities connected with the state registration of legal entities and with their registration as taxpayers are now under the auspices of the local tax inspectorates.

The following documents are required for registration purposes:

- An application;
- The protocol of the founders' meeting or, if the LLC has only one founder, the resolution of the founder on the establishment of the LLC;
- The charter of the LLC;
- A copy of the passport of the proposed general director of the LLC;
- Power(s) of attorney issued by the founder(s) for establishment of the LLC;
- Power(s) of attorney issued by the founder(s)s for filing the application for the state registration of the LLC;
- Confirmation of the legal status of the founder(s) (*e.g.* extract from the trade register or certificate of good standing);
- The charter (articles of association, by-laws) of any foreign legal entities;
- Confirmation of payment of the state registration fee;
- Foreign tax registration certificate of founders (to be provided to a bank);
- Bank letter of good credit standing of a foreign legal entity; and
- Confirmation of the foreign legal entity's contribution to the charter capital of the LLC.

Any Russian founder participating in an LLC must also provide additional documentation. All documents from a foreign legal entity must be notarized and apostilled/legalized in the country of preparation. Any document supplied in a language other than Russian must be accompanied by a Russian translation which has a notarized certification.

3.4 Joint Stock Companies

3.4.1 Types of Joint Stock Companies

A significant number of commercial organizations have been established since the *JSC Law* came into force on 1 January 1996. While the adoption of the *LLC Law* in 1998 introduced another option for investors seeking to establish a corporate entity, the *JSC Law* represented one of the most significant pieces of civil legislation of the post-Soviet era, and JSCs remain among the most important commercial corporate forms and structures for doing business in Russia.

A JSC is a legal entity which issues shares in order to raise capital for its activities. A shareholder of a JSC is not generally liable for the obligations of the JSC, and bears the risk of any such loss only in the amount paid by it for the shares.

Two types of joint stock companies exist in Russia:

- Closed joint stock companies; and
- Open joint stock companies.

An open JSC may have an unlimited number of shareholders. Shareholders in an open JSC are entitled to freely dispose of their shares. The number of shareholders in a closed JSC may not exceed 50, and the JSC must be transformed into an open JSC within one year should this number be exceeded. As with participants in an LLC, shareholders in a closed JSC have a right of first refusal to acquire shares sold by other shareholders to third parties, at the price offered to the third parties. Shareholders in both open and closed JSCs have a preemptive right to acquire newly issued shares that are to be privately placed, in proportion to their existing shareholdings.

Shareholders in an open JSC also have a preemptive right to acquire newly issued shares that are to be publicly placed, in proportion to their existing shareholdings, but do not have a right of first refusal to acquire shares sold to third parties.

All JSCs are required to maintain a shareholders' register. The register includes information about each registered shareholder including the number, category, and classes of shares held. A JSC with more than 50 shareholders must delegate the maintenance and keeping of the shareholders' register to a licensed registrar.

3.4.2 Formation of a Joint Stock Company

Individuals and legal entities may be the founders of a JSC. A company's foundation document, *i.e.* its charter, must include the following information:

- The name, address, and type of the JSC (i.e. open or closed);
- The size of the JSC charter capital;
- The quantity, nominal value, and categories (common or preferred) of shares, as well as the classes of preferred shares issued and distributed by the JSC;
- The rights of the holders of shares of each category;
- The structure and competence of the governing bodies of the JSC, and their decision-making procedures;

- The procedure for preparing for and holding general shareholders meetings, including a list of issues requiring either unanimous consent or a resolution adopted by a qualified majority of votes;
- Information on branches and representative offices;
- Information on the existence of any special right of participation in the management of the company (a "golden share") vested in the Russian Federation, a constituent entity of the Russian Federation, or a municipality of the Russian Federation; and
- Other provisions required by law.

The charter may include other provisions, so long as these comply with applicable Russian legislation.

3.4.3 Charter Capital

The charter capital of an open JSC may not be less than 1,000 times the Russian statutory monthly minimum wage (the monthly minimum wage used for the purposes of calculating the minimum charter capital of the JSC is currently 100 rubles). Currently, using an exchange rate of approximately 36 rubles/USD, the minimum charter capital for an open JSC is approximately USD 2,778. A closed joint stock company must have a minimum charter capital equivalent to at least 100 times the minimum monthly wage - currently approximately USD 278.

In contrast to LLC founders, the founders of a JSC must pay 50% of the JSC charter capital within three months following its state registration, with the balance payable in full within the first year.

3.4.4 Shares and Other Types of Securities

A JSC can issue securities in the form of shares, bonds, and issuer's options. Such securities must be registered with the Federal Service for the Financial Markets of the Russian Federation (the "FSFM"), which replaced the former Federal Commission for the Securities Market (the "FCSM") in March 2004. A JSC can issue common shares and/or several classes of preferred shares. The total value of a JSC's preferred shares may not exceed 25% of its charter capital.

The concept of a "fractional share" was introduced on 1 January 2002. A fractional share is a share representing a portion of a whole share, which can come into existence when it is not possible to acquire the whole share during the consolidation of shares, when a shareholder exercises its preemptive right, or in the course of acquiring nerwly-issued shares. A fractional share grants its owner the same rights that are granted by the whole share of the corresponding category or class, on a pro rata basis.

3.4.5 Management Structure

Both open and closed JSCs must maintain two governing bodies: the general shareholders meeting and the Executive Body. An open JSC with more than 50 shareholders must also have a board of directors (also called a supervisory board). An open JSC with less than 50 shareholders and all closed JSCs may appoint a board of directors, although this is not a requirement. The authority of the board of directors is defined by the charter of the JSC and, if a Board is not provided for in the charter, the corresponding authority must be vested with the JSC's general shareholders meeting.

In addition to the foregoing governing bodies, a JSC must either establish an internal auditing commission or elect an internal auditor to oversee its financial and economic activities, members of which must be elected by the shareholders.

The general shareholders meeting is the highest governing body overseeing the activities of a JSC. Its authority is outlined in the *JSC Law* and cannot be altered. Each common share carries one vote at the general shareholders meeting (except for cases of cumulative voting where provided for in the *JSC Law*), and most decisions are made by a simple majority vote, although for certain key decisions a supermajority of 75% is required.

The daily management of a JSC is the responsibility of the executive body, which may be comprised of one person (the general director) or may consist of both the general director and the management council. The executive body is responsible for all matters which do not fall within the authority of either the board of directors or the general shareholders meeting. The general shareholders meeting may (by a majority vote), choose to delegate the powers of the executive body to an external commercial organization or to an individual manager on the contractual basis: however this decision may be taken only pursuant to a proposal from the board of directors (if the company has a board of directors).

3.4.6 Registration

Effective as of 1 July 2002, the procedure for state registration described in Section 3.3.7 above in respect of LLCs is also applicable to JSCs: the only additional requirement in respect to JSCs is the registration of the issuance of the JSC shares with the FSFM, which is obligatory at the establishment of the company and when increasing the charter capital of the JSC.

4. ISSUANCE AND REGULATION OF SECURITIES

4.1 Introduction

The securities market and securities transactions within the Russian Federation are primarily regulated by Federal Law No. 39-FZ *On the Securities Market* (the *Securities Law*), dated 22 April 1996 (as amended). The offering of corporate securities is regulated by Federal Law No. 208-FZ *On Joint-Stock Companies* (the *JSC Law*), dated 26 December 1995 (as amended) and (with regard to credit institutions) by Law No. 395-1 *On Banks and Banking Activity*, dated 2 December 1990 (as amended). While recent years have seen considerable discussion on changes to the applicable legislation and the structure of the securities markets in general, to date such changes have been limited to the adoption of Federal Law No. 152-FZ *On Mortgage-Backed Securities* (the *MBS Law*), dated 18 November 2003 (as amended). The issuance of securities in the Russian Federation is also subject to a number of regulations issued by the Federal Service for the Financial Markets of the Russian Federation (the FSFM), and other regulatory agencies, as well as the general provisions of the *Civil Code*.

4.2 Securities in General

Particular instruments will not be considered securities unless they are specifically recognized as such under Article 143 of the *Civil Code* or other relevant securities laws.

Generally, all types of securities existing in the Russian Federation can be divided into two large groups: those which should be issued in compliance with a specific issuance procedure prescribed by the *Securities Law* and require registration with the securities regulator (such securities are usually referred to as "emissionnyie") and those which need not be registered ("ne-emissionnyie").

In some certain cases the *Securities Law* also requires a prospectus to be registered simultaneously with registration of the securities issue, namely:

- when securities are to be distributed through a public offering;
- when securities are to be distributed through a private placement among existing holders, whose number exceeds 500.

A prospectus may also be registered if securities are intended to be publicly traded.

The *Securities Law* also provides for disclosure of certain financial and other information by issuers, who have registered a prospectus. Such information includes:

- quarterly reports of the issuer (drafted in compliance with the FSFM requirements),
- material events which may affect the finances or the business activities of the issuer (a list of such events is established by the FSFM).

Generally information should be disclosed through one of the authorized news agencies (within one day of occurrence), through an internet site (within two days of occurrence) and in some cases relevant information should also be published in a printed publication that complies with requirements set out by the FSFM.

4.3 Equity Securities

Russian joint-stock companies (JSCs) may issue shares, options on shares, corporate bonds, and other securities. Open joint-stock companies may raise capital either by issuing shares to the public or by private placement. Shares of closed joint-stock companies may not be offered to the general public. Shares in a limited liability company are not deemed to be securities and cannot be used for raising capital from the general public.

4.4 Debt Securities

The issuance of corporate bonds is regulated by the *Civil Code*, the *JSC Law*, the *Securities Law* and, in respect of limited liability companies, by Federal Law No. 14-FZ *On Limited Liability Companies*, dated 8 February 1998 (as amended), (the *LLC Law*). This legislation introduced the concept of secured and unsecured bonds. Secured bonds must be fully secured with a third-party guarantee or suretyship, or with a pledge (or a mortgage) over the issuer's and/or third party's securities or immovable

property. Only companies (including credit institutions) which have existed for a minimum of two years may issue unsecured bonds. The above legislation provides that the par value of all unsecured bonds issued by a company must not exceed the charter capital of the company or the amount of a guarantee provided by a third party. The issuance of mortgage backed bonds and exchange bonds may be exempt from this restriction. Russian JSC's may also issue bonds convertible into shares.

Two specific types of securities were introduced in 2003 to facilitate mortgage securitizations. Pursuant to the *MBS Law*, Russian banks and certain other entities may issue mortgage-backed bonds and mortgage-participation certificates. Such securities must be backed by loan receivables secured by mortgages over real estate.

Besides bonds, Russian companies commonly use promissory notes and bills of exchange for debt financing. Under Russian law, promissory notes and bills of exchange are treated as securities. The legal regime for promissory notes and bills of exchange is prescribed in Federal Law No. 48-FZ, *On Promissory Notes and Bills of Exchange*, dated 11 March 1997. In addition, the Russian Federation is a party to the *Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes* (Geneva, 7 June 1930).

4.5 Russian Depositary Receipts (RDRs), Exchange Bonds, Investment Units

RDRs

An RDR is a registered issuable security without a nominal amount which certifies the right to a specified amount of shares or bonds of a foreign or Russian issuer of RDRs and the provision of services in connection with the realization of rights by a Russian holder of an RDR.

Only a Russian depository which has been in business for 3 or more years and is a professional participant in the securities market can issue RDRs. RDRs are documented bearer securities and are stored centrally by the issuer. In the event that the issuer performs services relating to the acquisition of income on shares or bonds certified by the RDRs, it must open separate depository accounts for the benefit of the holders of the RDRs. According to the issuer's obligations, funds in such accounts may not be executed.

A foreign issuer assumes obligations to Russian RDR holders by entering into an agreement governed by Russian law with a depository. Such agreement must specify

the order of voting under such securities, the obligation of the foreign issuer to disclose information in Russian, and other information. This agreement cannot be terminated without the consent of the RDR holders. Where a foreign issuer does not assume obligations to Russian RDR holders, public circulation of RDRs will only be allowed if the securities of such foreign issuer are listed on the foreign stock exchanges which feature on a list drawn up by the FSFR.

It should be noted that the RDR is a newly introduced type of security for the Russian financial market and no RDRs have been issued at the time of writing.

Exchange Bonds

Exchange bonds differ from ordinary bonds in that they can be issued through a simplified procedure. Maturity of exchange bonds may not exceed 36 months. The issuance, prospectus and placement report do not need to be registered. However, the following conditions are set out, inter alia: (i) the placement must be made through a public offering; (ii) the issuer must be a Russian company, a state corporation or an international financial institution, whose shares or bonds are listed on a stock exchange permitting the trading of exchange bonds; (iii) the issuer must have existed for 3 years and have annual accounts for the two closed financial years; (iv) exchange bonds may not be issued with pledge collateral; (v) the FSFM must be notified of the admittance to trading and placement on the stock exchange; (vi) such bonds may only be placed on one stock exchange although they may subsequently be circulated on other exchanges provided certain procedural rules are complied with.

Investment Units of Mutual Investment Funds ("Investicionnij Paj")

Pursuant to Federal Law No. 156-FZ *On Investment Funds* (the *Investment Funds Law*), dated 29 November 2001 (as amended) mutual investment funds are considered to be a property complex and not legal entities. Mutual investment funds are managed by a management company, which acts on behalf of the founders pursuant to a trust agreement. Management companies need to be licensed. An investment unit is a registered security issued by a management company, certifying the share of its holder in the ownership right to the property composing an investment fund and property resulting from the management.

The *Investment Funds Law* and relevant FSFM acts provide detailed regulation of various issues regarding investment funds, including the foundation, decision-making and asset structure thereof. Managing companies of mutual investment funds are also subject to certain information disclosure requirements (*e.g.* information on the value of an investment share).

4.6 Infrastructure of the Securities Market

The *Securities Law* regulates the status of professional participants of the securities market and provides the legal requirements for their operations. The activities of professional participants of the securities market are subject to licensing by the FSFM, and the procedures for obtaining a license and the requirements for professional participants of the securities market are prescribed in various regulations adopted by the FSFM. A summary of the types of professional participants of the securities market that are subject to FSFM licensing and regulation is set forth below.

4.6.1 Brokers, Dealers, and Trust Managers of Securities

Under the *Securities Law*, brokers are professional participants of the securities market who perform transactions with securities on behalf of and at the expense of their clients (investors or issuers) or on their own behalf and at the expense of a client.

Dealers are defined as professional participants of the securities market who perform transactions with securities on their own behalf and for their own account by declaring in public the bid/ask prices with the obligation to buy and/or sell securities at such prices.

Trust managers of securities are professional participants of the securities market who manage the securities of their clients under a trust management agreement. Trust management may be exercised over securities, money for investment in securities, and also assets and securities derived from such management activities.

4.6.2 Registrars, Depositories

Under the *Securities Law*, registrars are professional participants of the securities market who are charged with maintaining the register of securities owners. If a joint-stock company has over 50 shareholders, it must appoint a professional licensed registrar to maintain its shareholders' register. (A joint-stock company with 50 or less shareholders may maintain its own shareholders' register.)

Under the *Securities Law*, depositories are professional participants of the securities market who hold certificates of securities and/or record the transfer of rights to the securities. The conclusion of a depositary contract does not involve the transfer to the depositary of the right of ownership of the depositor's securities. The depositary has no right to dispose of the depositor's securities, to manage them, or to perform any actions with securities on behalf of the depositor, except for those performed on the depositor's order in cases provided for by the depository contract.

4.7 Organizers of Trade, Stock Exchanges, and Clearing Organizations

Under the *Securities Law*, "organizers of trades" are professional participants of the securities market who render services which directly facilitate the conclusion of transactions with securities among the participants of the securities market. The *Securities Law* requires organizers of trades to disclose information on the rules for trading, rules for the circulation of securities, rules for the conclusion and registration of transactions with securities and other information related to trade to any interested party.

The Russian Federation has several well-established stock exchanges in Moscow and throughout the country, including MICEX (Moscow Interbank Currency Exchange), RTS (Russian Trading System Stock Exchange), and certain others. A legal entity may exercise the activity of a stock exchange as a non-profit partnership or as a joint-stock company.

Under the *Securities Law*, clearing organizations are professional participants of the securities market that clear settlements under transactions with securities. Typically, a clearing organization will work closely with a stock exchange (*e.g.* MICEX Clearing House, RTS Clearing Center, etc.).

4.8 Regulation of the Securities Market

4.8.1 The Federal Service for the Financial Markets

Pursuant to Presidential Decree No. 314 dated 9 March 2004, the FSFM has replaced the FCSM as the primary regulator of the Russian securities market. The main functions of the FSFM, which it carries out either directly or through its authorized territorial agencies, include: the licensing and supervision of professional securities-market participants; the authorization of self-regulatory organizations; the registration of securities issuances and prospectuses and the approval of standards for them; the issuance of approvals for issuing securities outside the Russian Federation; and the classification and definition of different types of securities. The FSFM has the authority to take certain actions against professional participants of the securities market who have breached securities market regulations. Such measures include the suspension and revocation of licenses, enforcement actions, and petitions for criminal prosecution. In addition, the FSFM has the power to fine legal entities or individual entrepreneurs for various securities law violations. Any action pursued against issuers,

such as the invalidation of an issuance, must be effected through the courts. Consequently, the ultimate jurisdiction over breaches of securities laws remains with the courts.

As for banks, certain regulatory functions (including registration of securities, etc.) have been transferred from the FSFM to the Central Bank of the Russian Federation. Issuance of securities by state and municipal authorities also falls outside the domain of FSFM regulation and is regulated by the Ministry of Finance.

4.8.2 Self-Regulating Organizations ("SROs")

Under the *Securities Law*, an SRO is a voluntary association of professional participants in the securities market functioning on the principles of a non-profit organization established for the provision of their professional activity, the observance of standards of professional ethics, the protection of the interests of owners of securities and the implementation of regulations and standards to ensure the effective functioning of the securities market. Membership in an SRO is not mandatory.

4.9 Regulation of Certain Securities Transactions

4.9.1 Acquisition of More Than 30%, 50% and 75% of Voting Shares of an Open Joint-Stock Company

According to the *JSC law* a person who intendeds to buy more than 30% of voting shares in a company (including shares owned by its affiliates) should make an offer to the shareholders of the company (the "Voluntary Offer") to purchase their shares. A shareholder who together with its affiliates acquired more than 30%, 50% or 75% of the voting shares of a company must make an offer (the "Obligatory Offer") to purchase the remaining shares. The *JSC Law* provides general requirements as to terms, form and content of such an Obligatory and Voluntary Offer. The law also sets certain limitations with respect to determination of the price of purchased shares.

4.9.2 Acquisition of Remaining Shares by a Person Who Acquired More Than 95% of a Company's Voting Shares ("Squeeze Out")

Under the *JSC Law* a shareholder who has acquired more than 95% of a company's voting shares (as a result of an Obligatory Offer or Voluntary Offer) is entitled to purchase the remaining shares in the company and securities convertible to such shares. On the other hand a minority shareholder is entitled to demand purchase

of his shares. Pursuant to Federal law No. 7-FZ on amending the *JSC Law* dated 5 January 2006 the same right is granted to a shareholder who owns more than 95% of a company's voting shares as of 1 July 2006, in this case a minority shareholder is entitled to demand purchase of his shares before 1 August 2008.

4.10 Placement and Circulation of Russian Shares Overseas

Generally, no more than 30 per cent of shares in the capital of a Russian company may be placed outside Russia and even lower thresholds apply to "strategic" companies, namely:

- 5 per cent for the "strategic" companies conducting a geological survey at and/or exploration and development of deposits of federal significance (i.e. major deposits);
- 25 per cent for other "strategic" companies.

These requirements are intended to keep liquidity of Russian issuers within domestic financial markets and restrict foreign investment in certain strategic industries.

4.11 Regulation of Derivatives in Russia

4.11.1 General Overview

Although derivative transactions have been used in practice in Russia for some time, only some aspects of them have been dealt with by the law or courts, for instance, by the amended Article 1062 of the RF Civil Code, several normative acts of the Central Bank of Russia, the Federal Securities Market Commission, and in Russian tax legislation.

Prior to 2007, courts had denied judicial protection to claims based on non-deliverable derivatives transactions under Russian law unless they had an economic purpose. Courts were applying the rule on gambling laid down in Article 1062 of the RF Civil Code. On the contrary, deliverable transactions were treated as enforceable because they included an obligation to transfer the underlying asset (such as a particular currency or securities).

In 2007, amendments to Article 1062 were introduced which extended protection to claims based on "an obligation of a party or parties to the transaction to pay monetary amounts depending on the changes of prices for goods, securities, foreign

exchange rates, interest rates, levels of inflation, or parameters calculated based on an aggregate of such indicators, or on the occurrence of another circumstance is provided by law and relative to which it is unknown whether it will occur or not", provided that one of the parties to the transaction holds a license for banking operations or a license of a professional market participant. Since then, there have been a number of court precedents in which non-deliverable derivatives have been granted judicial protection.

4.11.2. The ISDA Master Agreement in Russia

The ISDA Master Agreement is often used by foreign companies in contracting Russian counterparties. Such agreements are typically governed by non-Russian law. If Russian law were to apply to the ISDA Master Agreement (for instance, if in the opinion of the respective court the parties did not rightfully choose foreign law to govern their relationship), some of the agreement's provisions may not be enforceable, while in general the contract would be valid. Russian law does not require a license or similar authorization of any party for derivative contracts governed by foreign law.

4.11.3. Netting

It is unclear whether the netting mechanism would stand in a Russian bankruptcy scenario, since netting is not expressly dealt with by Russian law and Russian court practice has not yet considered it as distinct from set-off of claims. This may lead by analogy to application of the rules for set-off of claims to netting. Set off is not possible after instituting bankruptcy proceedings or if such set off, made within 6 months prior to a bankruptcy petition being filed with the court, led to the preferential treatment of the claims of one creditor[1].

5. COMPETITION PROTECTION LAW

The basic law for antimonopoly regulation in the Russian Federation is the *Federal Law on Protection of Competition* (the "*Competition La*w"), adopted on 26 July 2006, effective as of 26 October 2006. Antimonopoly issues in the Russian Federation are under the auspices of the Federal Antimonopoly Service (the "FAS").

The Competition Law regulates competition in both the commodities market and the financial services market and includes seven main areas of particular interest to foreign investors:

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[1] *See* Article 103.3 of the Bankruptcy Law

- Abuse of a dominant position;
- Agreements limiting competition;
- State aid;
- Establishment of companies;
- Mergers and acquisitions;
- Unfair competition; and
- Requirements for tenders and selection of a financial organization by subjects of natural monopolies and various state and municipal bodies for provision of financial services under government tenders.

Please note that the regulations outlined in this chapter are effective as of the date of this guide, however, a number of amendments to the Competition Law are expected to be adopted in the next several months, and therefore it is recommended to reconfirm with Baker & McKenzie lawyers whether the regulations of interest to the reader contained herein have undergone any significant changes.

5.1 Abuse of a Dominant Position

Dominant entities are subject to certain restrictions on their activities. Determining whether a particular entity enjoys a dominant position involves a complex evaluation of various factors, the most important of which is the entity's market share.

For entities with a market share of 50% or greater, there is a presumption of market dominance.

Entities with a market share of between 35% and 50% are deemed dominant, provided their dominant position has been established by the FAS.

For entities with a market share of 35% or less, there is a conclusive presumption of non-dominance, with a few exceptions provided by the Competition Law.

The FAS deems a financial organization to be a dominant entity according to the criteria/thresholds set down by the Russian Government together with the Russian Central Bank. A financial organization whose share in any single market in the Russian Federation does not exceed 10%, or whose share does not exceed 20% in a commodity market where the commodity also circulates in other commodity markets in the Russian Federation, may not be deemed dominant.

When determining market share, the FAS may take into account not merely one company in isolation but also the group of companies to which it belongs. The "group" will include all persons/legal entities related by a common controlling share ownership, contractual or other de facto management control.

In addition to the term "dominant position" the Competition Law introduced a new concept of "collective dominant position", i.e. the collective domination of the market by between three and five independent companies. According to the Competition Law, a participant in this collective domination can occupy only 8% of the market and will be viewed as a violator in case it, together with one or two other participants jointly have more than 50% of the commodities' market share, or, together with up to four other participants jointly hold more than 70% of the commodities' market share, and such entities meet certain criteria specified in the Competition Law.

For those in a dominant position, the Competition Law prohibits any of the following activities:

- Setting and/or maintaining of monopolistically high or low prices;
- Withdrawal of goods from circulation if the result of such a withdrawal is a rise of the price of the goods;
- Creation of conditions that place one or more business entities in an unequal position as compared to other entities in their ability to access the market for particular goods (creation of discriminatory conditions);
- Imposition of contractual terms that are disadvantageous to the other party or do not relate to the subject matter of the contract on a contracting party (and which are not economically or technologically substantiated);
- Discontinuance or reduction of production of goods for which there is a consumer demand if it is possible to produce them on a profitable basis;
- Unjustified refusal to enter into a contract with particular customers if it is possible to produce or deliver the relevant goods to such customers;
- Setting different prices on the same goods where it is not economically or technologically substantiated;
- Creation of barriers for market entry or market exit for other business entities; or
- Violation of pricing rules established by legislation.

Some of the above activities may be allowed if the dominant entity is able to prove that the positive effects of a particular activity outweigh its negative consequences pursuant to the criteria set in the Competition Law.

5.2 Agreements Limiting Competition

The Competition Law prohibits agreements, transactions, or other business activities of business entities that lead or may lead to the following:

- Control or fixing of prices, discounts, bonus payments, or surcharges;
- Increase or reduction of prices or the manipulation of prices at tenders;
- Division of the market by reference to territories or according to the volume of sales/purchases, the range of marketable goods, or the range of sellers or buyers;
- Refusal to enter into a contract with particular sellers or customers without economic or technological justification;
- Imposition of contractual terms that are disadvantageous to the other party or do not relate to the subject matter of the contract;
- Setting different prices on the same goods without economic or technological justification;
- Discontinuance or reduction of production of goods for which there is a consumer demand if it is possible to produce them on a profitable basis;
- Restriction of access to the market or the removal from the market of other entities that sell or purchase particular products; etc.

The Competition Law further prohibits other agreements if such agreements lead or may lead to limitation of competition, with the exception of "vertical agreements" (agreements between economic entities not competing with each other, one of which acquires goods or is the potential acquirer, while the other supplies goods or is the potential seller) which are permitted by the Competition Law ("vertical agreements" between economic entities where the market share of each one is less than 20% or "vertical agreements" in written form which are commercial concession agreements).

In certain cases, some of the above-mentioned activities may be permitted if it can be proved that the positive effects of the action, including effects in the socio-economic sphere, outweigh its negative consequences pursuant to the criteria set in the Competition Law, or if it can be proved that federal laws permit such agreements or business activities.

The Competition Law prohibits the so-called "*coordination of economic activities*" by economic entities, if such coordination may lead to restriction of competition. "Coordination of economic activities" is understood as coordination of the actions of economic entities by a third person who does not belong to the "group of persons" at such economic entities.

5.3 State Aid

State aid is new to Russian competition legislation and was introduced by the Competition Law of 2006.

In accordance with the Competition Law, state (or municipal) aid consists in granting an economic entity certain privileges over other market participants, ensuring more favorable conditions for their activity in the relevant market by transferring property and (or) civil rights or providing priority access to information.

The Competition Law regulates the procedure of providing state (or municipal) aid for the following purposes:

- ensuring life activity of the population in Arctic regions and equivalent areas;
- carrying out fundamental scientific research;
- environmental protection;
- cultural development and conservation of the cultural heritage;
- agricultural production;
- support of small businesses engaged in high priority activities;
- rendering social services to the population; and
- rendering social support to unemployed citizens and facilitating employment of the population.

State (or municipal) aid shall be granted with the preliminary written approval of the FAS unless such aid is directly granted by a federal law, a law of a Russian Federation constituent entity or a regulatory act of the local government on the budget for the following year, or is granted from the reserve funds of the executive body of a constituent entity of the Russian Federation or the reserve funds of the local government.

In order to provide state (or municipal) aid, the authority intending to grant the aid submits an application to the FAS for approval to grant such state (or municipal) aid together with (a) a draft act which provides for the granting of the state (or municipal) aid with an indication of the goals and amounts of the aid; (b) a list of the beneficiary entity's activities over the two years preceding the date of the FAS application; and other information as provided for by the Competition Law.

The FAS shall make a decision on the application within two (2) months from the moment it is submitted together with all necessary documents. The FAS may extend the period for its review of the application for a term of up to two (2) months. If the FAS approves the granting of state (or municipal) aid, the authority granting the aid must submit documents confirming observance of the restrictions as indicated in the FAS approval within one (1) month after the aid has been granted.

5.4 Establishment of Companies

The founders of a new company must notify the FAS prior to the establishment of a company only if the charter capital of the company being established is paid by shares and/or property of another legal entity and the company acquires (as payment of the charter capital) more than 25%/50%/75% of such shares or more than $^{1}/_{3}$ / 50% / $^{2}/_{3}$ of such participatory shares, or where the company acquires more 20% of the main production facilities and (or) intangible assets (exclusive of most types of buildings and land plots) of another legal entity, and where the thresholds provided in the Competition Law are met.

According to specific conditions provided by the Competition Law the establishment of a company whose charter capital is paid by shares and/or property of a financial organization may be subject to a mandatory pre-establishment FAS notification. Such conditions are similar to those described above with respect to entities acting in the commodities market but contain certain differences that should be considered separately.

5.5 Mergers and Acquisitions

5.5.1 Mergers

Entities involved in a consolidation or a merger must obtain the prior approval of the FAS if the aggregate asset value of the entities exceeds 3 billion RUR or the aggregate revenue earned by the entities and their "group of persons" from sale of goods during the past calendar year exceeds 6 billion RUR or if either of the entities is included in the FAS Register of Entities with a market share exceeding 35% in the relevant market. The procedures for obtaining such approval are similar to the procedures used for acquisitions.

5.5.2 Acquisition of an Interest, Assets and Rights in a Russian Company

Acquisition of Shares/Participatory Interest in a Russian Company

When an individual, legal entity or group of persons acquires more than 25%/50%/75% of voting shares or more than $^{1}/_{3}$ / 50% / $^{2}/_{3}$ of participatory shares in an entity, such persons, entities or group of entities must receive prior approval from the FAS if:

- the aggregate book value of the assets of the acquirer and its "group of persons" plus the target and its "group of persons" exceeds 3 billion RUR and the balance sheet value of the total assets of the target and its group exceeds 150 million RUR; or
- the aggregate revenue earned by the acquirer and its "group of persons" plus the target and its "group of persons" from sale of goods over the past calendar year exceeds 6 billion RUR and the balance sheet value of the total assets of the target and its group exceeds 150 million RUR; or
- either the acquirer, or any of its "group of persons", or the target, or any of its "group of persons", is included in the FAS Register of Entities with a market share exceeding 35% in the relevant market.

Acquisition of Assets in a Russian Company

When an individual, legal entity or group of persons acquires the right of ownership or the right to use the main production (fixed) assets or intangible assets of an entity, if the acquired assets account for more than 20% of the book value of the main

production (fixed) assets and intangible assets of the selling entity, such persons, entities or a group of entities involved in the acquisition must receive prior approval from the FAS if:

- the aggregate book value of the assets of the acquirer and its "group of persons" plus the target and its "group of persons" exceeds 3 billion RUR and the balance sheet value of the total assets of the target and its group exceeds 150 million RUR; or
- the aggregate revenue earned by the acquirer and its "group of persons" plus the target and its "group of persons" from sale of goods during the past calendar year exceeds 6 billion RUR and the balance sheet value of the total assets of the target and its group exceeds 150 million RUR; or
- either the acquirer, or any of its "group of persons", or the target, or any of its "group of persons", is included in the FAS Register of Entities with a market share exceeding 35% in the relevant market.

The main production (fixed) assets or intangible assets of an entity taken into account for the purposes of the above calculation do not include land plots and non-industrial purpose buildings, constructions, premises and parts thereof or unfinished construction objects.

Acquisition of Rights in a Russian Company

When an individual, legal entity or group of persons acquires rights conferring the ability to determine the commercial behavior of the target company (including as a result of change of indirect control over a Russian target company) or of the right to perform the functions of its executive bodies, such persons, entities or group of entities involved in the acquisition must receive prior approval from the FAS if:

- the aggregate book value of the assets of the acquirer and its "group of persons" plus the target and its "group of persons" exceeds 3 billion RUR and the balance sheet value of the total assets of the target and its group exceeds 150 million RUR; or
- the aggregate revenue earned by the acquirer and its "group of persons" plus the target and its "group of persons" from sale of goods over the past calendar year exceeds 6 billion RUR and the balance sheet value of the total assets of the target and its group exceeds 150 million RUR; or

- either the acquirer, or any of its "group of persons", or the target, or any of its "group of persons", is included in the FAS Register of Entities with a market share exceeding 35% in the relevant market.

In practice, the FAS supervises those offshore mergers or other transactions involving the acquisition of shares, as a result of which indirect control over a Russian entity changes. It is presumed by the FAS that as a result of an indirect change of control of a Russian legal entity, the foreign entity acquiring the shares would obtain rights over the Russian entity which would allow it to determine the conditions of this Russian entity's business activity.

Depending on the asset value threshold, the acquisitions described above need to be either preliminarily approved by FAS or only notified to the FAS post-closing.

In determining the threshold for asset values, FAS takes into consideration not only the acquirer and the target company, but also all persons (individuals or legal entities) in the acquirer's "group of persons." The broad term "group of persons" includes all individuals or legal entities related to the acquirer as a result of controlling share ownership or through certain management contracts, familial relations, and/or other *de facto* control mechanisms.

Where a merger or acquisition takes place between entities in the same "group of persons", and where preliminary approval by the FAS is required by law, the Competition Law permits the application for preliminary approval to make a post transaction notification to the FAS within 45 days after the transaction is completed. In this case the group structure must be submitted to the FAS no later than one (1) month prior to the transaction, and may not change until after the transaction is completed.

The Competition Law contains separate articles for the acquisitions of interest, assets and/or rights in *financial organizations* which are subject to a pre-acquisition FAS notification, and the articles contain specific conditions and thresholds applicable to such acquisitions concerning financial organizations that should be considered separately.

5.5.3. Procedures and Timing

If the FAS determines that an establishment, merger, or acquisition may restrict competition or strengthen a dominant position, it may request additional information and documentation. The FAS may also require the parties to take measures to ensure competition.

After all documents have been submitted, the FAS has thirty (30) days to review the application or notification. If the FAS believes that the transaction may lead to restriction of competition, the review period may be prolonged for an additional two (2) months, during which the FAS places information about the transaction on its official web-site and invites all interested parties to send their opinions to the transaction.

5.6 Unfair Competition

Unfair competition, namely any actions of commercial entities aimed at acquiring competitive advantages in commercial activity which contradict the Competition Law, business customs, the requirements of good-faith, reasonableness and fairness, which may or have caused losses to other competing legal entities, or damage their business reputation, is prohibited in Russia.

Types of activities, which constitute unfair competition, include:

- distribution of false, inaccurate or distorted information, which may cause losses to a commercial entity or damage this entity's business reputation;
- misleading consumers about the nature, methods and place of production, as well as consumer properties and quality of goods;
- incorrect comparison by a commercial entity of goods produced or sold by this entity with the goods of other commercial entities;
- sale of goods with illegal use of the results of intellectual activity (i.e., intellectual property) and of the means of individualization of a commercial entity, products, or services, such as trademarks, logotypes and other objects of intellectual property;
- receipt, use and disclosure of scientific and technical, production or trade information, including commercial secrets, without the consent of the commercial entity to which this information belongs, etc.

5.7 Requirements for Tenders and Selection of a Financial Organization by Subjects of Natural Monopolies and Various States and Municipal Bodies

The Competition Law provides for a list of actions in conducting tenders (including governmental tenders) which are prohibited if they lead to restriction of competition.

All federal and municipal bodies, bodies of Russian Federation constituent entities and subjects of natural monopolies shall select a financial organization by holding a public tender (in the procedures set down by other federal laws) to render certain number of financial services for them, a full list of which is provided by the Competition Law, and which includes granting credits, rendering services on the securities market and under leasing contracts, attraction of monetary funds of legal entities for deposits, opening and maintaining bank accounts of legal entities, and making settlements with these accounts, etc.

6. TAXATION

6.1 Introduction

Over the past 10 years, Russia has been engaged in a significant reform of its tax system, which has been implemented in phases. This reform has improved procedural rules and made them more favorable to taxpayers, has reduced the overall number of taxes, and has reduced the overall tax burden in the country.

Part I of the *Tax Code of the Russian Federation* (the "*Tax Code*") came into effect in 1999, dealing largely with administrative and procedural rules. The latest significant amendments to Part I clarified certain administrative and procedural issues raised by over ten years of practice of the application of Part I of the Tax Code (in particular, regarding tax audit procedures, procedural guarantees for taxpayers, operations with taxpayer bank accounts and bank liability). Starting January 1, 2009, taxpayers are required to adverse appeal tax inspectorate decisions on a tax audit to a higher-tier tax authority before bringing a court claim. The provisions of Part II of the *Tax Code* regarding excise taxes, VAT, individual income tax, and the unified social tax came into force in 2001, followed by the profits tax and mineral extraction tax provisions of the *Tax Code* in 2002.

In 2003, further amendments introduced a simplified system of taxation, a single tax on imputed income, a new Chapter on transportation tax, and established a special tax regime for production sharing agreements in Russia. A Chapter on corporate property tax came into effect as of January 1, 2004. In 2005 the water tax, land tax, and state duty Chapters came into effect. Most of these Chapters of the Tax Code replaced and significantly updated or improved individual tax laws that initially were enacted as for back as 1991. The remaining Chapter of the *Tax Code* still under review covers the property tax on individuals, which is currently governed by the old 1991 legislation. In 2006, the inheritance and gift tax that was in existence since 1991 was repealed. In addition, over the last several years, various amendments have been made to the *Tax Code*, including several recent key changes largely intended to address the economic downturn in Russia.

The Russian authorities have announced that more tax reforms may follow, including revision of the social taxes, proposals to further modify the provisions governing the dividend exemption for "strategic investments," transfer pricing and tax consolidation for certain groups of taxpayers. Thus, tax reform continues to be an ongoing process.

6.2 Types of Tax

The *Tax Code* sets forth three levels of taxation: federal, regional and local. Currently, federal taxes include VAT, excise taxes, profits tax, unified social tax, personal income tax, mineral extraction tax, state duty, special tax regimes, and several other taxes. Regional taxes include corporate property tax, transportation tax, and gambling tax, while local taxes include land tax and individual property tax.

There are four types of special tax regimes that may be applicable to certain activities and/or categories of taxpayers: single agriculture tax, simplified system of taxation, single tax on imputed income from certain kinds of activity, and taxation of production sharing agreements. These special tax regimes have the status of a federal tax and may provide exemptions from certain federal, regional, and local taxes.

6.3 Tax Audits

The Russian tax authorities may conduct off-site or on-site tax audits of taxpayers. Amendments that came into affect starting from January 1, 2009 clarified certain procedural aspects for both types of tax audits. Tax authorities may audit several different taxes simultaneously as part of on-site tax audits. However, except in cases

of a liquidation or reorganization, when a higher tax authority inspects the activities of a lower tax authority that conducted an on-site audit, or when a taxpayer files an amended tax return claiming a lower level of taxation, a tax for a given period may only be audited once. The taxpayer may also be repeatedly inspected for the same tax period upon a decision of the Head of the Federal Tax Service of Russia. In case during repeat tax audit the tax authorities find an underpayment that was not found during a previous tax audit, the penalty for such underpayment would not be applied to the taxpayer, except for cases where the undetected violation resulted from a conspiracy between the taxpayer and the tax authorities. In exceptional cases provided by the Tax Code, the Russian tax authorities may suspend an on-site tax audit. However the overall term of suspension in any case may not exceed nine months. The results of a tax audit relating to reviewed taxes may only be reconsidered by supervising tax authorities. In any case, however, tax authorities may only audit the three calendar years preceding the year of the tax audit. As a general rule, a three-year statute of limitations applies to the imposition of penalties for tax violations, although according to a position taken in Constitutional Court Ruling No. 9-P, dated July 14, 2005, this type of defense could be rejected by the court if the taxpayer impeded the tax audit by the tax authorities. Also, the tax authorities may levy for outstanding taxes and late payment interest unilaterally without a court decision. The imposition of penalties larger than 5,000 rubles in case of individuals and 50,000 rubles in case of legal entities for a given tax period requires a court decision. Starting from January 1, 2007, in certain circumstances the amount of tax that was not duly paid during the three months period may be collected from companies affiliated with the taxpayer if such affiliated companies receive payments for goods, works or services provided by the taxpayer.

6.4 Corporate Profits Tax

Prior to 2009, following the introduction of Chapter 25 of the *Tax Code* the maximum tax rate for all companies was set at 24%. To address the economic downturn in Russia, starting from January 1, 2009, the maximum tax rate is reduced to 20%, which is currently payable at a rate of 2% to the federal budget and 18% to regional budgets. The regional authorities may, at their discretion, reduce their regional profits tax rate to as low as 13.5%. Thus, the overall tax rate can vary from 15.5% to 20%.

In the course of ongoing reforms significant changes were recently introduced to dividends taxation. Effective January 1, 2008 the tax rate on dividends received from foreign companies decreased from 15% to 9% to match the rate applicable between Russian entities. Also, to promote Russian holding companies, starting from January, 1 2008, dividends payable by foreign and Russian entities qualifying as "strategic investments" to Russian companies are exempt from profits tax. The exemption applies provided on the day the corporate decision to pay the dividends is taken, the following four tests are met:

(1) the recipient of the dividends continuously has held shares for not less than 365 days;

(2) the recipient of the dividends owns not less than 50% of the shares in the company paying the dividends;

(3) the shareholder's cost of acquisition of shares or participation in the charter capital of the company paying dividends exceeds 500 million rubles (approximately USD 15 million); and

(4) the company paying dividends is not located in a jurisdiction included in a "black list" of off-shore jurisdictions adopted by Order No. 108n of the Russian Ministry of Finance, dated 13 November 2007 (the "black list" includes most of the off-shore low-tax jurisdictions and territories, including Cyprus).

As a result of the significant investment requirement the dividend exemption has very limited application; however, the Russian Ministry of Finance is discussing relaxation of the exemption criteria by reducing (or repealing) the 500 million rubles requirement.

After these amendments to Chapter 25, the following tax rates apply to dividends:

- 0% withholding tax on dividends payable by Russian and foreign companies qualifying as "strategic investments";
- 9% withholding tax on dividends payable by Russian and foreign companies to Russian shareholders in all other cases; and
- 15% withholding tax on dividends payable by Russian companies to foreign legal entities.

Chapter 25 also introduced special tax rates on income earned from Russian state securities and on the profits of the Russian Central Bank.

Taxable profit is defined as income less deductible expenses. Although, prior to 2002, deductions were limited and were subject to substantial restrictions, as of January 1, 2002, many of those expense limitations disappeared under the new profits tax provisions of the *Tax Code*. Under the current rules, a taxpayer is generally permitted to deduct economically justified and documentarily confirmed business expenses. Deduction of certain types of expenses are subject to restrictions (*e.g.* certain advertising costs and representational, including business entertainment, and travel costs). As of January 1, 2009 some of these restrictions were repealed, in particular, taxpayers are now entitled to deduct per diems (previously only within the limits set by the Russian Government) and expenses on education of employees in Russia and certain voluntary insurance expenses. Expenses on research and development (including those that failed to yield a positive result) falling into the list approved by the Russian Government (which has not been adopted yet) are now deductible in the reporting period at a rate of 150% of their actual amount. The positive changes contrast with the tax authorities recently having taken a more aggressive approach to the economic justification of expenses that in some instances has appeared to be an indirect way of reintroducing some of the old law restrictions. In some instances, unfortunately, the courts have supported this position of the tax authorities.

6.4.1 Interest Deductibility and Thin Capitalization Rules

Generally, under the *Tax Code*, interest is deductible as long as it does not deviate by more than 20% from market interest rates paid on comparable loans in the same calendar quarter. Any excessive part of the interest will not be deductible. If no such comparable loans exist, interest is deducted within certain limits. To meet the growth of interest rates forced by the global financial crisis, during the period September 1, 2008 - December 31, 2009 the interest deductibility limit for ruble loans has been increased from 1.1 times the Russian Central Bank refinancing rate up to 1.5 times (19.5% at the effective 13% refinancing rate) and for loans denominated in a foreign currency from 15% up to 22% per annum.

In addition, there is a specific provision with respect to "thin capitalization." The *Tax Code* introduces a 12.5/1 debt-to-equity ratio limit for banks and leasing companies, and a 3/1 ratio limit for all other companies. If the ratio of the Russian borrower company's internal capital to its outstanding debt owed to a foreign shareholder holding more than a 20% interest in the Russian borrower company (including debt owed to a Russian affiliate of the foreign shareholder and debt guaranteed by the

foreign shareholder or its Russian affiliate) exceeds these limits, the Tax Code restricts the deductibility of interest paid on the excess debt. Non-deductible interest is also considered to be a dividend payment to the foreign shareholder and hence is subject to a 15% withholding tax, unless the latter is reduced or eliminated by an applicable tax treaty.

6.4.2 Asset Depreciation and Carrying Forward Losses

Assets with a value exceeding 20,000 rubles (approximately USD 550; 10,000 rubles prior to January 1, 2008) and a useful life of more than 12 months are subject to depreciation. Chapter 25 allows taxpayers to split assets into ten groups, depending on the type of asset and its useful life, and to apply accelerated depreciation rates; for example, the useful life for buildings under the new rules is 30 years. Under Chapter 25, taxpayers are able to choose between a linear method (somewhat similar to the old method of asset depreciation) and a non-linear method. As of January 1, 2009, the non-linear method is substantially revised. Most importantly, the depreciation of assets under the non-linear method is performed by groups of assets (rather than on a stand-alone basis for each individual asset) and under a new formula and depreciation rates. Effectively, taxpayers can deduct approximately a half of the depreciation value of assets for 25% of their useful lifetime (certain limitations on the application of the non-linear method must be observed). Land, subsoil, and natural resource assets are not subject to depreciation and hence do not reduce the tax base of the profits tax.

Starting from January 1, 2006, a lump-sum deduction in the amount of 10% of the initial book value of newly acquired fixed assets is allowed to be made for profits tax purposes in the period when the fixed assets are acquired. As of January 1, 2009, for the capital assets with a useful life of from more than 3 to 20 years this special investment incentive is increased from 10% to 30%. As a downside, if the taxpayer alienates any capital asset during the first five years of its use, the investment incentive deduction must be recaptured. This provision applies both to the 10% and 30% investment incentive deductions.

Losses may be carried forward for ten years. Also, there is no requirement to spread the loss over the entire carry-forward term. Starting from January 1, 2007, the limitation on the amount of taxable profit that could be reduced by a loss carry-forward in a particular year was eliminated. In addition, capital losses may be offset against operating income; this deduction, however, must be evenly spread over the residual useful life of the capital asset for which the loss was incurred.

6.4.3 Investment Benefits

Russian companies enjoyed various regional and local tax concessions under the 1991 *Corporate Profits Tax Law*, and under the relevant regional and/or local laws of several territories (particularly Chukotka, Kalmykia, Mordovia, and Evenkia). Chapter 25 of the *Tax Code* abolished all tax incentives, including the capital investment allowance. Some types of tax benefits (including investment benefits) were grandfathered, although they ceased to be effective as of January 1, 2004. Presently, regional and local legislative bodies are no longer authorized to provide tax concessions, except for regional authorities, which may reduce their regional profits tax rate by 4% and thus reduce the overall tax rate to 15.5%. However, the effective tax rate could be even lower under the special tax regimes referred to under section 6.2 above or under the special economic zone regime.

In 2005, Federal Law No. 116-FZ *On Special Economic Zones in the Russian Federation*, dated July 22, 2005 was passed. It introduced a new concept for the provision of investment benefits. Please refer to section 2.3 above for more information on this topic.

6.4.4 Transfer Pricing Rules

The *Tax Code* contains several rules related to transfer pricing. Specifically, it sets forth the presumption that the contractual price agreed to by the parties is the "market price." At the same time, in any of the following four circumstances, the tax authorities may exercise control over contractual prices:

- A transaction between affiliated parties;
- A barter transaction;
- A foreign trade transaction; or
- A transaction involving significant variations in prices (*i.e.* a fluctuation of more than 20%) for identical goods or services within a short period of time (in practice, this term is interpreted as 30 days immediately preceding the date in question).

If a transaction falls under one of the above four categories, the tax authorities can adjust the contract price based on the market value and impute additional taxes, penalties, and late payment interest accordingly.

Finally, Chapter 25 requires taxpayers to maintain a completely separate set of books for the purpose of calculating the tax base for profits tax. Traditionally, profits tax had been calculated based on book profit adjusted for tax purposes. However, from January 1, 2002, the tax base must be calculated from tax accounting ledgers; statutory accounting records are no longer the primary source of information for profits tax calculations.

The transfer pricing rules are currently being reviewed by the Russian government. Recent proposals to amend the transfer pricing rules provide for the following significant changes: an extended scope of controlled transactions, new methods for determining market prices, transfer pricing documentation requirements, and the introduction of advanced pricing agreements. There is no exact information on when these rules will be adopted. However, any new transfer pricing rules most likely will not be adopted and come into effect prior to 2010.

6.5 Taxation of Foreign Companies

Russian legislation taxes profits derived from a "permanent establishment" in Russia, as well as certain other types of income derived without a permanent establishment in Russia. Importantly, whether a permanent establishment exists under Russian law is unrelated to whether a foreign company's office has been registered in Russia. A permanent establishment may exist even if the office is not registered, and the existence of a registered office may not necessarily give rise to a taxable permanent establishment. Profit derived by foreign legal entities from their having a permanent establishment in Russia is generally taxed at the same profits tax rates applicable to Russian taxpayers.

Chapter 25 sets forth a limited list of Russian source income not connected with a permanent establishment in Russia that is subject to Russian withholding tax. The list includes mainly passive types of income, such as royalties, interest, dividend income, and rentals. Other income received by non-Russian residents that is not specified in the list is not subject to any withholding tax.

Unless an applicable double taxation treaty provides for a lower rate, dividends payable by Russian companies to foreign shareholders are subject to a 15% withholding tax. Other listed income received by foreign legal entities from Russian sources is subject to either a 20% withholding tax (for most categories of income, including royalties

and most types of interest) or a 10% withholding tax (for income from freight and lease of transportation vehicles), subject to any reduction available under an applicable double taxation treaty.

Russia is now a party to 69 double taxation treaties, which can provide for the reduction of the withholding tax rate on dividend income to as low as 5% and generally provide for a 0% withholding rate on other income (*e.g.* interest, royalties, and capital gains). For example, the *1998 Russia-Cyprus Double Taxation Treaty* provides for a 0% withholding tax rate on interest, royalties, capital gains, and other income not related to a permanent establishment; a 5% withholding tax rate on dividends payable to Cypriot shareholders who have contributed over USD 100,000 to the charter capital of a Russian subsidiary responsible for paying out these dividends; and a 10% withholding tax rate on dividends payable to all other Cypriot shareholders. Many other tax treaties provide for similar rates.

Chapter 25 includes a provision that explicitly states that, in the event of a conflict, double taxation treaties override the *Tax Code*. Chapter 25 contains more beneficial rules than had existed under previous laws governing tax treaty relief for a foreign legal entity. Under the new rules, taxpayers should be allowed to obtain preliminary tax treaty relief from tax-withholding in Russia without any filings with the Russian tax authorities, by presenting documents evidencing the tax residency status of the taxpayer to the tax-withholding agent (usually the Russian payer). However, obtaining a tax refund where the tax was actually withheld would require the filing of the relevant forms with the Russian tax authorities.

The profits tax is payable on a quarterly basis. The annual tax return and a report on a foreign legal entity's activity in the Russian Federation must be submitted to the tax authorities by March 28 of the year following the close of the taxable year.

6.6 Double Taxation Treaties

Russia has entered into the following bilateral treaties for the avoidance of double taxation which are currently in force:

No.	Country	Dividends		Interest[2]	Royalties
		Individuals, Companies	Qualifying Companies		
1.	Albania	10	10	10	10
2.	Armenia	10	5[3]	0	0
3.	Australia	15	5[4]	10	10
4.	Austria	15	5[5]	0	0
5.	Azerbaijan	10	10	10	10
6.	Belarus	15	15	10	10
7.	Belgium	10	10	10	0
8.	Bulgaria	15	15	15	15
9.	Canada	15	10[6]	10	0/10[7]
10.	China	10	10	10	10
11.	Croatia	10	5[8]	10	10

[2] Many treaties provide for an exemption for certain types of interest *e.g.* interest paid to the state local authorities, the central bank export credit institutions or in relation to sales on credit. Such exemptions are not considered in this column.

[3] The rate applies if the value of the holding is at least USD 40,000.

[4] The rate applies if the recipient company (other than a partnership) directly owns at least 10% of the company paying the dividends, and if the value of the holding is at least AUD 700,000, and the dividends to be paid by the Russian company are exempted from the Australian taxes.

[5] The rate applies if the recipient company directly owns at least 10% of the capital in the Russian company and the value of the holding exceeds USD 100,000.

[6] The rate applies if the recipient company owns at least 10% of the capital or voting power in the Russian company, as the case may be.

[7] The lower rate applies to computer software, patents and know-how.

[8] The rate applies if the recipient company owns at least 25% of the capital in the Russian company and the value of the holding is at least USD 100,000.

No.	Country	Dividends		Interest	Royalties
		Individuals, Companies	Qualifying Companies		
12.	Cyprus	10	5[9]	0	0
13.	Czech Republic	10	10	0	10
14.	Denmark	10	10	0	0
15.	Egypt	10	10	15	15
16.	Finland	12	5[10]	0	0
17.	France	15	5/10[11]	0	0
18.	Germany	15	5[12]	0	0
19.	Greece	10	5[13]	7	7
20.	Hungary	10	10	0	0
21.	Iceland	15	5[14]	0	0
22.	India	10	10	10	10
23.	Indonesia	15	15	15	15
24.	Iran	10	5[15]	7.5	5

[9] The rate applies if the value of the holding is at least USD 100,000.

[10] The rate applies if the recipient company directly owns at least 30% of the capital in the Russian company and the value of the holding is at least USD 100,000.

[11] The 5% rate applies if the French company: (1) has directly invested at least EUR 76,225 in the Russian company; and (2) is subject to tax in France, but is exempt with respect to the dividends (i.e. participation exemption). The 10% rate applies if only one of the requirements is fulfilled.

[12] The rate applies if the German company owns at least 10% of the capital in the Russian company and the value of the holding is at least EUR 81,806.70.

[13] The rate applies if the Greek company (other than a partnership) owns at least 25% of the capital in the company paying the dividends.

[14] The rate applies if the recipient company directly owns at least 25% of the capital in the paying dividends and the value of the holding is at least USD 100,000.

[15] The rate applies if the recipient company directly owns at least 25% of the capital in the Russian company.

No.	Country	Dividends		Interest	Royalties
		Individuals, Companies	Qualifying Companies		
25.	Ireland	10	10	0	0
26.	Israel	10	10	10	10
27.	Italy	10	5[16]	10	0
28.	Japan	15	15	10	0/10[17]
29.	Kazakhstan	10	10	10	10
30.	North Korea	10	10	0	0
31.	Korea (Rep.)	10	5[18]	0	5
32.	Kuwait	5	5	0	10
33.	Kyrgyzstan	10	10	10	10
34.	Lebanon	10	10	5	5
35.	Lithuanian Republic	10	5[19]	10	5/10[20]
36.	Luxembourg	15	10[21]	0	0
37.	Macedonia	10	10	10	10

[16] The rate applies if the recipient company directly owns at least 10% of the capital in the Russian company and the value of the holding exceeds USD 100,000.

[17] The lower rate applies to copyright royalties.

[18] The rate applies if the recipient company (other than a partnership) directly owns at least 30% of the capital in the company paying the dividends and the value of the holding is at least USD 100,000.

[19] The rate applies if the recipient company (other than a partnership) directly owns at least 25% of the capital in the company paying the dividends and the value of the holding exceeds USD 100,000.

[20] The lower rate applies to the royalties for the use of industrial, commercial, and scientific equipment.

[21] The 10% rate applies if the Luxembourg recipient directly owns at least 30% of the capital in the Russian company and the value of the holding is at least EUR 75,000.

No.	Country	Dividends		Interest	Royalties
		Individuals, Companies	Qualifying Companies		
38.	Malaysia	-/15[22]	-/15[23]	15	10/15[24]
39.	Mali	15	10[25]	15	0
40.	Mexico	10	10	10	10
41.	Morocco	10	5[26]	0/10[27]	10
42.	Moldova	10	10	0	10
43.	Mongolia	10	10	10	-[28]
44.	Namibia	10	5[29]	10	5
45.	Netherlands	15	5[30]	0	0
46.	New Zealand	15	15	10	10
47.	Norway	10	10	10	0
48.	Philippines	15	15	15	15
49.	Poland	10	10	10	10

[22] The 15% rate applies to profits of joint ventures. Otherwise, the domestic rate applies; there is no reduction under the treaty.

[23] The 15% rate applies to profits of joint ventures. Otherwise, the domestic rate applies; there is no reduction under the treaty.

[24] The lower rate applies to industrial royalties.

[25] The rate applies if the value of the holding is at least FRF 1 million.

[26] The 5% rate applies if the value of the holding is at least USD 500,000.

[27] The lower rate applies to interest on foreign currency deposit.

[28] The domestic rate applies, there is no reduction under the treaty.

[29] The rate applies if the recipient company owns at least 25% of the capital in the Russian company and the value of the holding is at least USD 100,000.

[30] The rate apples if the Netherlands company directly owns at least 25% of the capital in the Russian company and has invested in it at least EUR 75,000 or its equivalent in national currency.

No.	Country	Dividends		Interest	Royalties
		Individuals, Companies	Qualifying Companies		
50.	Portugal	15	10[31]	10	10
51.	Qatar	5	5	5	0
52.	Romania	15	15	15	10
53.	Serbia and Montenegro	15	5[32]	10	10
54.	Slovakia	10	10	0	10
55.	Slovenia	10	10	10	10
56.	South Africa (Rep.)	15	10[33]	10	0
57.	Spain	15	5/10[34]	0/5[35]	5
58.	Sri Lanka	15	10[36]	10	10
59.	Sweden	15	5[37]	0	0

[31] The rate applies if the Portuguese company has owned directly at least 25% of the capital in the Russian company during an uninterrupted period of at least 2 years prior to the payment.

[32] The rate applies if the recipient company owns at least 25% of the capital in the Russian company and the value of the holding is at least USD 100,000.

[33] The rate applies if the recipient company directly owns at least 30% of the capital in the Russian company and the value of the holding is at least USD 100,000.

[34] The 5% rate applies if: (1) the Spanish company has invested at least EUR 100,000 in the Russian company; and (2) the dividends are exempt in Spain. The 10% rate applies if only one of the conditions is met.

[35] The lower rate applies to long term loans (minimum seven years) granted by credit institutions resident in a contracting state.

[36] The rate applies if the company in Sri Lanka owns at least 25% of the capital in the Russian company.

[37] The rate applies if the Swedish company owns 100% of the capital in the Russian company (or in the case of a joint venture, at least 30% of the capital in such a joint venture) and the foreign capital invested exceeds USD 100,000.

No.	Country	Dividends		Interest	Royalties
		Individuals, Companies	Qualifying Companies		
60.	Switzerland	15	5[38]	5/10[39]	0
61.	Syria	15	15	10	4.5/13.5/18[40]
62.	Tajikistan	10	5[41]	10	0
63.	Turkey	10	10	10	10
64.	Turkmenistan	10	10	5	5
65.	Ukraine	15	5[42]	10	10
66.	United Kingdom of Great Britain and Northern Ireland	10	10	0	0
67.	United States of America	10	5[43]	0	0
68.	Uzbekistan	10	10	10	0
69.	Vietnam	15	10[44]	10	15

[38] The rate applies it the Swiss company owns at least 20% of the capital in the Russian company and the value of the holding exceeds CHF 200,000.

[39] The lower rate applies to loans of any kind granted by a bank.

[40] The 4.5% rate applies to cinema movies and TV and radio broadcasting programs, the 13.5% rate applies to literature, art, and science products, and the 18% rate applies to computer software, patents, trademarks, and know-how.

[41] The rate applies if the recipient company owns at least 25% of the capital in the company paying the dividends.

[42] The rate applies if the value of the holding is at least USD 50,000.

[43] The rate applies if the recipient company owns at least 10% of the capital or voting power in the Russian company as the case may be.

[44] The rate applies if the Vietnamese company has invested directly in the capital of the Russian company at least USD 10 million.

In addition to the above, Russia has entered into the following tax treaties for the avoidance of double taxation which do not apply (*e.g.*, have not been ratified, the exchange of ratification instruments process is pending):[45]

No.	Country	Dividends		Interest[46]	Royalties
		Individuals, Companies	Qualifying Companies		
1.	Algeria	15	5[47]	15	15
2.	Argentina	15	10[48]	15	15
3.	Botswana	10	5[49]	10	10
4.	Brazil	15	10[50]	15	15
5.	Chile	10	5[51]	15	5/10[52]
6.	Cuba	15	5[53]	10	0/5[54]

[45] The double tax treaties concluded with Algeria, Brazil, Singapore, Thailand and Venezuela and the protocol amending the Germany-Russia Tax Treaty were ratified by Russia in 2008, however, have not become effective due to notification requirements.

[46] Many treaties provide for an exemption for certain types of interest *e.g.* interest paid to the state local authorities, the central bank, export credit institutions or in relation to sales on credit. Such exemptions are not considered in this column.

[47] The rate applies if the recipient company (other than a partnership) directly owns at least 25% of the capital in the company paying the dividends.

[48] The rate applies if the recipient company owns at least 25% of the capital in the company paying the dividends.

[49] The rate applies if the recipient company owns at least 25% of the capital in the company paying the dividends.

[50] The rate applies if the recipient company directly owns at least 20% of the capital in the company paying the dividends.

[51] The rate applies if the recipient company directly owns at least 25% of the capital in the company paying the dividends.

[52] The lower rate applies to the royalties for the use of, or the right to use, any industrial, commercial, or scientific equipment.

[53] The rate applies if the recipient company (other than a partnership) owns at least 25% of the capital in the company paying the dividends.

[54] The lower rate applies to copyright royalties.

No.	Country	Dividends		Interest	Royalties
		Individuals, Companies	Qualifying Companies		
7.	Estonia	10	5[55]	10	10
8.	Ethiopia	5	5	5	15
9.	Georgia	10	10	10	5
10.	Laos	10	10	10	0
11.	Malta	10/-[56]	5[57]	0	0
12.	Mauritius	10	5[58]	0	0
13.	Oman	10	5[59]	0	5
14.	Saudi Arabia	5	5	5	10
15.	Singapore	10	5[60]	7.5	7.5
16.	Thailand	15	15	10[61]	15
17.	Venezuela	15	10[62]	5/10[63]	10/15[64]

[55] The rate applies if the recipient company (other than a partnership) owns at least 25% of the capital in the company paying the dividends and the value of the holding exceeds USD 75,000.

[56] The rate shall not exceed the rate established for Maltese income tax purposes if the recipient company is a Russian resident.

[57] The rate applies if the recipient company (Maltese resident) directly owns 20% in the capital of the Russian company and the foreign capital invested exceeds USD 100,000.

[58] The 5% rate applies if the value of the recipient company's holding is at least USD 500,000.

[59] The rate applies if the value of the recipient company's holding exceeds USD 500,000.

[60] The rate applies if the recipient company owns at least 15% of the capital in the company paying the dividends and the value of the holding exceeds USD 100,000.

[61] The 10% rate applies to loans granted by Russian banks.

[62] The rate applies if the recipient company (other than a partnership) directly owns at least 10% of the capital in the company paying the dividends and the value of the holding is at least USD 100,000.

[63] The 5% rate applies to bank loans.

[64] The lower rate applies to the fees for technical assistance.

6.7 Value Added Tax ("VAT")

VAT is imposed on all goods imported into Russia and is also applied to the sale of goods, work, and services. The period for VAT for all taxpayers and tax agents is the calendar quarter (previously for most taxpayers the tax period was a monthly period). Taxpayers must pay the VAT by equal installments not later than the 20th day of each month following the reporting quarter (this procedure replaced a single-installment payment effective as of the third quarter of 2008). Current legislation imposes a VAT rate of 18% on the sale of most goods. A lower 10% rate is applied to limited types of goods, such as pharmaceuticals, medical equipment, and certain food products and periodicals. The export of goods is subject to a 0% VAT. In addition, certain types of goods, work, and services are exempt from VAT (for example, land plots, dwelling houses and apartments, lease of office space to accredited representative offices and branches of foreign legal entities from jurisdictions which apply reciprocal benefits, certain medical goods and services, etc.). As of January 1, 2008 the assignment of exclusive IP rights (*e.g.,* patents, licenses, know-how), with the exception of trademarks, and rights to use the results of these IP rights (*e.g.,* software) based on licenses (including non-exclusive licenses) is no longer subject to Russian VAT. The import VAT exemption for technological equipment contributed to the charter capital of a Russian entity is narrowed to include only technological equipment that is not produced in Russia according to a list adopted by the Russian Government (the rule applies as of the first day of the quarter following the adoption of such list which has not yet been adopted).

Generally, VAT paid on the acquisition of goods, work and services may be offset against VAT collected from customers. Starting from January 1, 2009 Russian buyers are not required to postpone offsetting the input VAT on advance payments until the goods, work and services are dispatched and could take the offset on special advance VAT invoices. For barter transactions, taxpayers are no longer required to transfer VAT to each other in cash and remit VAT under general rules. In order to claim a refund of input VAT paid in relation to goods that subsequently were exported and subject to a 0% VAT, the taxpayer is required to file various supporting documents with the Russian tax authorities. Starting from January 1, 2009 instead of filing copies of numerous customs declarations the exporter is entitled to file registers of customs declarations stamped by the customs authorities. In capital construction, the input VAT paid to suppliers of goods, work, and services may be offset under a general procedure as the construction progresses (prior to 2006, such input VAT could be offset only when the constructed assets are recorded on the taxpayer's balance sheet).

An enterprise ends up transferring to the state only the difference between VAT paid and VAT collected. As a general rule, however, a taxpayer may not offset input VAT if such VAT is incurred on goods, works or services used by the taxpayer for the sale of goods or the provision of services that are exempt from VAT. In this case, the taxpayer will be required to include such input VAT into its production costs and will effectively lose this input VAT for future recovery. In those cases where only a portion of certain input costs was used for the production of goods or the provision of services subject to VAT, the corresponding input VAT may be offset only on a pro-rata basis. Careful planning will therefore be required to maintain full recovery if part of a newly constructed building is to be directly leased to representative offices or branches of foreign legal entities accredited in Russia for which a VAT exemption applies.

Starting from 2006, foreign legal entities having more than one representative office and/or branch registered in various locations in Russia may consolidate all VAT accruals and offsets on a company level (prior to 2006, each representative office and/or branch was regarded as a separate VAT payer). For that purpose a foreign legal entity must choose a particular representative office or branch that would be responsible for VAT reporting on a company level and notify the local tax authorities responsible for each representative office and branch registered in Russia of its decision.

A Russian customer of a foreign company that is not registered with the tax authorities and is active (making sales or providing services) in Russia must withhold either 9.09% or 15.25% reverse charge VAT (depending on the applicable underlying VAT rate of 10% or 18%, respectively) from the amounts transferred to the foreign company and must itself remit such VAT directly to the state budget.

6.8 Mineral Extraction Tax

Prior to 2002, licensed subsoil users had to pay, *inter alia*, a tax on the restoration of the mineral resource base and subsoil use payments. The tax base was calculated as a percentage of the value of the minerals actually extracted. Chapter 26 of the *Tax Code* introduced a new mineral extraction tax, which came into effect on January 1, 2002. The mineral extraction tax has replaced the tax on restoration of the mineral resource base and the subsoil use tax payable on the value of minerals extracted. Subsoil users are now required to make subsoil use payments provided that they conduct at least:

- Prospecting and appraisal;
- Exploration of subsoil deposits; or
- Construction works on an extraction site (not connected with mineral extraction).

The law has set the minimum and maximum rates with respect to each type of activity, depending on the territory used within the subsoil activity, rather than on the value of minerals extracted (as was the case prior to 2002). Regional state executive bodies set specific rates within these limits, which are reflected in the relevant licenses.

The mineral extraction tax is generally calculated as the value of the mineral resources extracted from the subsoil based on the prices (excluding VAT and excise taxes) at which the extracted minerals were sold, subject to the transfer pricing provisions of the *Tax Code*, and effectively not lower than the market price. Taxpayers are required to calculate the tax base separately for each type of mineral resource extracted and pay it on a monthly basis. In particular, Chapter 26 sets out a tax rate of 6% for gold, 6.5% for silver, 17.5% for gas condensate, and 147 rubles (approximately USD 4) per 1,000 cubic meters of gas. Subsoil users that simultaneously meet the following requirements: (1) have prospected and explored an oilfield at their own expense and (2) were exempt from the tax on the restoration of the mineral resource base confirmed in the relevant license issued before June 1, 2001, are entitled to pay 70% of the tax normally due for the natural resources extracted from the relevant licensed oilfield. Subsoil users include the mineral extraction tax paid to the state budget in their deductible expenses, decreasing the taxable base of the corporate profits tax due. Chapter 26 does not provide for any special concessions for subsoil users.

The mineral extraction tax with respect to crude oil is determined as the quantity of extracted crude oil multiplied by the tax rate. The basic tax rate is 419 rubles (approximately USD 11.5) for a ton of crude oil, which is adjusted monthly by a multiplier reflecting fluctuations in world prices for Urals crude (M) determined under the following formula:

$M = (P - 15) \times E / 261$

where P is the average price for Urals crude in USD per ton and E is the average Ruble / USD exchange rate determined by the Central Bank of Russia over the calendar month. Starting from January 1, 2009 the non-taxable crude oil price minimum was increased from USD 9 to 15, which effectively was intended as an incentive for oil companies.

If the reserves depletion rate for oil or gas field equals or exceeds 80%, a special multiplier (RD) is added in calculating the mineral extraction tax rate: (419 x M x RD). The reserves depletion rate is calculated as the accumulated volume of crude oil produced from the field (including normal shrinkage) based on the information in the state balance of mineral reserves (N) divided by the total volume of reserves (sum of reserves by categories A+B+C1+C2): RD = 3.8 - 3.5 x N/V. The RD multiplier effectively reduces the mineral extraction tax rate for depleted fields.

Oil companies may enjoy tax holidays with respect to crude oil that is difficult to develop (*e.g.*, produced from oilfields located in certain regions of Russia, ultraviscous oil.).

6.9 Taxation Under Production Sharing Agreements

Pursuant to Chapter 26.4 of the *Tax Code*, effective as of June 10, 2003, companies extracting minerals under production sharing agreements ("Investors") are subject to a special (and, in comparison with the mineral extraction tax, entirely different) tax regime. For instance, an Investor pays 50% of the mineral extraction rate for oil and gas condensate until it reaches a certain limit of commercial production, specified in the Production Sharing Agreement ("PSA"). Once an Investor has reached such limit, however, it pays the full mineral extraction rate for oil and gas condensate.

At the same time, Investors may be exempted from regional and local taxes (assuming applicable legislation at the regional levels of government), the corporate property tax, and the transportation tax, the latter with respect to fixed assets and vehicles used directly for the purposes of oil and gas extraction under the PSA. In addition, depending on the conditions of the PSA, Investors may secure a further refund of VAT, the unified social tax, subsoil use payments and water tax, state duties, customs fees and duties, the land tax, the excise tax, and the ecological tax previously paid to the budget within the terms of the PSA.

The PSA taxation regime introduced by Chapter 26.4 of the *Tax Code* has increased the number of tax law requirements for, and taxes payable by, Investors. These amendments (together with other legislative amendments described in Section 2.2 above) are unlikely to make PSA's an attractive proposition to Investors, especially since Russia has only three PSA's and has not entered into any new PSA's since the mid-1990's.

6.10 Corporate Property Tax

As of January 1, 2004, Chapter 30 of the *Tax Code* (covering the corporate property tax) came into effect, replacing the former 1991 *Corporate Property Tax Law*. The property tax is a regional tax, *i.e.* its imposition is regulated by the legislation of the relevant region, to a maximum rate of 2.2%. The tax base includes movable and/or immovable fixed assets owned by the taxpayer in Russia, and is calculated based on the depreciated book value of those assets. Taxable assets no longer include any costs or intangible assets recorded on the taxpayer's balance sheet, nor land and water objects, and such are not subject to the property tax either.

Chapter 30 of the Tax Code further exempts from taxation certain categories of property, such as assets used by religious organizations to maintain religious activities. Furthermore, when imposing property tax, Russian Federation regional governments may fix lower or differentiated rates for different categories of payers and/or types of taxable property. Corporate property tax is payable on an annual basis, with advances due every quarter. However, regional governments in the Russian Federation may exempt certain categories of payers, including both Russian and foreign organizations, from the obligation to assess and make such advance payments.

6.11 Unified Social Tax

Effective January 1, 2001, one Unified Social Tax replaced employers' contributions to four separate social benefit funds (the Pension Fund, the Social Security Fund, the Mandatory Medical Insurance Fund, and the Employment Fund). The Unified Social Tax is paid centrally and is afterwards distributed among these three funds (the Employment Fund having been abolished in 2001). The Unified Social Tax has a regressive tax scale from 26% to 2% of an employee's salary, with the lowest rate applicable to the portion of an employee's annual salary in excess of 600,000 rubles (approximately USD 16,700). The tax period is one year, and the tax is paid on a monthly basis.

In the past, the salaries of foreign citizens employed or acting as individual entrepreneurs in Russia were exempt from the Unified Social Tax, provided that under Russian legislation or the relevant employment/service contract those expatriates were not eligible for Russian state pensions, social benefits, and state-subsidized medical treatment. However, this tax exemption has ceased to exist effective January 1, 2003, and the salaries of expatriates working in Russia have become subject to the Unified Social Tax pursuant to the rules outlined above.

The salaries of foreign personnel employed by foreign branches of Russian companies and/or of foreign personnel working abroad are specifically exempt from the Unified Social Tax under amendments to the *Tax Code* effective from January 1, 2008.

6.12 Personal Income Tax

Individuals who are defined as "Russian tax residents," *i.e.* those who have been in the country for 183 days or more during any 12 consecutive months, are subject to personal income tax on all their income, both that earned in Russia and that earned elsewhere. Individuals who do not meet this criterion are subject to tax on any income received from Russian sources. From January 1, 2001, Russia has enacted various income tax rates, including: a 13% flat rate applicable to most types of income; a 9% rate applicable to dividend income; a 35% rate applicable to income from gambling, lottery prizes, deemed income from low-interest or interest-free loans (except loans directed at new construction or acquisition of a residence) and excessive bank interest; and a 30% rate applicable to Russian-source income received by non-residents.

By April 30 of the following year, a taxpayer must file a tax return based on his/her actual income for the previous year, and settle tax obligations for that year. Foreign individuals are required to file annual tax returns with the tax authorities by April 30 of the year following the reporting year only if they receive income from non-Russian sources, or income where no income tax was withheld at the source of payment. Those foreign individuals who leave the country during a calendar year should file a tax declaration for the relevant taxable period no later than one month prior to leaving Russia.

6.13 Regional and Local Taxes

Regional and local legislative bodies may, at their discretion, introduce various tax incentives and credits with regard to regional and local taxes. Regional taxes currently include corporate property tax, transportation tax, and gambling tax. Local taxes currently include property tax on individuals and land tax. Although these taxes are set regionally and locally, the federal legislature has enacted limits on their overall rates.

7. CURRENCY REGULATIONS

7.1 Introduction

The *Civil Code* states that the ruble is the national currency of the Russian Federation. Although agreements may refer to the ruble value equivalent of foreign currency, all transactions conducted inside the Russian Federation must, as a general rule, be settled in rubles. The *Civil Code*, however, permits the use of foreign currency in cases provided for by law. Federal Law No. 173-FZ *On Currency Regulations and Currency Control*, dated 10 December 2003, as amended, (the *Currency Law*) establishes the basic rules of currency regulation and control.

7.2 Currency Operations

The *Currency Law* regulates a broad range of currency operations including:

- Payments made in a foreign currency;
- Transfer of foreign securities;
- Ruble transfers between a Russian resident and a non-resident or between two non-residents;
- Transfer of domestic securities between a resident and a non-resident or between two non-residents;
- The import and export of rubles and securities;
- Transfer of funds and securities from the overseas account of a resident into a domestic account, and *vice versa*; and
- Transfer of rubles and securities between the domestic accounts of a non-resident.

7.3 Resident vs. Non-Resident Status

The *Currency Law* divides individuals and legal entities into two classes: residents and non-residents. Residents include: Russian citizens and other individuals whose permanent place of residence is the Russian Federation; legal entities established in accordance with Russian legislation; representative offices (branches) of Russian legal entities outside of Russia; and the governments of the Russian Federation, constituent entities of the Russian Federation, and municipal units. Non-residents are defined as individuals whose permanent place of residence is located outside

of Russia; legal entities incorporated outside Russia; enterprises/organizations that are not legal entities, organized and located outside the Russian Federation; and representative offices (branches) of foreign legal entities in Russia.

7.4 Special Currency Control Rules

As of January 1, 2007 most currency control limitations have been eliminated. However certain requirements still apply to Russian residents:

- Russian companies must hold all foreign currency export proceeds in their Russian bank account(s) ("repatriation of currency proceeds");
- "transaction passports" are required for certain transactions (external trade, loans) at Russian banks;
- most Russian residents are prohibited from performing foreign currency transactions (the Currency Law provides some exceptions);
- the purchase and sale of foreign currency may only be performed at authorized Russian banks;
- cash exports are subject to restrictions;
- when a Russian company or individual opens an overseas bank account in OECD/FATF member countries they must notify the tax authorities and present regular reports on the cash flow in such accounts ; and
- the operation of an overseas bank account by a Russian resident is subject to certain restrictions.

7.5 Liability for Violation

The *Currency Law* has reproduced the system of state agencies which are responsible for the execution of currency control. This includes: the CBR, the Government, and the federal agencies authorized by the Government. Currency control is executed through agents of the currency control regime, including: authorized banks, professional participants of the securities market, and governmental agencies.

Violation of Russian currency control requirements may entail civil, administrative, or criminal liability. Administrative penalties for violation of Russia's currency control requirements include various fines, which may be imposed on individuals, legal entities, and company executives. The amount of a fine may be as high as the entire value of a transaction performed in violation of the currency control requirements. Other sanctions include the revocation of licenses (primarily applicable to banks), and imprisonment.

8. EMPLOYMENT

8.1 Introduction

The principal legislation governing labor relationships in the Russian Federation is the *Labor Code of the Russian Federation* (the *Labor Code*), effective February 1, 2002, as amended through 2008. In addition to this core legislation, labor relationships are regulated by the 1996 Federal Law *On Trade Unions, Their Rights and Guarantees of Activities*, as amended (currently through 2008), as well as Russian legislation on minimum wages, labor safety and other related laws and numerous regulations.

Russian Labor Law applies equally to regular employees and top managers, in particular, CEOs of Russian companies and heads of representative offices and branch offices of foreign companies accredited in Russia. Russian Labor Law also applies to foreign nationals employed by Russian or foreign businesses in Russia. All employers should comply with special immigration law requirements in respect of foreign employees (please see Section 8.14 below).

A written employment agreement in Russian setting out the basic terms and conditions of the employment relationship must be entered into with each employee working in Russia. The *Labor Code* provides all employees with mandatory minimum guarantees and employment-related benefits and compensations, which cannot be superseded by the agreement between the employer and the employee. Accordingly, any provisions in an employment agreement that impair the employee's position as compared to that set forth by such guarantees will be invalid. As a general rule employment agreements are entered into for an indefinite period of time. A definite term (fixed-term) employment agreement may also be concluded, but such an agreement cannot be enforced for longer than five years, and it may only be concluded when the nature or conditions of work make it impossible for the parties to enter into an indefinite term agreement, in particular upon circumstances specifically provided for by Article 59 of the *Labor Code*. Further, an employee cannot be prohibited from holding a second job in addition to his/her full-time employment, with certain limited exceptions and restrictions provided by the *Labor Code* and other federal laws.

Under Russian labor legislation relevant employment duties and obligations must be expressly defined in the employment agreement. It is important that these duties and obligations are defined broadly enough since an employee cannot be required to perform tasks outside the scope of job duties expressly described in his/her

employment agreement. The employer cannot expand or otherwise modify them unilaterally without the written consent of the employee. Similarly, the employer generally cannot make unilateral changes to the employee's obligations. In general, employment terms and conditions that have been agreed upon by employer and employee can only be amended by a written agreement of both parties. In the limited cases where an employer is allowed to unilaterally amend the employment terms and conditions agreed upon by the parties the employer must have legal grounds for such changes, must notify the employee two months in advance of any changes, and follow other formalities prescribed by law.

8.2 Employment-Related Orders

Employers in Russia are required to issue an internal order each time an employee is hired, transferred to a new job, granted vacation, disciplined or terminated, and in certain other cases. For example, Article 68 of the *Labor Code* expressly requires that the order on hiring must be issued and presented to the employee for countersignature no later than three days after the employee has commenced work. When an employment agreement is terminated, for any reason, the order on termination must be issued and presented to the employee for countersignature on the last day of employment (Article 841 of the *Labor Code*).

8.3 Labor Books

A labor book is a principal document containing the formal record of a person's employment history and certain other information. The employer must make a record of employment in its employees' labor books in respect of any employment exceeding five days. The labor book is vital to each employee because it confirms his/her right to a state pension and other social benefits. Employers are responsible for keeping their employees' labor books and making all records in them in a timely manner and in strict conformity with the required format. The employer must return the labor book, duly completed and stamped, to the employee on the last day of employment.

8.4 Mandatory Policies and Procedures

All employers in Russia are required to issue Internal Labor Regulations and other mandatory labor- related policies and procedures. All employees should be personally familiarized with these policies against their signature. This procedure is essential for the relevant policies, procedures and other mandatory requirements to become

binding on the employees. The employer's policies and procedures should be issued in the Russian language (or in a bilingual version) and approved by an internal order of the CEO of the company or head of representative office and branch office.

8.5 Probationary Period

The employer has the right to establish a three-month probationary period for a newly hired employee. The employer may also set a six-month probationary period for employees hired for certain top executive positions (*e.g.*, head of an organization and chief accountant and their deputies, and head of a branch office, representative office, or other separate structural subdivision of an organization). The imposition of a probationary period must be specifically stated in both the employment agreement and the order on hiring. If during the probationary period the employer determines that the employee does not meet the criteria established for the role for which he/she was hired, the employee can be dismissed by the employer without payment of severance and with only three days' written notice. Importantly, such notice to the employee must provide the reasons why the employee is deemed as having failed to pass the probation. The employee is also entitled to resign during the probationary period, without stating any reason, with three days' written notice to the employer.

8.6 Minimum Wage

Wages for full-time work may not be lower than the minimum monthly wage established by the applicable Russian legislation. The amount of the minimum monthly wage is periodically indexed by the government. The federal statutory minimum monthly wage is currently 4,330 rubles per month (as of March 1, 2009, approximately USD 119).

Regional minimum wages are established by regional agreements on the minimum wage. They apply to all employers in that region that do not opt out within 30 calendar days of the official publication of the respective regional agreement. Some of the constituent regions of the Russian Federation, including the City of Moscow, have already implemented regional agreements on the minimum wage. Regional minimum wages are always higher than the above-mentioned federal minimum wage and are tied to the regional minimum standard of living. For instance, the minimum monthly wage in Moscow equals to 8,300 rubles (as of March 1, 2009, approximately USD 228).

8.7 Work Time

Employers are required to keep a record of all the time worked by each employee, including any overtime. The regular work week is 40 hours. Any time worked over 40 hours per week is classified as overtime and may only be demanded by employers in extraordinary circumstances, as specified in Article 99 of the *Labor Code*, and in most cases only upon an employee's prior written consent. The *Labor Code* limits the total amount of overtime for an employee to 120 hours a year, and an employee cannot be required to work more than four hours of overtime over two consecutive days. Overtime must be paid at a rate of 150% of the regular hourly rate for the first two hours of overtime worked in any one day, and at a rate of 200% of the regular hourly rate thereafter. Upon the employee's written request, the employer can compensate overtime work by granting the employee additional time off in lieu of payment; the time off should be no less than the time worked as overtime.

It should be noted that certain limitations regarding overtime work apply to certain protected categories of employees, including employees under the age of 18, pregnant women, women with children under the age of three, disabled employees, and some other categories as defined by federal laws.

Workers may also be hired on terms of an open-ended working day. The primary advantage of this is that there is no need to obtain consent whenever the employer asks an employee to work overtime. Moreover, the extra hours worked by employees with an open-ended working day need not be paid as overtime: they are entitled to additional paid vacation of no less than three calendar days per year. Nevertheless, it is important to note that employees with an open-ended working day can be required to work overtime only occasionally and upon a specific order of the employer when there is a need for such overtime work. Further, job positions subject to the open-ended working day regime must be approved by the employer and listed in the company's Internal Labor Regulations.

8.8 Holidays and Non-Working Days

There are currently 12 public holidays in the Russian Federation.

Uninterrupted weekly time off at weekends must not be less than 42 hours. As a rule, employees may only be required to work on a non-working day or public holiday in extraordinary circumstances, as specified in the *Labor Code*, and only upon the employees' prior written consent. As a general rule, employees must receive payment at no less than twice the regular rate for any work performed on a non-working day or public holiday, or be given time off in lieu of payment.

Some limitations regarding work requirements on public holidays and non-working days apply to certain protected categories of employees, including employees under the age of 18, pregnant women, women with children under the age of three, disabled employees, and other categories as defined by federal laws.

8.9 Vacations

Employees in Russia are entitled to annual paid vacation of at least 28 calendar days per year of employment. An employee is entitled to use his/her vacation time in full once he/she has worked for the employer for at least six months. The *Labor Code* requires that the dates of the annual vacation of each employee be indicated in the vacation schedule for the calendar year, which the employer must approve by mid-December of the preceding year. The *Labor Code* further requires that employers notify their employees in writing at least two weeks before the commencement of vacation. Each employee's vacation allowance should be paid at least three days before a vacation is due to start.

8.10 Sick Leave

Employees are required to submit a doctor's note for any absence only after their recovery and return to work. Generally, employees cannot be terminated by the employer while absent on sick leave, and are entitled to receive statutory sick leave compensation. Sick leave compensation is covered by the Russian State Social Insurance Fund, which is funded by the employer's mandatory contributions paid as a percentage of its employees' salaries in the form of the Unified Social Tax.

Since January 1, 2007, sick leave compensation and maternity leave compensation have been regulated by Federal Law No. 255-FZ *On the Provision of Sick Leave and Maternity Leave Compensation to Citizens Eligible for Mandatory Social Insurance* (as amended), dated December 29, 2006. Pursuant to this law sick leave compensation must be paid to an employee in the event of his/her illness or injury (labor-related or other) and in cases when an employee is caring for a sick family member, as well as in some other instances.

The duration of payment and amount of sick leave compensation varies according to the grounds for the sick leave. In cases of a labor-related injury or occupational disease, the amount of sick leave compensation is 100% of the employee's average earnings. In other cases sick leave compensation may not exceed the statutory maximum, which in 2009 is 18,720 rubles per month (approximately USD 514).

If the employee has more than one place of employment, he/she is entitled to sick leave compensation at each place of employment. If the employee's total work history totals less than six months, the sick leave or maternity leave compensation cannot exceed the federal minimum monthly wage.

8.11 Maternity Leave

Paid maternity leave starts to accrue no later than 70 calendar days prior to a birth, and continues to accrue for an additional 70 calendar days thereafter. Paid maternity leave is provided for a longer period in the event of complications while giving birth or in cases of multiple births. Just like sick leave compensation, maternity leave compensation is covered by the Russian State Social Insurance Fund, which is funded by the employer's contributions paid as a percentage of its employees' salaries in the form of the Unified Social Tax. As of January 1, 2009, the maximum amount of statutory maternity leave compensation equals to 25,390 rubles per month (approximately USD 697).

A child's care provider (the employee who has given birth or who is the father, grandmother, grandfather or other relative who is taking care of the child) may request partially paid childcare leave until the child is three years old. The employee retains the right to return to his/her job during the entire period of paid/unpaid leave, and the full leave period is included when calculating the employee's length of service.

8.12 Dismissal

An employment relationship may be terminated by the employer only on the specific grounds provided in the *Labor Code*, including, in particular: a reduction in the workforce, the employee's repeated failure to perform his/her employment duties without justifiable reasons (if the employee was lawfully disciplined within the preceding 12 months), the employee's unjustified absence from the workplace for more than four consecutive hours during one working day, and other reasons. Arbitrary termination of an employment relationship by the employer is not allowed, except in the case of the company CEO, who can be terminated by the unilateral decision of the owner, provided he/she is paid adequate severance compensation.

Employers must strictly comply with specific procedures and documentary requirements provided by the *Labor Code* when terminating employment for any reason. The *Labor Code* gives additional protection to a number of specific categories

of employees, including minors, female employees, employees with children, trade union members, and various other categories. Conversely, employees are entitled to terminate their employment at any time, without stating any reason, and, as a general rule, with only two weeks' written notice to the employer.

8.13 Compensation

Salaries must be paid to employees at least once every half-month. Employers are obliged to pay salary and other employment-related payments on the dates set by their internal labor regulations and by the individual employment agreement. The employer is required to pay compensation (*i.e.*, interest) for any delay in payment of salary and other employment-related payments in accordance with Article 236 of the *Labor Code*. In addition, employees have the right, upon prior written notice to their employer, to stop working if their employer delays payment of their salary for more than 15 days. Employees must be compensated in the currency of the Russian Federation (rubles). As a general rule, employment-related payments in a foreign currency (both in cash and by bank transfer) are prohibited.

8.14 Employment of Foreigners in Russia

All employers must obtain permission to hire foreign nationals, work permits and work visas before foreign nationals are employed and/or actually commence work in Russia (except citizens of Belarus). This applies to foreign nationals working in Russia under civil-law agreements for the performance of work or the provision of services (*e.g.*, marketing consultants or sales representatives).

The procedure and required documents vary according to whether or not the foreign national requires a Russian visa. In Moscow the procedure for obtaining permission to hire foreign nationals, individual work permits and work visas may take from four to six months to complete. This period may be shorter in other regions of the Russian Federation. Additionally, as a precondition for obtaining permission to hire and a work permit, a company is to annually file an application for a quota for work permits for following year before May 1 of the current year. Thus, employment of a foreign national in Russia requires advance planning to allow sufficient time for such procedures.

Permission to hire, work permit and work visa requirements equally apply to representative offices and branch offices of foreign firms. Foreign nationals working at accredited Russian representative offices or branch offices of foreign firms also need to obtain a personal accreditation card from the accrediting body of the representative or branch office in order to apply for a work permit and work visa.

Russian law provides for severe penalties for non-compliance with the above work permit and work visa requirements for foreign employees. During the past year, the Russian government has made it a priority to increase control over the use of foreign employees in Russia. It has considerably extended regulation and enforcement of the above-mentioned immigration law requirements. Also, employers should comply with the general migration monitoring requirements and file notifications of foreign employees' travel in and out of Russia pursuant to the statutory procedure.

Importantly, the Russian migration legislation is currently subject to significant amendments, so the procedures involved could be modified at any time. It is highly recommended to verify the procedures and documentary requirements on a case-by-case basis in advance.

Employers are required to provide financial, medical and social guarantees in respect of their foreign employees in Russia.

8.15 Trade Secrets

Trade secrets can form an important element of an employment relationship. In particular, Federal Law No. 98-FZ *On Trade Secrets*, which was enacted on July 29, 2004, and Part Four of the Civil Code of the Russian Federation, effective from January 1, 2008, provide for regulation of trade secrets in an employment relationship context. Under these laws, if an employer wishes to protect its trade secrets from unauthorized disclosure by employees it should implement certain statutory procedures under a "trade secrets regime".

In order to implement a trade secrets regime, an employer should determine a list of trade secrets, restrict access to them, and include in the employment agreements provisions regulating trade secrets. Also, the Federal Law *On Trade Secrets* expressly lists information that may not constitute a trade secret and that therefore is not protected under the trade secrets regime.

Employees should be notified, against their signed receipt, of the trade secrets directly related to their job functions and of their liability for violation of the trade secrets regime. Also, the employer is required to provide the conditions necessary for employees to observe the trade secrets regime.

The participating employees, for their part, must observe the trade secrets regime, must not disclose trade secrets, and must pay damages arising out of a culpable disclosure of protected trade secrets, if all the statutory procedures were properly implemented by the employer. In accordance with Part Four of the Civil Code of the Russian Federation the protection of trade secrets extends beyond the termination of the employment relationship, forbidding employees from disclosing trade secrets for as long as the employer has effective exclusive rights to the secrets. However, it is recommended to conclude a separate civil-law contract on non-disclosure of trade secrets by an employee after employment termination in order to protect trade secrets.

8.16 Personal Data

Pursuant to Federal Law No. 152-FZ *On Personal Data*, enacted on July 27, 2006 and effective as of January 26, 2007, employers are required to obtain prior written consent from employees and other individuals in order to process their personal data. In particular, an employer must obtain such consent when transferring personal data to any third parties or abroad. These requirements are of importance to transnational companies with subsidiaries, representative offices or branch offices in Russia that generally process the personal data of their Russian employees and individual contractors at a central location abroad. They are also important for all employers who transfer the personal data of their employees to law firms, audit and accounting firms, and other providers of professional services. As of January 1, 2008, employers in some cases are also required to notify the respective government agency of their intent to process personal data.

9. PROPERTY RIGHTS

9.1 Introduction

Both the *Constitution of the Russian Federation* and the *Civil Code of the Russian Federation* uphold the right to own private property. The *Land Code* of October 2001 and other legislation adopted in development of the *Land Code's* provisions implement this principle further.

The *Land Code*, together with Federal Law No. 101-FZ *On Circulation of Agricultural Land* of 24 July 2002 as amended (the *Agricultural Land Law*), which entered into force in January 2003, put an end to the political debate as to whether land ownership in Russia is possible. Federal Law No. 172-FZ *On Reclassification of Land and Land Plots from One Category to Another* of 28 December 2004 as amended (the *Land Reclassification Law*), came into force on 5 January 2005. Being a follow-up on the *Land Code*, it detailed the procedures for the reclassification of land and land plots from one category to another. The *Land Reclassification Law* defines the respective powers of federal authorities, authorities of the constituent entities of the Russian Federation (see p. 1.3), and local authorities in the procedure of changing the category of land plots. The uniform mechanism instituted at the federal level to move land plots from one category to another marks a significant development in making the land market in Russia more transparent.

Owing to some historical aspects such as the fact that transactions with real properties (other than land plots) became possible earlier than the transactions with land plots, at present Russian law still treats land plots and buildings as separate objects of real estate. Despite this, however, there is a concept of a single object of real estate embodied through provisions which prohibit the disposal of a land plot and a building located on such land plot separately from each other in the circumstances where such properties are owned by one and the same owner. In circumstances where a building is located on a land plot which is state or municipality owned and unless there are other buildings or structures on the land plot owned by third parties, the owner of such building has an exclusive right to lease such land plot or acquire it into ownership.

Under Russian law, the most common types of rights to real estate available for investors are the right of ownership and leasehold. However, there are, for the moment, different regulations with regard to land plots and buildings.

Land

The *Land Code* distinguishes the following rights to land: the right of ownership (by the Russian Federation, constituent entities of the Russian Federation, municipalities, private individuals, and legal entities), the right of perpetual (indefinite) use, the right of free fixed-term use, leasehold, the right of lifelong inheritable possession, and easements (servitudes). Land plots are generally available for investors under the right of ownership and lease.

Right of Ownership

The general principles of land ownership are set forth in the *Constitution of the Russian Federation*, adopted in December 1993. The *Constitution* establishes the principle of private ownership of land but does not regulate land relations in detail. The core legislative act governing land relations is the *Land Code*, which establishes fundamental terms and procedures for the land use. It is further supplemented by other federal laws regulating land issues, often referred to in the *Land Code*. For instance, it has limited applicability to agricultural land, as it expressly provides that the circulation of such land is also the subject of a separate law, the *Agricultural Land Law*. The *Land Code* is also supplemented by regional laws and other regulations, which the constituent entities of the federation may issue in compliance with the *Land Code*. In the case of disagreement between such laws and the *Land Code*, the latter enjoys preferential status.

The possession, use, and disposal of land plots attributable to the category of agricultural land are regulated by the *Agricultural Land Law*. Not all agricultural land, however, is subject to the *Agricultural Land Law*. It does not extend, for example, to those land plots that were provided to individuals for the construction of individual homes or garages, or for a smallholding or dacha garden, and land plots underlying buildings and other structures; the circulation of such land plots is governed by the provisions of the *Land Code*. Agricultural land plots may be held by right of ownership, perpetual (indefinite) use, lifelong inheritable possession, or free fixed-term use, and such plots may also be leased.

Ownership of land plots in state or municipal ownership, where such land plots are free from any buildings and structures, is to be awarded (for the purposes other than development and construction to which special rules apply) to individuals and legal entities, as a rule, through bidding by tender or auction. Such bidding may also be held for granting the lease of a land plot when it is claimed by two or more potential lessees - the organization of such tenders or auctions is detailed in Article 38 of the *Land Code*.

Although there is no express provision permitting land ownership by foreigners (including stateless persons), the *Land Code* may clearly be interpreted as allowing such ownership, except in cases where it is specifically prohibited. The rights to acquire land plots under existing buildings, or for construction, into lease or ownership are equally vested to foreigners, subject to the following restrictions set out in the *Land Code*:

- Foreigners are specifically prohibited to own land plots in border areas (a list of which is to be drawn up by the President), or in other special territories of the Russian Federation pursuant to other federal laws. Additionally, the President may establish a list of types of buildings and other structures to which pre-emptive buy-out or lease rights to land plots for foreigners may not apply. Under the *Implementing Law* and pending the preparation of the Presidential list, the border restrictions apply to all border areas.
- Foreigners are prohibited to own agricultural land. The *Agricultural Land Law* further specifies the rights to agricultural land that may be granted to foreign nationals and foreign legal entities (and stateless persons): those in this category may only lease agricultural land plots. This restriction on foreign legal entities also extends to Russian legal entities in which the equity participation of foreign nationals, foreign legal entities, and/or stateless persons exceeds 50%.
- Foreigners are prohibited to own land plots located within the boundaries of sea ports.

Lease

Foreign legal entities and individuals may be granted leases to land plots. Such leases for state or municipally owned property are usually based on a standard local form. Although neither the *Civil Code* nor the *Land Code* stipulate a statutory maximum length of land lease, the lease term in most cases does not exceed 49 years.

For instance, In Moscow, Moscow City Law No. 48 *On Land Use in the City of Moscow* of 19 December 2007, which came into force on 5 January 2008, sets different periods for which leases of Moscow-owned land plots may be obtained. The lease terms for sites free of any buildings, structures, or facilities may not exceed five years. Land plots on which such property is located are, however, available for 25-49 years of lease. This term can be reduced upon the parties' consent.

The level of rent payments for the majority of land leases granted by the state or municipalities is set by a general local decree. In Moscow a lessee must pay for the right to lease any land in excess of the area of the existing buildings on that land. In St. Petersburg, the level of rent is determined by the city law No. 608-119 "On the Method for Determination of Rental Payments for Land Plots Owned by St Petersburg" of 5 December 2007 (the law came into effect on 1 April 2008). If the right of ownership to a land plot has not been delimited, the level of rental payments with regard to such land plot is established by a resolution of St Petersburg government. In both cases the lease rates vary depending on the location of the site, the type of activity of the lessee etc.

The *Land Code* provides a lessee with certain basic rights. A lessee that properly fulfills its obligations under a lease has a pre-emptive right of lease renewal at the end of the lease term. The renewal rights of a lessee under a land lease are to be treated in conjunction with the pre-emptive right to purchase the land granted to the lessee (where the land in lease is state or municipally owned) and the exclusive right of the owners of the existing buildings and structures to purchase or lease the underlying land plot.

Significantly, the provisions of the *Civil Code*, in so far as they apply to land leases, are supplemented by the *Land Code* in a number of areas. In particular, the *Land Code* sets forth a series of modified rights for land lessees. Their applicability will in part depend upon the precise drafting of a lease. For example, the presumption under Article 615 of the *Civil Code* that a lessee needs a lessor's consent to sublease has been reversed for lessees of land. Of particular significance is the provision that lessees of state or municipally owned land under a lease exceeding five years term are free to assign their rights under the lease, to mortgage such rights or grant the land plots for sublease to third parties, subject only to giving notice to the lessor. This rule will also apply to land leases for a period of more than 5 years with private lessors (in contrast to the prior consent requirement established under Article 615(2) of the *Civil Code*). The assignee of a land lease does not need to enter into a new land lease.

The lessor and the lessee may terminate the lease contract (1) upon mutual agreement, (2) unilaterally in circumstances stipulated in the lease, (3) by a court order in circumstances provided by the *Civil Code* or the *Land Code* or in the lease. The *Land Code* contains provisions that deal with the termination of land leases in conjunction with a court order. For example, the following will constitute grounds for termination of a land lease:

- Misuse of the land plot (a more stringent test than that under Article 619 of the *Civil Code*, which requires either substantial or repeated violations);
- Use of the land plot that results in a decline in the fertility of agricultural land or, importantly for industrial users, a material deterioration in the environmental situation;
- Failure to correct a range of other intentional environmental violations of applicable land use regulations; and
- Where the designated purpose of the land plot is agricultural production or development - failure to use the land plot for its designated purpose for a period in excess of three years.

Other Rights to Land

The right of perpetual (indefinite) use may be granted only to state and municipal institutions, federal treasury-owned enterprises, and state and local authorities. Legal entities which possessed land plots on the right of perpetual (indefinite) use before the introduction of the *Land Code* and which do not fall under the above categories of legal entities had to convert and re-register this right at their choice either into lease or ownership until 1 January 2004. This deadline has been extended several times and is currently established as 1 January 2010 as a general rule and as 1 January 2013 with regard to land plots under transportation, communications and utilities lines[65]. Failure to convert the rights by the established deadlines will trigger an administrative penalty of 20,000 - 100,000 rubles (approximately USD 580 - 2,900 as at February 2009). However, the penalty is established with effect from 1 January 2011. As the civil circulation of land plots held on the right of perpetual (indefinite) use is restricted, *e.g.*, such land plots cannot be sold, leased, mortgaged, or assigned, the disposal of such land plots by legal entities (which do not fall under the above categories) will always require a prior conversion of the right of perpetual (indefinite) use into another title (*e.g.*, for commercial legal entities - into lease or ownership).

[65] It is currently considered to further extend these deadlines to 1 January 2013 and 1 January 2016 respectively.

Acquisition of Rights to Land Plots for Construction Purposes (Other Than Residential Construction)

The *Land Code* sets out detailed procedures for acquiring rights over state or municipally owned land plots for the purpose of new non-residential construction. The *Land Code* distinguishes two kinds of procedure: (1) without preliminary approval of the location of facilities, and (2) with such preliminary approval.

The granting of land plots without preliminary approval of the location of facilities is carried out through bidding by tender or auction (Article 38 of the *Land Code*).

A land plot which is granted for construction purposes in accordance with the procedure where no preliminary approval of the location of facilities is required must satisfy the following criteria: (1) its boundaries must have been defined for the plot to be eligible for sale or lease, (2) a cadastral number (indicating the area, location, category, and other essential characteristics of the plot) must have been assigned, (3) a designated use of the land plot must have been properly defined, and (4) technical conditions for the connection to utilities must have been determined.

The granting of land plots with preliminary approval of the location of facilities is applied when a land plot meeting the requirements of a particular project does not exist or a new construction project requires a thorough investigation of ecological, sanitary, architectural and other issues, and upon a specific request for granting a land plot for construction from an investor. This may also involve the investigation of public opinion regarding the planned construction. In accordance with this procedure a land plot initially is granted to legal entities and individuals into lease only. This, however, does not preclude the owner of the facilities (upon their completion and state registration) from acquiring the underlying land plot into ownership. With regard to construction of facilities of religious function, religious organizations are granted the right of free fixed-term use for the period of such construction. In this case, land plots are granted without holding an auction.

The preliminary approval of the location of facilities is not required with regard to land plots in urban areas if town-planning documentation and zoning plans have been approved for such land plots. Such land plots must be granted through an auction.

Exclusive Right

As mentioned in Section 9.1 above, the owners of buildings and structures which are located on land plots owned by the state or by a municipality are vested an exclusive right to acquire the underlying land plots either into ownership or lease (Article 36 of the *Land Code*). With regard to facilities erected on such land plots after the *Land Code* had become effective this rule signifies that an owner of the facility, upon registration of title (see p. 9.4), may opt either for the extension of the lease, the extension of the lease and subsequent acquisition into ownership, or immediate acquisition into ownership. Availability of a valid lease contract does not preclude the owner of the facilities from acquiring the underlying land plot into ownership before the expiry of the lease. The *Land Code* does not establish a deadline by which the owners of the facilities should exercise their right. With regard to facilities erected before the entry of the *Land Code* into effect the rule is generally the same, although in circumstances where the underlying land plots had been granted on the right of perpetual (indefinite) use, then in accordance with the Federal Law No. 137-FZ *On the Entry into Effect of the Land Code of the Russian Federation* of 25 October 2001 (the *Land Code Enforcement Law*) the owners of facilities located on such land plots must acquire such land plots into ownership or lease until 1 January 2010 (in case of land plots under transportation, communications and utilities line - until 1 January 2013)[66].

9.3 Other Real Estate

Ownership

Russian legislation permits both Russian and foreign nationals and legal entities to own real estate (apart from land plots) such as buildings, premises (as parts of buildings), structures and other facilities. In general, the rules relating to the use, disposal, and sale of real estate are set forth in the *Civil Code*, which guarantees the freedom to sell, rent, and carry out other transactions with real estate. Title to real estate is usually acquired through a sale-purchase transaction or by means of new construction. For legal entities which were formed in the course of privatization of Soviet era enterprises it is usual that title to buildings and structures had been obtained as a result of such privatization.

[66] It is currently considered to further extend these deadlines to 1 January 2013 and 1 January 2016 respectively.

In accordance with the *Civil Code*, title (and other rights) to real estate arises after its state registration, which is governed by Federal Law No. 122-FZ *On State Registration of Rights to Real Estate and Transactions Therewith* of 21 July 1997, as amended (the *Registration Law*). Upon request of a legitimate acquirer of title (*e.g.*, buyer under a sale-purchase agreement), the authority in charge of the state registration of rights to real estate must state register the title and issue an ownership certificate evidencing the registration of title (see Section 9.4 below).

For all owners of real estate, the ownership right has to be state registered in accordance with the procedure set forth by the *Registration Law*. The exceptions to this rule relate to rights to real estate which had been acquired prior to the adoption of the *Registration Law*. The owner of such real estate is not obligated to state register its rights unless it wishes to enter into any transaction involving its real estate (*e.g.*, lease, mortgage, sale).

Obtaining an ownership certificate is a fairly straightforward, although sometimes lengthy, process, as long as the private company seeking to obtain such certificate can clearly demonstrate that real estate in question was purchased, constructed, or privatized in accordance with the established procedures. Before an ownership certificate is issued a cadastral documentation must be obtained on such real estate.

Title to real estate acquired through privatization sometimes cannot be registered as a result of deficiencies in privatization documentation. In the past, state-owned real properties were granted to state-owned enterprises for economic management or use. During privatization process of the early 1990s such real properties were usually transferred into the ownership of those enterprises which were formed on the basis of Soviet state-owned enterprises which operated and used such real properties on the basis of various "usage"-type rights. A newly privatized enterprise thus "inherited" such real properties from the state-owned enterprise, provided that the real properties as recorded on the balance sheet of the state-owned enterprise were easily tracked out in a privatization plan of a newly formed (privatized) enterprise. The problem of title registration is not unusual for legal entities which are the legal successors of such Soviet era state-owned enterprises. Such legal entities may, however, register title by virtue of acquisitive prescription (15 years) on the basis of court order.

Lease

Foreign legal entities and individuals may be granted leases to other real properties (apart from land plots). Alike with leases of state or municipality owned land plots, leases of other real properties in state or municipal ownership are usually based on a standard local form.

The *Civil Code* provides a lessee with certain basic rights. When the property is granted into lease, it must be in the condition stipulated by the lease. Thereafter, unless the lease specifies otherwise, the lessor is liable for the repair of defects of the premises. If the lessor fails to carry out the necessary repairs, the lessee can opt either for the reduction of rent or termination of lease and compensation of losses incurred. A lessee that properly fulfills its obligations under the lease has a pre-emptive right to renew the lease (i.e., enter into a new lease for the same premises and not necessarily on the terms of the preceding lease) unless this right is expressly excluded by the lease contract.

The lease survives the change of ownership over the leased property. The lease of buildings and structures assumes the right to use (either in lease or under another right of usage) the land plot which underlies such buildings and structures and which is necessary for their operation and use. Similar to the lease of land plots, the lessor and the lessee may terminate the lease (1) upon mutual agreement, (2) unilaterally in circumstances stipulated in the lease, (3) by a court order in circumstances provided by the *Civil Code* or in the lease.

Leases for one year and longer must be state-registered and are deemed concluded upon such state registration. Leases for less than a year (any 365 consecutive days) do not require state registration and become valid when signed. To avoid the obligation of state registration, which can be a time consuming process, leases are often concluded for less than a year and renewed on a regular basis. If the procedure is properly described in the lease, such renewal of the lease is regarded as conclusion of a new lease for a period of less than a year.

9.4 State Registration of Rights to Real Estate

The right of ownership and other proprietary interest to real properties, their creation, encumbrance (*e.g.*, mortgage, leasehold for a term of one year and longer, easement), transfer and termination are subject to state registration. In the absence of state registration, the rights to real estate are invalid. The *Registration Law*

stipulates procedures for the identification and registration of rights to real estate. In many cases, registration of title is a prerequisite for the validity and enforceability of transactions involving real estate.

Certain transactions (in addition to the *rights* or *titles*) with real estate are also subject to state registration, and become effective only upon such registration. The registration process is carried out by the registration authorities at the location of the real estate in question. Under the *Registration Law*, state registration of a right to an object of real estate and/or registration of a transaction with an object of real estate takes one month, although in practice this term may be significantly extended as a result of suspension or refusal of registration. In certain cases, however, state registration of rights and transactions takes less than one month. The grounds for suspension or refusal of registration of rights/transactions are specified in the *Registration Law*. Refusal of state registration can be contested in court.

The registration authorities maintain the Unified State Register of Rights to Real Estate and Transactions Therewith (the "Register"), which indicates the history and the current legal status of a real estate object. The Register also records various "registerable" encumbrances over real estate (including long term leases and easements) and restrictions (such as freezing orders against, or court disputes relating to, the real state object). The registration authority issues a certificate in a statutorily defined form that certifies on which right an object of real property is held by a legal entity or individual and which encumbrances and restrictions, if any, are established with regard to such object. Information on state-registered transactions with immovable property is also included in the Register. Basic information on the right holder(s) and restrictions (encumbrances) of such rights is open to the public, and can be provided for a fee to any person submitting a written request within five business days after submission of an application to the registration authority.

Land plots are also required to undergo cadastral registration. The procedures and rules for the state cadastral registration of land are outlined in Federal Law No. 221- FZ *On State Cadastre of Immovable Property* of 24 July 2007 (the *Cadastre Law*) upon the enactment of which on 1 March 2008 *Law on the State Cadastre* of 2 January 2000 ceased to have effect. Under the *Land Code*, only land plots that have been subject to state cadastral registration can be the objects of sale-purchase transactions. Particularly in Moscow, this applies to all transactions with land plots. The State Cadastre is established pursuant to the *Cadastre Law* and contains detailed

information on all objects of real properties including land plots, buildings, structures, premises and other facilities. Information contained in the State Cadastre is available to the public.

As a single source of information on real estate available in electronic format the State Cadastre will become operational from 1 January 2012. Transition rules apply until 1 January 2010. The *Cadastre Law* provides for a unified system of state cadastre registration of all basic types of real estate, including land plots, buildings, premises, unfinished construction, complex immovable property objects, territorial and functional zones and zones with usage conditions.

With effect from 1 March 2009 the government agency which performs state registration of rights to real properties (formerly named as Federal Registration Service) has been renamed into Federal Service on State Registration, Cadastre and Cartography and became responsible also for cadastre registration of real estate (including land plots).

The *Cadastre Law* does not apply to forests, perennial plantations, bodies of water, subsoil resources, marine vessels and aircraft.

9.5 Classifications of Real Estate

There is no official legislative classification of real estate (properties) in Russian law. In practice, real properties are classified on the basis of their intended use (*e.g.*, residential or non-residential for buildings, agricultural or industrial for land plots, etc). The designated use should be identified in the lease, the certificate of ownership, as well as in the BTI technical documentation and cadastral documents.

Building, structures and other facilities require various obligatory state permits and approvals. The *Town Planning Code* of 29 December 2004, as amended (the *Town Planning Code*), stipulates documents and procedures to be obtained / followed for the purpose of carrying out construction. Construction activities are also governed by regional and municipal legislation, such as, for instance, the Town Planning Code of the city of Moscow, adopted by Moscow City Law No. 28 of 25 June 2008, which came into effect on 10 July 2008.

9.6 Payments for Real Properties

Historically, when a foreign investor acting through a non-Russian entity purchased or leased real estate from Russian residents, payments effected under such transactions (in foreign currency) were classified as "capital transfer transactions", requiring a specific license from the Central Bank of the Russian Federation.

This licensing requirement had been abolished and under Federal Law No. 173-FZ *On Currency Regulation and Currency Control* dated 10 December 2003 (the greater part of which came into effect on 17 June 2004), foreign currency payments made by foreign investors to Russian residents in consideration for purchased or leased real estate are no longer regarded as "capital transfer transactions". Payments between Russian residents can be carried out in rubles only. Where a seller or a buyer, or both the seller and the buyer (or the lessor and the lessee) are foreign legal entities, settlements are possible in foreign currency. Settlements between foreign residents (including legal entities and individuals) can be carried out through foreign (non-Russian) bank accounts. However, transactions with real properties may trigger Russian tax consequences even if carried out outside Russia.

9.7 Residential Real Estate

Until the early 1990s, most apartments in the Russian Federation were state or municipally owned. However, many (if not most) apartments have since been privatized and many new residential developments have been constructed by investors, and most of these apartments are in private ownership. Relations arising in connection with residential real estate are regulated by the *Housing Code* of 29 December 2004 (the *Housing Code*), which came into effect on 1 March 2005. The *Housing Code* defines categories of residential property, which include a residential house (cottage), an apartment in a multi-storey (multi-apartment) building or a room in such an apartment, as well as various forms of rights to residential real estate. The *Housing Code* prohibits the use of residential property for purposes other than residence by individuals.

9.8 Mortgage of Real Properties

General

Mortgage arises either by virtue of law or the mortgage agreement. Mortgage rights must be state registered and are invalid without such registration. Registration is mandatory and in its absence a mortgage agreement is null and void.

Federal Law No. 102-FZ *On Mortgage of Real Property* of 16 July 1998 (the *Mortgage Law*) stipulates the following essential terms of a mortgage agreement: (1) description of the mortgaged property (described to the extent sufficient to identify it), its location, and valuation; (2) nature, scope and maturity date of an obligation secured by mortgage; (3) the right on which the mortgaged property is held by the mortgagor; and (4) name of the registration authority that registers the mortgage. Per request and subject to the payment of state duty, local offices of the state registration authority (from 1 March 2009 - Federal Service on State Registration, Cadastre and Cartography) can provide information on whether a specified object of real properties is mortgaged. Such information is provided in the form of an extract from the Register.

According to the *Mortgage Law*, the following types of real properties can be subject to a mortgage:

- Land plots (including agricultural land plots), with the exception of land plots which have been withdrawn from or are limited in circulation, and the land plots held by state or municipalities;
- Enterprises registered as real estate;
- Buildings, structures, and other immovable property that are used for business activities;
- Residential houses, apartments and parts thereof, consisting of one or several separate rooms;
- Cottages, garages, and other structures for personal use;
- Aircraft, sea and river vessels; and
- A lessee's interest in leased real properties, which may be the subject of a "leasehold mortgage".

Buildings and structures can only be mortgaged together with the land plots, or together with leasehold rights to such land plots, on which such buildings and structures are located.

The existing mortgage of a land plot is automatically extended to cover a building or structure erected on such land plot by the mortgagor, unless otherwise provided by the mortgage agreement. This provision of the *Mortgage Law* allows a mortgagee to

extend the mortgage over a land plot to all buildings and structures that may be constructed on the plot, without the need for a subsequent addendum to the mortgage agreement.

The terms and conditions of a mortgage may restrict the owner's or user's capability to dispose of the property, including its contribution to charter capital and/or lease to third parties. The disposal of mortgaged property generally requires a mortgagee's consent unless the mortgage agreement provides otherwise. Notwithstanding such consent, the mortgage survives the change of ownership over the mortgaged property, or the change of holder of such property, unless and until the primary obligation secured by the mortgage is performed and the property is released from it. The release of property from mortgage is also subject to state registration.

The *Mortgage Law* provides that, unless otherwise provided in the mortgage agreement or by federal law, a residential house or an apartment that was purchased or constructed with loans from banks or other credit companies is deemed to be mortgaged from the date of state registration of the ownership right of the purchaser/investor of the house or the apartment. The *Mortgage Law* further provides that foreclosure by the mortgagee on a mortgaged residential house or apartment and disposal of such property constitutes grounds for termination of the occupancy rights of a mortgagor and the family members residing together in such residential house or apartment, provided that this residential house or apartment was mortgaged under a mortgage agreement to secure the return of a loan granted for the purchase or construction of such residential house or apartment, or a loan granted to refinance the previous construction / acquisition loan.

The implications of these provisions of the *Mortgage Law* are that a mortgagee can now demand that a mortgagor vacates the mortgaged property if the mortgagee intends to foreclose on it. However, this rule would apply only if the mortgaged property were mortgaged to secure the repayment of a loan taken by a mortgagor to purchase or construct a property or to refinance such previous construction / acquisition loan. It is also important to note that those individuals who occupy mortgaged property pursuant to a lease or a "hiring" agreement (under Russian law, a specific type of residential lease where the lessee is a private individual) cannot be evicted upon foreclosure on the mortgaged property. Such a lease or a "hiring" agreement concluded prior to the mortgage agreement will remain in force and can be terminated only under specific circumstances provided for by the *Civil Code* or applicable housing legislation.

Amendments Introduced with Effect from January 2009

The *Mortgage Law* has been significantly modified to improve the potential of mortgages as an instrument for securing investments by the two federal laws which were adopted in December 2008 - Federal Law No. 264-FZ of 22 December 2008 and Federal Law No. 306-FZ of 30 December 2008. The laws came into effect on 26 January 2009 and 11 January 2009, respectively. Key amendments are as follows.

Foreclosure on the mortgaged property. There are two types of foreclosure on mortgaged property: court and out-of-court. With regard to an out-of-court foreclosure, before the amendments, the parties could enter into a contract for the transfer of the mortgaged property to the mortgagee to discharge the secured obligation only after an event of default under the secured obligation has occurred. In the absence of such contract, a mortgagee cannot automatically acquire rights to the mortgaged property if an event of default occurs, and in most cases the mortgaged property must be sold at a public auction, with the proceeds then being used for repayment of the debt.

Now, the transfer of the mortgaged property to the mortgagee after an event of default has occurred is possible if the parties stipulate so in the mortgage agreement or in a separate agreement, provided that a notarized consent of the mortgagor to such an out-of-court foreclosure on the mortgaged property has been obtained. In an agreement on out-of-court foreclosure the parties are required to stipulate, among other things, the method of an out-of-court foreclosure (i.e., realization of the mortgaged property at an auction or the acquisition of ownership of mortgaged property by the mortgagee for itself or for third parties), initial sales price of the property or the procedure for the sale price determination.

Out-of-court foreclosure on mortgaged property is prohibited with regard to residential properties held by individuals under the right of ownership and with regard to real properties owned by the state and municipalities.

Mortgage certificates. Mortgage certificate can be issued to the mortgagee at any time after the state registration of the mortgage and until the termination of secured obligation. Mortgage certificates can be transferred to depositary for registration and custody, which is evidenced by respective note on the document. Such note should also disclose if the custody is temporary or obligatory. The type of custody can be chosen by the issuer or by a subsequent holder of the mortgage certificate.

Mortgage agreement vs mortgage certificate. If a mortgage agreement, on the basis of which a mortgage certificate is issued, stipulates that with the issuance of the mortgage certificate both the mortgage agreement and the principal agreement (obligations under which are secured by the mortgage) terminate, all relations between the mortgagor, the debtor, and the mortgagee become governed by the mortgage certificate.

10. PRIVATIZATION

10.1 History of Privatization

In general, the privatization process in Russia can be roughly summarized as occurring in three progressive stages. The first stage of "voucher-assisted privatization" lasted from 1992 to 1994, and included the privatization of state property on a massive scale. This first privatization scheme allocated vouchers to state employees, with these vouchers later transformed into shares in the capital structures of newly established (privatized) joint stock companies.

Although at this early stage the country lacked experience in all privatization matters, and the first *Privatization Law* of 3 July 1991 was perhaps inevitably undeveloped, the Government's rush to privatize companies through the allocation of vouchers resulted in a very large percentage of state-owned entities being transferred into private hands.

The second stage of the privatization process lasted from 1995 to 1996, and was focused on obtaining large payments for significant enterprise stakes. The principal objective of this scheme was to replenish the state budget and to attract domestic and foreign investment into Russia. Unfortunately, this objective was never achieved because:

- Most of the financially viable and attractive businesses had already been privatized during the first stage of development;
- Domestically, large-scale investors did not yet exist; and
- Foreign investors were still wary of large-scale capital injections into Russian entities (particularly due to the volatile political environment in the Russian Federation at the time).

As a result of the difficulty in attracting investment during this second stage, the "loans for shares" scheme was introduced. The outcome of these auctions was that a limited number of Russian businessmen were able to acquire state property at artificially low prices.

The next *Privatization Law* of 21 July 1997 established the special right ("golden share") of the relevant state authorities to participate in management of those open joint stock companies where such a right was provided during privatization. This right is realized by nominating representatives of the relevant state authorities to the board of directors and audit committee of such open joint stock companies, participation in general meetings of shareholders and veto rights on certain agenda issues of such general meetings of shareholders.

Since that time, there have been very few major developments within the sphere of privatization.

The *Privatization Law* provided for a single fundamental sanction for the failure to abide by the privatization rules, *i.e.* that the corresponding transaction could be declared void, and the property unlawfully acquired be returned to the state. Furthermore, the privatized entities and the procedures relating to their privatization could be challenged and declared invalid for a period of up to ten years. In this context, returning those companies that had been privatized in gross violation of the applicable legislation to the state would appear to be justifiable from both a legal and political standpoint.

Mindful of the potentially negative effects of any reversal of the privatization process President Putin indicated on several occasions that he would be unlikely to allow any significant reviews of previously held privatization proceedings. Shortly after that the statute of limitations to restitute a void transaction (including past privatization deals which it was still possible to restitute by 25 July 2005 on the ground of the deals' alleged invalidity) was reduced from ten to three years.

10.2 Current Status

The new *Privatization Law* entered into force on 26 April 2002. In contrast to previous legislation and consistent with Government policy with respect to the sale of land, the new *Privatization Law* allows the privatization of land plots associated with real estate objects. In addition to the usual methods of privatization such as sale of state-owned property and shares in open joint-stock companies at tenders and auctions, reorganization of unitary enterprises into open joint-stock companies, contribution

of state-owned property to the share capital of open joint-stock companies, the new *Privatization Law* also established a number of new privatization methods including, for example, the sale of shares in open joint stock companies on stock exchanges, and the sale of such shares outside the Russian Federation. At the same time, some of the previously well-known and widely used methods of privatization (such as the sale of shares in open joint stock companies to their employees, or the buyout of the leased state property by the lessees) are now excluded from the new *Privatization Law.* In doing so, the Government is trying to eliminate the use of "cheap" methods of privatization, which appears to be a reasonable and long-expected change based on the inadequacies of previous privatization attempts.

In accordance with the new *Privatization Law* the Russian Government each year approves an annual plan with a list of federal property intended for privatization during the relevant year. The planning procedure for privatization of property owned by the Russian Federation subjects and for municipal property is defined by the relevant state and municipal authorities. Such annual plans and decisions on the conditions of privatization of state and municipal property are published in the official mass media nominated by the relevant authorities.

Current legislation on privatization clearly demonstrates an overall increase in state control over the privatization process, the specific forms of which, in many instances, are yet to be developed. It is unlikely that there will be a great deal of privatization activity in the short run.

11. LANGUAGE POLICY

Under Article 68 of the *Constitution of the Russian Federation*, the state language throughout the territory of the Russian Federation is Russian. All official election materials, legislation, and other legal acts, must be published in the official state language.

In addition, the *Constitution* upholds the rights of each of the individual republics within the Russian Federation to establish its own state language. Thus, regional state bodies and local institutions of self-government within Russia's 21 republics may conduct official state business in two languages: Russian and the republic's national language.

Foreign investors should be aware of some of the restrictions governing the use of the Russian language. For example, the Federal Law *On the State Language of the Russian Federation* requires that all advertising in the Russian Federation must be

either in Russian or in the particular state language of the individual republic in which the advertising appears. The exceptions to this rule are trademarks, which may be in the original language of the trademark, and mass media designed for teaching foreign languages. In addition, the use of the word "Russia" or "Russian Federation" in the name of a company (except for the transliterated foreign spelling of the same words) requires a special permit from the Government of the Russian Federation and exposes that company to certain tax consequences.

12. CIVIL LEGISLATION

The adoption of the new *Civil Code of the Russian Federation* represents one of the landmarks in Russia's transition to a market economy. The *Civil Code* consists of four parts. Part I of the *Civil Code* came into effect on 1 January 1995, and Part II on 1 March 1996. Together, these two parts serve as the legal basis for virtually every transaction in the Russian Federation.

Part I of the *Civil Code* upholds such rights as the rights to own and inherit property; to engage in entrepreneurial activity; to establish independent legal entities, and provides for the protection of non-material attributes, in particular, defense of honor, dignity and business reputation. Part I also defines concepts such as legal entity, securities, transaction, obligation, power of attorney and contract.

Part II further expands on the law of obligations, and contains provisions governing certain types of contracts: sale and purchase; barter; donation; annuity; rent; contractor's agreement; provision of services; transportation; forwarding; loan; insurance; agency. In addition, Part II of the *Civil Code* provides for non-contractual obligations such as agency without authority, torts (including product liability), unjust enrichment, public contest, and public promise of a reward.

Although Parts I and II of the *Civil Code* were signed into law, several provisions of the *Civil Code* required the adoption of additional legislation. Such legislation has now, in large part, been adopted including the Federal Law *On Joint Stock Companies*, the Federal Law *On Limited Liability Companies*, the Federal Law *On State Registration of Legal Entities*, the Federal Law *On Pledge* and the Federal Law *On State Registration of Rights to Real Estate and Transactions Therewith*. It should be noted that significant amendments to the *Civil Code*, and respective federal laws related to limited liability companies, pledge

and mortgage were adopted in December 2008 and will come into force in 2009. Instances remain, however, where appropriate legislation has not been adopted - the absence of a direct multimodal transport law being one such example.

Part III of the *Civil Code* entered into force on 1 March 2002, covering the law of succession and choice of law rules. Part III, Chapter V of the *Civil Code* (the *Inheritance Law*) details the rights of citizens to dispose of their property by devise, establishes priority categories of heirs-at-law (i.e. those who inherit absent a devise), and provides for other forms of taking the inheritance. Legal entities and the state may act as heirs. In addition to regular wills (which should be executed in writing and notarized), Chapter V provides for confidential wills and wills made in a simple written form. Furthermore, irrespective of the contents of a testator's will, the testator's minor or disabled children (as well as their disabled spouse, parents, or dependents) are entitled to a compulsory inheritance of at least one half of the amount they would have been allocated under the *Civil Code* had there been no will.

Part III, Chapter VI (the *International Private Law*) regulates transactions "complicated by a foreign element" *i.e.* transactions with a foreign citizen or with a foreign legal entity, or otherwise when a "foreign element" is involved (for instance, a contract for the sale of real property located abroad). Chapter VI contains a number of essential innovations, including, for instance, the default rule of the closest connection for determining substantive law applicable to a civil-law obligation. The parties to a transaction that is complicated by a foreign element are free to choose any nation's law (either Russian or foreign) as applicable to their transaction, except for cases where the chosen law contravenes the public policy (public order) of the Russian Federation or peremptory rules of Russian Federation law.

Part III, Chapter VI of the *Civil Code* also provides other conflict-of-law rules, relating to both contractual and non-contractual (*e.g.* torts) obligations. In particular, specific provisions in the *Code* determine law applicable to international consumer transactions; assignment of rights; obligations arising from unilateral transactions; interest accrued on monetary liabilities; product and service liability; liability for unfair competition; unjust enrichment.

Part IV of the *Civil Code* covering various intellectual property issues, came into force on January 1, 2008.[67]

[67] For intellectual property, see Chapter 13.

13 INTELLECTUAL PROPERTY

13.1 Regulatory Environment

Russian IP legislation consists for the most part of the *Civil Code of the Russian Federation*, specifically its new Part Four *("Part IV of the Civil Code")* put into force by Federal Law No. 230-FZ dated December 18, 2006. Part IV of the *Civil Code* along with Federal Law No. 231 FZ dated December 18, 2006 "On Enacting Part Four of the *Civil Code* of the Russian Federation" (the "*Enactment Law*") have replaced or amended accordingly as of 1 January, 2008 all preceding individual IP laws. Part IV of the *Civil Code* represents a codification of pre-existing IP laws, which have been compiled as respective chapters in Part IV of the *Civil Code*, partially unaltered with certain instances where significant amendments have been made. Parts I-III of the *Russian Civil Code* also set out certain general provisions pertaining to legal protection of IP rights. Any foreign legal entity or individual may use and seek protection for its/his/her intellectual property rights in Russia, provided that the requirements of the law are satisfied. Russia is a signatory to major international treaties on intellectual property rights, including the Universal Copyright Convention, the Berne Convention for the Protection of Literary and Artistic Works, the Paris Convention for the Protection of Industrial Property, the Patent Cooperation Treaty, the Madrid Agreement on the International Registration of Trademarks, the Protocol to the Madrid Agreement, WIPO Performances and Phonograms Treaty, and WIPO Copyright Treaty.

13.2 Patents

An **invention** is a technical solution in any field related to a product (*inter alia*, to a device, substance, microbial strain, cell culture of plants and animals) or a process. Patent protection is given to an invention if it is novel, inventive and industrially applicable. The maximum duration of patent protection for an invention is 20 years from the date of the application, subject to payment of annuities. The term of a patent for an invention related to a medicine, pesticide or agrochemical, the use of which is subject to obtaining special permission, may be extended at the request of the patent owner for a period not exceeding five years. The right to obtain a patent belongs to the inventor, his/her employer (in case of an employee's invention) and their assignees. A patent application is filed with the Federal Service for Intellectual Property, Patents and Trademarks ("Rospatent"), which examines it and grants the patent if the invention meets the above-mentioned criteria.

A **utility model** is a technical solution pertaining to a device. Utility model protection is similar to that of inventions with certain limitations and restrictions. A utility model is granted patent protection if it is new and industrially applicable. The term of a utility model's patent protection is 10 years from the filing date of the application, subject to payment of annuities, and may be extended for an additional period not exceeding 3 years.

An **industrial design** is the artistic and construction solution, which determines the outer appearance of a product of industrial or handicraft origin. An industrial design is granted patent protection if its essential features are new and original. An industrial design is deemed new if the combination of its essential features does not comprise part of the information publicly available in the world before the priority date of the industrial design. An industrial design is considered original if its essential features evince the creative character of a product's distinctive features. Industrial design patent protection is granted for 15 years, subject to payment of annuities, and with the possibility of extension for an additional period specified in the application, but not exceeding 10 years.

Under Russian law it is possible to assign or license an invention, utility model and industrial design, protected by a patent, to another person. Such assignment and license agreements should be recorded with Rospatent, failing which the agreements are deemed null and void. These agreements enter into force as of the date of such recordation. The patent owner has the sole right to use an invention, utility model or industrial design that is protected by such patent. Without the patent owner's permission, no one is allowed to use a patented object in any way, including importation, manufacture, application, offer for sale, sale, other introduction into commercial interactions or storage for this purpose. Infringement of patent rights may entail civil, administrative or criminal liability in accordance with the applicable legislation.

13.3 Trademarks, Service Marks, and Appellation of Origin of Goods

Under Part IV of the Russian Civil Code, **trademarks** (**service marks**) are designations, individualizing goods or services of legal persons and individual entrepreneurs. Legal protection of trademarks and service marks is granted by virtue of their registration with Rospatent or by virtue of international agreements to which the Russian Federation is a party. A mark may be represented by a word

or words, pictures, three-dimensional signs and other designations or combinations thereof. The trademark may be registered in any color or color combination. The trademark and service mark protection is granted for a period of 10 years from the filing date of the application and may be renewed during the last year of its validity for subsequent 10-year periods. The trademark and service mark registration is cancelled when its term expires without having been renewed. The trademark and service mark legal protection may be terminated upon a request from an interested party in respect of all or part of goods and services due to non-use of the trademark or service mark during any continuous three year period counted from the registration date. Assignments and licenses of trademarks and service marks must be registered with Rospatent. In the absence of such registration, they are deemed null and void.

The appellation of origin of goods is a name constituting or containing a current or historical denomination of a country, settlement, locality or other geographic unit (hereinafter referred to as a "geographic unit") or a derivative of such denomination that has become known as a result of its use with respect to goods the specific features of which are mainly or exclusively determined by natural conditions or human factors which are characteristic of such geographic unit. The designation which, through representing or containing the name of a geographic unit, has entered in the Russian Federation into the public domain as a designation of goods of a certain kind (has become generic), which are not related to the place of their manufacture, may not be deemed to be the appellation of the origin of goods. Legal protection is given to an appellation of origin of goods based on its registration with Rospatent. An appellation of origin of goods may be registered in the name of one or more persons. Person/persons that have duly registered an appellation of origin of goods obtain a right to use such appellation, provided that the goods manufactured by such person/s satisfy the criteria mentioned above. The right to use an appellation of origin of goods may be granted to any legal entity or individual which produces the goods with the same specific features within the same territory. The term of protection is for 10 years from the date of filing the application and may be renewed for subsequent 10-year periods. The owner may not grant licenses for the use of the appellation of origin of goods. Infringement of rights to a trademark, service mark or appellation of origin of goods may entail civil, administrative or criminal liability.

13.4 Company Names and Trade Names (Commercial Designations)

Company names are designations that identify or distinguish different legal entities when conducting their commercial activities. Legal protection of company names is provided by the Civil Code and the Paris Convention for the Protection of Industrial Property, to which the Russian Federation is a party. In the Russian Federation, a company name consists of two parts: the indication of a business legal structure and the distinctive name of the company. A company may use in its company name the official name of the Russian Federation or any words derived there from only with the assent of the Russian Government. The right to a company name arises from the moment of the state registration thereof along with the state registration of the legal entity. The owner of a company name is allowed to use its company name exclusively, and to prohibit others from its unauthorized use. The owner of a company name may not alienate its company name or grant the right to use it to another person. A legal entity may not use a company name which is identical or confusingly similar to the company name of another legal entity, if both entities are engaged in similar business activities and the company name of the former legal entity has been incorporated in the state register of legal entities prior to the state registration of the latter. A legal entity illegally using the company name of another legal entity is obliged to cease its use at the request of the company name owner and to compensate for any incurred losses. A company name owner may use its company name or its individual elements as a part of its trade name or a trademark (service mark) belonging to the company name owner. A company name incorporated in a trade name or a trademark (service mark) is protected regardless of the protection of the trade name or the trademark itself.

Trade names are protected by virtue of the *Civil Code* and the Paris Convention for the Protection of Industrial Property, to which the Russian Federation is a party. Part IV of the *Civil Code* contains a special section concerning legal protection of trade names. Trade names (so-called "commercial designations") are designations which individualize trading, industrial or other types of enterprises owned by legal entities and individual entrepreneurs. Trade names are other than company names, they do not require registration and are not subject to obligatory incorporation into the foundation documents of trade name owners. The owner of a trade name enjoys an exclusive right to its trade name and may use it by any lawful means. The exclusive right to a trade name arises if the designation which is used as a trade name possesses sufficient distinctiveness and its use has gained notoriety within certain territory. The scope

of protection of a trade name used for the purpose of individualization of an enterprise located in the Russian Federation is limited to the territory of the Russian Federation. An exclusive right to a trade name terminates if the owner of the trade name fails to use it during a continuous one-year period. A trade name owner may grant the right to use its trade name to another person under a lease of enterprise agreement or a franchising agreement.

13.5 Copyrights and Neighboring Rights

Part IV of the *Civil Code* protects works of science, literature and the arts (copyright) and grants protection to rights of performers, phonograms producers broadcasting and cable-casting organizations, database compilers and publishers (Part IV of the *Civil Code* uses the term "publicators") (neighboring rights). Copyright protection arises by virtue of the creation of a work of art without any registration requirements. An author enjoys personal (moral) rights (right of authorship, right to the name, right to public disclosure, right to protect the author's reputation) and proprietary rights (right of reproduction, distribution, import, public demonstration, public performance, translation, modification etc.). The personal (moral) rights are inalienable from the author and cannot be assigned or transferred by agreement. The proprietary rights to a copyrighted object may be licensed or assigned by virtue of a copyright agreement. Part IV of the *Civil Code* allows for the transfer of copyright in the form of an exclusive or a non-exclusive license agreement as well as by an assignment of copyright. The term of copyright protection for all works, including software programs or databases, shall be the lifetime of the author, plus 70 years after his/her death. The author's moral rights (right of authorship, right to the name and right to protect the author's reputation) are protected perpetually. Infringement of copyright may entail civil, criminal or administrative liability.

13.6 Software Programs and Databases

Copyright protection also applies to computer programs and databases. Pursuant to Part IV of the *Civil Code*, software programs are protected as literary works, while databases are protected as compilations. Although registration is not mandatory for protection, an author may optionally register and deposit software or a database with Rospatent. A software program or a database is protected for the lifetime of the author(s) plus 70 years after his/her (their) death(s). The right to use a software program may be granted under a software license agreement.

13.7 Topologies of Integrated Microcircuits

In accordance with Part IV of the *Civil Code*, legal protection is granted with regard to original topologies of integrated microcircuits, developed as the result of an author's work. The author enjoys the exclusive right to use the topology as he/she sees fit, including the prohibition of its unauthorized use by third parties. The rights into a topology may be transferred fully or partially to the other person under a written assignment agreement or license agreement. Although the registration of a topology is not mandatory for its protection, an author may voluntarily register it with Rospatent. The exclusive right to use the topology is effective for 10 years from the date of its initial use or from the date of the topology's registration, whichever is earlier.

13.7.1 Trade Secrets and Know-How

Use of trade secrets and know-how is regulated by the *Civil Code* (Part IV) and Federal Law No. 98-FZ dated July 29, 2004 "*On Trade Secrets*" (*the "Trade Secrets Law"*), as amended. Pursuant to the Trade Secrets Law, in order to protect (and have others respect) its trade secrets, an entity needs to establish a so-called Trade Secrets Regime and ensure that it is complied with by all of its employees and counterparties. Therefore, broadly interpreted confidential information may fail to be protected under the Trade Secrets Law. According to the *Civil Code* (Part IV) and *the Trade Secrets Law*, information may be treated as a trade secret only if: (i) it has real or potential commercial value due to the fact that it is unknown to third parties; (ii) it is not freely accessible using lawful means; (iii) the owner has taken reasonable measures to protect its confidentiality, including legal, organizational, technical and other measures; and (iv) its confidentiality allows, under the existing or potential circumstances, the increase of revenue, the avoidance of unnecessary expenses or receipt of other commercial benefits. If any of the steps required to establish a Trade Secrets Regime are not taken, the entity might be unable to protect its trade secrets under the Trade Secrets Law (*e.g.*, to initiate criminal or administrative prosecution for violation of the trade secrets regime, to claim damages, to terminate the employee for disclosure, etc.). Part IV of the *Civil Code* prescribes that an employee who has obtained access to a trade secret of the employer is obliged to keep such information confidential until termination of the exclusive right to the trade secret.

13.7.2 Domain Names

Please note that .ru zone domain names are registered in Russia on a first-come, first-served basis by several registrars. When registering domain names, the registrars

neither check nor require domain name applicants to prove that they have a legitimate right to use the names they seek to register. The adopted text of Part IV of the *Civil Code* retains a reference to domain names, prohibiting registration of trademarks that are identical to domain names, rights into which have arisen prior to the priority date of the filed trademark application. However, Part IV of the *Civil Code* lacks any criteria of recognizing identity between a trademark and a domain name. Neither does it contain a legal definition of a domain name. Pursuant to Part IV of the *Civil Code*, no one may use, without the permission of the trademark owner, designations that are confusingly similar to the trademark in respect of goods and services, for individualization of which the trademark was registered, or similar goods. Part IV of the *Civil Code* specifies some acceptable forms of use of a trademark by its owner. The exclusive right into a trademark may be exercised, in particular, by application of the trademark in the Internet, including its application in domain names and other means of addressing. There is no procedure similar to UDRP in Russia, therefore, all domain name disputes that are not amicably resolved need to be taken either to a court of general jurisdiction (when the defendant is an individual) or an arbitrazh (state commercial) court (when the defendant is a legal entity). There is a trend to submit all domain name disputes to arbitrazh courts, regardless of whether the defendant is an individual or a legal entity. While this is not based on any written legislation, it happens more and more often.

14. BANKRUPTCY

14.1 Overview

Russia has had a series of bankruptcy regulations and laws in place since 1992, and has most recently passed two sets of amendments, the first in December 2008 and the second in April 2009, to the current bankruptcy law since the inception of the financial crisis. The Russian bankruptcy law is comprehensive and provides several variants for resolving a company's insolvency, including reorganization and rehabilitation of an insolvent company as an alternative to liquidation of its assets.

However in practice bankruptcy is not yet widely viewed as a reliable and transparent process for resolving debtor-creditor issues. Indeed, it has been widely perceived as a process used by debtors to transfer assets and avoid creditors, hence the concept of "sham bankruptcy" is addressed in the legislation.

The recent amendments to the law have been aimed at strengthening the role and regulation of bankruptcy administrators, and at broadening the scope of suspicious debtor transactions occurring before bankruptcy that can be reversed by creditors on application to the court.

14.2 Legislation

Bankruptcy and restructuring in Russia is governed by Part I of the Civil Code of the Russian Federation (Article 64) and by the Federal Law on Insolvency (Bankruptcy) of October 26, 2002, including subsequent amendments. This does not apply to insolvent banks and other financial institutions, which are governed under separate legislation. In addition, there are extensive rules and regulations adopted by the government, the Ministry of Economic Development and various state bodies, in addition to court decisions from the Supreme Arbitrazh Court and other courts designed to standardize bankruptcy in practice.

14.3 Procedure

The Russian bankruptcy procedure can be initiated by either creditors or the debtor itself. Creditors can file a petition to begin bankruptcy proceedings only after obtaining a court judgment that a debtor owes them in excess of 100,000 Russian rubles (approximately 3000 USD) and only after debt has remained unpaid for more than three months. The requirement for a court judgment is a relatively new requirement, which was designed to encourage parties to reach informal settlements. It however imposes delays on creditors seeking to initiate external controls over debtor companies.

The law requires debtor companies to file a petition for bankruptcy within a month of determining that satisfying one creditor's debt would make it impossible to satisfy the company's other debts.

Once the petition for bankruptcy has been filed, the debtor enters the first phase of the procedure, which is entitled Observation. Every bankruptcy involves an Observation period. Other phases, which will vary depending on the circumstances of the insolvency, include Financial Rehabilitation, External Administration, Competition Proceedings and Amicable Settlement.

14.3.1 Observation

The Observation phase of the process lasts for a period of not more than seven months. The important activities during this phase include securing and valuing the debtor's assets, and compiling the list of creditors. Once this has taken place, the last step in the Observation process is conducting the first Creditors' Meeting to determine what procedure should be invoked. During the observation stage, business proceeds more or less as normal for the debtor, as the court-appointed administrator has only limited authority over the debtor's activities. Management remains in place, unless the administrator obtains the approval of the court to dismiss them. Even in such an event, the new management is selected by the debtor. During Observation, the administrator's approval is required to purchase or sell assets totaling more than 5% of the debtor's assets and to grant and receive loans or guarantees. Debtors are prohibited from withdrawing from a LLC, issuing bonds or dividends and from making major decisions regarding reorganizations, liquidations, branch offices or joint ventures.

14.3.2 Amicable Settlement

The creditors and the debtor are allowed, at any stage of bankruptcy proceedings, to come to a settlement agreement, subject to the court's approval. Once a settlement agreement is arranged, the bankruptcy procedure is closed, though breaches the settlement agreement can be brought to the court for redress.

14.3.3 Financial Rehabilitation

This phase is triggered if the creditors and court believe there is a reasonable chance for the debtor to avoid bankruptcy. Business proceeds largely as it did in the Observation stage, with the following changes and exceptions: the court appointed administrator is now responsible for compiling a report for the court, which determines the outcome of this phase, and the Creditors' Meeting has the same limited authority as the administrator in Observation. In addition, the administrator's authority is broadened, and prior approval is required to increase accounts payable, to sell the debtor's assets, or to incur debt. The Financial Rehabilitation phase cannot exceed two years. At its end, the administrator's report to the court will be a major factor in the court determining whether the bankruptcy proceeding can be closed, or if the process must be continued, with more stringent measures being applied to satisfy creditors.

14.3.4 External Administration

External Administration is like Financial Rehabilitation aimed at restoring the debtor to financial health. However, in External Administration the debtor's management is dismissed and the court-appointed administrator manages the firm according to an External Administration Plan drawn up by the administrator and approved by the Creditors' Meeting. In this phase the administrator has the authority to embark on radical restructuring plans in an attempt to satisfy creditors' claims and restore the debtor's financial health, provided they are agreed to by the Creditors' Meeting. The Creditors' Meeting is also responsible for approving major transactions and the granting of loans and guarantees. External Administration is to last for no more than 18 months, with the possibility of a six month extension. At the end, if all debts have not been discharged and no agreement has been struck, the debtor proceeds to Competition Proceedings.

14.3.5 Competition Proceedings

In this stage the debtor is liquidated to pay creditors' claims in the order prescribed by law. During Competition Proceedings, it is still legally possible for an Amicable Agreement to be concluded between debtor and creditors.

14.4 Satisfaction of Claims

In the event of a liquidation, creditors' claims are divided into three classes. The first class of creditors are individuals owed compensation for physical injury or moral damages. The second class of creditors are employees owed severance pay and/or salaries, and authors or inventors owed royalty fees for intellectual property. All other creditors are treated as ordinary creditors to be paid after both of the preferred creditor claims have been satisfied in full. In the event that a class of creditor cannot be paid in full, they will be paid in part in proportion to the size of their claims relative to other claims in their class. Secured creditors are outside the bankruptcy to the extent their claims can be satisfied from the security they hold.

14.5 Banks and Financial Institutions

In the event that a bank or financial institution is unable to meet its obligations to its creditors, the Central Bank will revoke its license and it will be liquidated. The claims of its depositors will be satisfied before any other claims; otherwise things proceed as they do in other liquidations.

15. THE RUSSIAN JUDICIAL SYSTEM

15.1 Introduction

The Russian judicial system consists of federal courts (the Constitutional Court of the Russian Federation, courts of general jurisdiction, and state "arbitrazh" (commercial) courts) and the courts of the Russian Federation constituent entities (Constitutional Courts and magistrates). The Constitutional Court generally resolves issues relating to the compliance of federal and regional laws and regulations with the Russian Constitution. Courts of general jurisdiction and magistrates hear criminal cases, civil disputes between individuals, and disputes arising from administrative relationships between individuals and state bodies. Disputes regarding business activities are heard before the state arbitrazh courts.

15.2 State Arbitrazh Courts

The title "arbitrazh court" is not related to arbitration tribunals but originates from an old Soviet tradition whereby disputes between state enterprises were heard before so-called "State Arbitrazh." In the USSR, it was assumed that under a planned economy no disputes could arise between socialist enterprises (since all enterprises ultimately had the same owner), and any differences which did arise could be settled by an intermediary - the State Arbitrazh - which was a quasi-judicial government institution.

The procedural rules applicable to the Russian arbitrazh courts are based on the general principles of procedural law adopted in continental Europe, i.e., the procedure is more inquisitorial than adversarial like in common law jurisdictions.

However, the new Arbitrazh Procedural Code (the Code), adopted in July 2002, made this procedure more adversarial by limiting the abilities of the courts to collect evidence independently from the parties. The Code supersedes the previous procedural statute, issued in 1995, by setting out in more detail the day-to-day functioning and procedures of arbitrazh courts. These issues were previously dealt with by judges at their own discretion. With the adoption of the Code, some changes regarding the competence of arbitrazh courts were made. For example, some types of disputes involving individuals are now resolved by arbitrazh courts rather than courts of general jurisdiction as was previously the case.

Traditionally, Russian arbitrazh courts favor written, documentary evidence rather than examination of witnesses, hearing experts, or use of audio or video records.

Arbitrazh courts have four levels:

(a) Trial courts;

(b) Appellate courts;

(c) Cassation appeal courts; and

(d) The Supreme Arbitrazh Court of the Russian Federation.

Russian arbitrazh courts have an important advantage: the trial period in these courts is relatively short. Proceedings start with a statement of claim. Under current regulations, a court must consider cases within three months of its receipt of a statement of claim. The judgment is announced immediately after the final hearing. The maximum state fee is limited to approximately 2,195 euro (as of March 2009).

A judgment of the first instance may be appealed within one month of being rendered, otherwise it comes into force at the end of the month. The ground of an appeal could be mistakes in establishing the factual circumstances of the case or in application of the law. In fact, an appeal is a limited retrial.

In most cases it takes around one month between filing an appeal with an appeals court and an oral hearing of the appeal. Before the hearing, all parties to a case are allowed to provide the court with written responses to the appeal.

A judgment of the first instance, and also a resolution on an appeal, may also be appealed in the cassation appeal court (third level court) after such judgment comes into force (i.e., for a first level court judgment - one month after it is rendered, if it is not appealed; for the appellate court resolution - immediately after its operative part is announced). The cassation court does not retry the case or re-evaluate the evidence but deals only with points of law. As a result of the cassation hearing the judgment may be upheld, reversed, or amended, or the case may be sent back to the court which issued the judgment for a rehearing.

The role of cassation appeal courts is performed by federal commercial courts. A cassation appeal must be filed within two months of the date of the relevant judgment and is heard within one month of the date of filing. Generally, the submission of a cassation appeal does not suspend the enforcement of the appealed judgment, though the cassation court may order a stay of execution.

A party may also challenge a judgment of any court by filing a supervision appeal with the Supreme Arbitrazh Court. The appeal may be filed within three months of the last judgment in the case.

In contrast to the procedures in the lower courts, the supervisory review is a two-tier process. Before the appeal is actually heard on the merits, a panel of judges of the Supreme Arbitrazh Court reviews the party's appeal and decides whether there are grounds for carrying out a supervisory review of the judgment that is appealed against. If the panel decides to refer the case for supervisory review, it is the Presidium of the Russian Supreme Arbitrazh Court that would then proceed to hear the appeal.

In practice, less than two percent of applications are accepted for hearing an appeal in the Supreme Arbitrazh Court.

A legal entity involved in an arbitrazh court case in Russia may represent itself in court using the services of an in-house lawyer or retain one of the foreign or local law firms.

Certain formalities must be followed in order for a person to appear as a legal representative in court. The Code of Arbitrazh Procedure provides that a legal entity may be represented by its general director or by another person acting pursuant to a power of attorney. The power of attorney must be signed by the general director of the company and sealed by the corporate seal. Where a power of attorney is issued outside the Russian Federation, it must be notarized and apostilled (i.e., a special stamp should be affixed to the certified document according to the Convention of October 5, 1961 Abolishing the Requirement of Legalization for Foreign Public Documents).

Moreover, a representative acting under a power of attorney may perform certain procedural actions only if such actions are expressly stated in his/her power of attorney. These actions include the right to sign a statement of claim, statement of defense, appeals, applications to amend the cause of an action and subject matter of the action, applications for provisional remedies, acceptance of withdrawal of claims, etc.

15.3 Personal Jurisdiction Over Foreign Defendants

Russian courts have jurisdiction over foreign defendants if:

(a) the defendant is located or resides in the Russian Federation or the defendant's assets are located in the Russian Federation;

(b) the management body or a branch or representative office of the foreign party is located in the Russian Federation;

(c) the dispute arose out of a contract, performance under which should have taken place, or actually took place, in the Russian Federation;

(d) the claim arose out of damage caused to assets by an act or other event that occurred in the Russian Federation, or upon the onset of harm in the Russian Federation;

(e) the dispute arose out of unjust enrichment that took place in the Russian Federation;

(f) the claimant filing an action for the protection of its business reputation is located in the Russian Federation;

(g) the dispute arose out of a relationship connected with circulation of securities that were issued in the Russian Federation;

(h) the applicant in a case to establish a fact of legal relevance claims that such fact occurred in the Russian Federation;

(i) the dispute arose out of a relationship connected with state registration of names and other assets and the provision of services via the Internet in the Russian Federation; or

(j) in other cases where the disputed legal relationship is closely linked with the Russian Federation.

In addition, Russian courts also have jurisdiction over disputes involving foreign parties if such disputes fall within the exclusive jurisdiction of the Russian courts, i.e.:

(i) disputes relating to state property, including privatization disputes and takeovers of private property for public needs;

(ii) disputes relating to title and other registered rights to real property located in the Russian Federation ;

(iii) disputes connected with the registration in the Russian Federation of patents, trademarks, designs or utility models, or registration of other rights in the results of intellectual pursuits;

(iv) disputes involving the establishment, liquidation or registration of legal entities and self-employed entrepreneurs in the Russian Federation; or

(v) disputes arising over administrative and other public law relationships with Russia or Russian state agencies.

Russian courts also have jurisdiction over a foreign defendant where the parties have agreed in writing to submit their disputes to Russian courts, provided that the agreement does not violate the exclusive jurisdiction of a foreign court.

It is comparatively rare for a dispute to arise over jurisdiction of Russian courts because the criteria for establishing the jurisdiction of the Russian courts are generally perceived as straightforward to apply.

15.3 International Arbitration

As an alternative to the state arbitrazh courts, foreign investors may refer disputes to a private arbitration tribunal, including ad hoc and institutional arbitration tribunals located either in the Russian Federation or abroad. The arbitration proceedings may cover a wide range of issues, but not disputes arising from administrative relations (*e.g.*, tax and customs) and disputes that fall within the exclusive jurisdiction of the Russian arbitrazh courts (*e.g.*, disputes arising from bankruptcy proceedings, or other disputes specifically enumerated in the Code and other Russian laws).

The principal rules of international arbitration are governed by the Federal Law On International Commercial Arbitration, enacted on July 7, 1993; these rules are identical to the provisions of the Model UNCITRAL Law.

In addition, the international commercial arbitration provisions of various international treaties to which the Russian Federation is a party and, in particular, the European Convention on International Commercial Arbitration of 1961 and the New York (United Nations) Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (the New York Convention), also apply in Russia.

15.5 Enforcement of Judgments and Arbitral Awards

Judgments of Russian courts of general jurisdiction and of Russian arbitrazh courts are enforced through the state bailiff service.

A foreign court judgment may be enforced in Russia only if such judgment has been recognized by a Russian court. Such recognition is available if supported by a relevant international treaty and federal law that applies. Despite the lack of direct regulation, Russian courts recognize and enforce foreign court judgments relying on the principle of reciprocity on a case by case basis.

Russia is a party to the Kiev Convention on the Procedure for Resolving Disputes Relating to Business Activities (the Kiev Convention). According to the Kiev Convention, judgments rendered by state courts of certain CIS nations are enforceable in the Russian Federation. The Russian Federation is also a party to a number of bilateral agreements concerning the recognition and enforcement of court judgments.

Arbitral awards rendered by arbitration tribunals located in the Russian Federation or abroad are also executed by the bailiff service after such awards are recognized and ordered to be enforced by Russian courts. As a rule, Russian courts may not review any foreign arbitral award on its merits. The grounds for the refusal to recognize and enforce foreign arbitral awards are generally the same as those set forth in the New York Convention.

15.6 Alternative Dispute Resolution

Although mediation and other forms of alternative dispute resolution (ADR) are fairly widely discussed in the legal community, there is no established practice for invoking such procedures in the Russian Federation. Nor is there any legislative regulation available for ADR (apart from commercial arbitration). There is no statutory provision, for example, that states that documents received by the parties in the course of mediation may not later be used as evidence in the court, or that the ADR mediator may not subsequently be called as a witness in legal proceedings between the parties.

16. NATURAL RESOURCES (OIL AND GAS/MINING)

Today Russia is one of the largest mineral producers in the world. Russian deposits contain approximately 15- 17 per cent of the world's global mineral deposits and Russian mineral resources are an important component of its wealth.

16.1 Introduction

Russia differs from other countries where the private ownership of minerals in the ground exists and where land owners have title to all mineral resources located below their land plots. All Russian subsoil resources in the ground, including oil, gas, gold and other minerals, unless extracted, are owned by the Russian state, irrespective of who holds the title to the relevant land plot or holds the relevant subsoil license. Rights to extract subsoil resources can be granted under subsoil licenses which, as a rule,

provide that ownership rights to the extracted resources belong to the holder of the relevant license. Geological survey rights may be granted under both a license and a state contract (when a geological survey is performed at a request of the Russian state).

16.2 Subsoil Legislation

The Constitution of the Russian Federation stipulates that subsoil-use legislation falls within the joint competence of the federal and regional state authorities. However, in practical terms the regional authorities have competence over deposits of certain widespread mineral resources and insignificant subsoil deposits.

The core legal act in the mining and oil and gas domain is Russian Federation Law on Subsoil Resources dated 21 February 1992, as amended (the Subsoil Law). The Subsoil Law provides the general legal framework for the use of subsoil resources in Russia and covers almost all principal issues connected with geological survey, exploration and production/mining of underground resources.

The other principal law governing the use of subsoil resources in Russia is the Federal Law on Production Sharing Agreements dated 30 December 1995, as amended (the PSA Law). The PSA Law sets forth the legal framework for Russian and foreign investments in the geological survey, exploration and production of subsoil resources.

16.3 Subsoil Users

Under the Subsoil Law, both Russian and foreign companies may hold subsoil licenses in the Russian Federation, save for licenses for strategic deposits which may be developed by Russian companies only. In respect of off-shore fields, the user of such fields may only be a Russian company which is at least 50% owned by the Russian state and which has at least five year experiences of development of off-shore fields. Although foreign companies are allowed to hold subsoil rights in respect of non-strategic deposits, in practice there are only a few cases where a foreign company directly holds subsoil rights in Russia. Therefore, usually foreign companies hold subsoil rights to Russian deposits indirectly through their Russian subsidiaries which are allowed to hold subsoil rights in respect of on-shore strategic deposits.

16.4 Licenses

Russia, similarly to many other countries, has adopted a licensing system. Subsoil licenses in Russia include: geological survey licenses, exploration and mining/production licenses and combined licenses (geological survey, exploration and mining/production licenses).

A geological survey license may be granted for a maximum period of 5 years and can be extended if needed for completion of the works. Exploration and mining/production licenses and combined licenses can be issued for a term equal to the life of the project, however in practice they are usually granted for 20 or 25 year terms and can generally be extended.

Geological survey licenses are issued without a tender or auction based on an application of the interested party. Unlike geological survey licenses, mining/production licenses and combined licenses can be granted only through a tender or auction, except when a mining/production or combined license is issued to a holder of geological rights that made a commercial discovery under a geological survey license.

Subsoil licenses are issued by the Federal Agency for Subsoil Use (Rosnedra). Rosnedra is in charge of granting subsoil rights with respect to all onshore deposits, as well as granting rights for the geological survey of offshore deposits. Rights to production of oil and gas on offshore fields may only be granted based on a decision of the Government of the Russian Federation.

16.5 Transfer of Subsoil Rights

As a general rule, subsoil rights in Russia are not freely transferable. This means that they cannot be sold, pledged or otherwise encumbered. However, the Subsoil Law permits the transfer of subsoil rights, except for the rights to strategic deposits, in certain instances, which makes such rights transferable to a limited extent. Such instances include: (i) transfer of subsoil rights from a parent company to its subsidiary and vice versa and transfer between the subsidiaries of the same parent company; (ii) transfer following a merger of the license holder with and into another company; (iii) transfer following a consolidation of the license holder with another company; (iv) transfer following a spin-off or split-off of a new company. Any such transfer of subsoil rights requires a special decision of Rosnedra. Rights to strategic deposits are not transferrable unless otherwise is determined by the Russian Government in respect of a specific deposit.

The above options are often used by subsoil users for structuring their business, as well as for the "sale" of licenses, which is only possible through a sale of the licensee's shares.

16.6 Strategic Deposits

In 2008 Russia introduced a long-discussed set of restrictions for foreign investors in respect of strategic subsoil plots (subsoil plots of federal significance). Strategic deposits include the following:

1) subsoil plots containing deposits and showings of uranium, diamonds, high-purity quartz, the yttrium group of rare earths, nickel, cobalt, tantalum, niobium, beryllium, lithium, or the platinum group of metals (irrespective of the size of the deposits);

2) subsoil plots containing the following reserves, as evidenced by the State Register of Reserves, as of January 1, 2006:

   - recoverable oil reserves equal to or exceeding 70 million tons;
   - gas reserves equal to or exceeding 50 billion cubic meters;
   - hard-rock gold reserves equal to or exceeding 50 tons; or
   - copper reserves equal to or exceeding 500 thousand tons;

3) subsoil plots located in the inland sea waters, territorial sea waters, or on the continental shelf of the Russian Federation;

4) subsoil plots that can only be developed using land used for defense and security.

The list of subsoil plots of federal significance has been published by the Federal Agency for Subsoil Use and includes approximately 1,000 strategic deposits.

16.6 Production Sharing Agreements

In the Russian Federation Production Sharing Agreements (PSAs) are used to provide a particular legal framework for foreign investors in the mining, oil, gas, and other extraction sectors. The main objective of the PSA legislation is to provide investors in these sectors with greater stability in fiscal and regulatory areas over long-term periods. The main legislation governing PSAs in Russia is the PSA Law.

Since 2003 subsoil plot development under the PSA Law has been available only if such subsoil plot was put out to auction and the auction failed. That is, only those plots that are not interesting to subsoil users on standard license terms and conditions may be developed under a PSA. Therefore, the best deposits are distributed under subsoil licenses and the PSA regime is not very attractive to subsoil users.

Due to the above and to the PSA tax regime established at the same time (see section 6.9 below), PSAs have, in practice, become largely ineffective in terms of attracting foreign investment into Russia.

17. BANKING

17.1 Legal Framework

The foundations of the Russian banking system are provided in Federal Law No. 395-1 *On Banks and Banking Activities*, dated 2 December 1990 (the "Banking Law"), and Federal Law No.86-FZ *On the Central Bank of the Russian Federation*, dated 10 July 2002 (the "CBR Law"). Bank insolvency is regulated by Federal Law No. 40-FZ *On Insolvency (Bankruptcy) of Credit Organizations*, dated 25 February 1999. The Central Bank of the Russian Federation (the "CBR") is responsible for regulating banking activities. Through its instructions, regulations, and other acts, the CBR establishes rules, standards, and obligatory requirements for banks and non-banking credit organizations throughout the territory of the Russian Federation.

17.2 Regulatory Bodies

The primary regulatory body governing the banking sector of the Russian Federation is the CBR. The CBR is one of the few institutions under the control of the Russian legislative (rather than executive) branch. The State Duma must not only approve the nomination of the chairman of the CBR, but also approve the resignation of the chairman. However, the CBR Law provides for the establishment of a specific body within the structure of the CBR, the National Banking Council (the "NBC"), comprised of representatives of various executive and legislative bodies. The NBC exercises control over the CBR's board of directors, and participates in establishing the basic principles of Russian banking and financial policy.

The CBR and the Government share authority over monetary policy. The CBR is responsible for circulating monetary funds and ensuring the stability of the Russian

ruble. As part of its general oversight role, the CBR establishes state registration and licensing rules, determines minimum reserve requirements, and also approves the appointment of the senior management of all credit organizations. The CBR maintains regional offices throughout the Russian Federation.

Several associations of Russian banks, among which the Association of Russian Banks (the "ARB") is the largest, are also important standard-setting bodies.

17.3 Credit Organizations in the Russian Market

Pursuant to the Banking Law, there are two main groups of credit organizations: banks and non-banking credit organizations. A bank is a credit organization which has the right to carry out such banking operations as opening and maintaining bank accounts of legal entities and individuals, attracting deposits of monetary funds from legal entities and individuals and placement of those funds in its own name and at its own cost and expense. Conversely, a non-banking credit organization is an entity which is allowed to perform a limited number of specified banking operations.

Both banks and non-banking credit organizations are entitled to carry out respective banking operations from the moment of receipt of a banking license issued by the CBR. Both types of credit organizations may participate in banking groups (when the controlling company is a credit organization) and banking holdings (when the controlling company is a non-credit organization).

Currently, foreign banks may not establish branch offices in the Russian Federation but may set up Russian banking subsidiaries. The participation of foreign banks in the Russian market is subject to certain restrictions. However, at the end of 2006 the regulatory regime in this area was significantly liberalized. In particular, non-residents now need the CBR's prior approval only if they acquire 20% or more of a Russian bank's shares. When a non-resident acquires more than 1% but less than 20%, the CBR need only be notified. This is similar to the regulation which applies to Russian residents. Also, the CBR may not establish additional requirements for the subsidiaries of foreign banks related to mandatory ratios and minimal charter capital. However, additional requirements in respect of reporting procedures, approval of management bodies and permitted operations of the representative offices and subsidiaries of foreign banks may still be introduced.

17.4 Banking Activities

According to the Banking Law, the list of banking operations includes the following: attraction of monetary funds for on-call and term deposits and placement of such funds in the own name and at the own cost and expense of the relevant credit organizations; depositing precious metals; opening and maintaining bank accounts for individuals and legal entities; collecting money, promissory notes and bills of exchange, payment and settlement documents; cash servicing of individuals and legal entities; exchanging foreign currency; issuing bank guarantees; and transferring money on the instructions of individuals without the opening of bank accounts. Banks are also entitled to perform certain non-banking operations, inter alia: providing financial suretyship; trust management; performing operations with precious metals and stones; renting out safe deposit boxes; participating in financial leasing operations; and providing consultancy and other informational services. Credit organizations are prohibited from engaging in any industrial, trade, or insurance activities.

17.5 Licensing

A credit organization must be licensed by the CBR in order to conduct "banking activities" as defined in the Banking Law, and must be registered in the Russian Federation. License applicants must submit a feasibility report, detailed information on senior management and their compliance with qualification requirements, and documents certifying the source of funds contributed to the charter capital of the credit organization, to the CBR. Newly established banks can receive the following licenses:

- A license to carry out banking operations with monetary funds in rubles only (without the right to attract deposits from individuals);
- A license to carry out banking operations with monetary funds in rubles and in foreign currency (without the right to attract deposits from individuals);
- A license to deal with precious metals.

A registered bank that has held a license for a period of two years or more is entitled to obtain the following additional licenses:

- A license to attract deposits from individuals in rubles;
- A license to attract deposits from individuals in rubles and in foreign currency;
- A general license, which covers all of the above activities (except for operations with precious metals).

The above licenses to attract deposits from individuals may also available to newly registered banks or banks which are less than two years old, if their capital exceeds 3.6 billion rubles, provided certain additional disclosure requirements are complied with .

The CBR may refuse to issue a banking license in the event of the following: non-compliance of the application documents with Russian legal requirements; the unsatisfactory financial standing of the founders of the credit organization, or their failure to perform their respective obligations before the federal budget, the budgets of constituent entities of the Russian Federation or local budgets; the failure of the nominee chief executive officer and chief accountant of the credit organization (or their deputies) to meet the qualification requirements; or an unsatisfactory business reputation of nominee members of the board of directors of the credit organization.

17.6 Deposit Insurance

Federal Law No. 177-FZ *On Insurance of Deposits of Individuals in the Banks of the Russian Federation*, dated 23 December 2003 (the "Deposit Insurance Law"), came into effect at the end of December 2003 and established an insurance system for the deposits of individuals. The Deposit Insurance Law is intended to protect the interests of individual depositors. It stipulates that all banks accepting individual deposits become members of the deposit insurance system. The Agency for Deposit Insurance (the "Agency") is responsible for supervising the bank deposit insurance system. Banks that have been issued a retail banking license are entered into the Agency's register. Banks that hold a valid retail banking license will need to apply to the CBR to become registered as a participant in the mandatory deposit insurance system. A bank is expected to pass a number of tests before it can be admitted. The CBR must be assured that: the bank's financial accounts and reports are accurate; the bank is in full compliance with the CBR's mandatory ratios (capital adequacy, liquidity, etc.); the bank's solvency position is sufficient; and that the CBR has not cancelled such bank's banking license. If a bank fails the above tests or chooses not to participate in the deposits insurance system, it will not be able to attract deposits from, or open accounts for, individuals. Member banks have to make contributions to the special deposit insurance fund. These contributions are calculated as a percentage of the average daily balance of individual deposits maintained with a particular bank, and beginning from the 4th quarter of the year 2008 are subject to an upper limit of 0.1%. All individual depositors with deposits in member banks are entitled to 100% compensation for aggregate amounts up to 700,000 rubles (approximately 22,500 USD).

17.7 Countering Money Laundering

On the basis of recommendations made by the Financial Action Task Force on Money Laundering (the "FATF"), the State Duma adopted Federal Law No. 115-FZ *On Combating Money Laundering and the Financing of Terrorism* (the "Anti-Money Laundering Law"), which came into force on 1 February 2002. The Anti-Money Laundering Law requires banks and a wide range of financial institutions to report to the Federal Financial Monitoring Service any cash or electronic transactions of 600,000 rubles (approximately 19,350 USD) or more (or the equivalent of such amount in a foreign currency), and transactions with real property of 3,000,000 rubles (approximately 97,000 USD) or more (or the equivalent of such amount in a foreign currency). Beginning 15 January 2008 all settlement transactions and transfers of funds carried out without opening an account must be performed with an obligatory indication, either in the payment documents or otherwise, of information on the payers and their respective account numbers (if available) at each stage of the execution of transactions.

The Anti-Money Laundering Law establishes requirements relating to preventing and reporting of suspicious transactions (including internal record-keeping and customer identification procedures) by financial institutions such as banks and non-banking credit organizations, professional participants of securities markets, insurance and leasing companies, postal and other non-credit organizations that deal with the transmission of money. As of 15 January 2008 banks are required to identify foreign public officials serviced by them and sources of their financial means and other property. Banks are required to pay increased attention to transfers of monetary funds and other property between foreign public officials and their close relatives. The rules governing a financial institution's internal record-keeping and the reporting of suspicious transactions include an obligation to investigate all complex or unusual transaction schemes that have no apparent economic or lawful purpose. Anonymous accounts are prohibited. Financial institutions are exempt from legal responsibility for a breach of any obligatory information disclosure restrictions when such a breach is necessary for compliance with the Anti-Money Laundering Law. The Anti-Money Laundering Law requires financial institutions to ascertain the actual identity of their customers and to disallow the creation and maintenance of anonymously held accounts.

Administrative penalties for violation of Russia's anti-money laundering requirements include various fines, which may be imposed on officials and legal entities. The fines can be up to 20,000 rubles (approximately 650 USD) for officials, and up to 500,000 rubles (approximately 16,000 USD), for legal entities. Additionally, a legal entity

which carries out operations in monetary funds and other property may be prohibited from carrying out its business activities for a period of up to 90 days. Failure by a credit organization to comply with the requirements of the Anti-Money Laundering Law may serve as a basis for revocation of its banking license, or imposition of a fine in the amount of up to 1 per cent of the minimal statutory amount of charter capital (according to the Banking Law, the minimal statutory amount of the charter capital of a credit organization is 180 mln. rubles), or prohibition to perform certain banking operations for up to twelve months, or entail other administrative law liability. Furthermore, criminal liability is also applicable to persons (including company officers) for failure to comply with some of the requirements of the Anti-Money Laundering Law which, depending on the circumstances, varies from fines in the amount of up to 1 mln. rubles (approximately 35,000 USD), or the other income of the convicted person for up to five years, or imprisonment for up to 15 years (which may be applied together with the fine in the amount of up to 1 mln. rubles or the other income of the convicted person for a period of up to 5 years).

18. INSURANCE IN RUSSIA

18.1. Introduction

The insurance business and distribution of life insurance products in Russia is mainly regulated by Federal Law No. 4015-1 "On the Organization of the Insurance Business in the Russian Federation" dated November 27, 1992, as amended (the **OIB Law**) and the Civil Code of the Russian Federation (the **Civil Code**). In the cases envisaged by the OIB Law, federal executive authorities may adopt further regulatory acts governing insurance procedures. The insurance business is supervised by the Federal Insurance Supervisory Service (**FISS**), which is responsible for issuing insurance licenses and supervising the compliance of insurers with applicable regulations. The RF Ministry of Finance is in charge of developing various regulations in the insurance market.

Conducting insurance activities requires a license in Russia. Pursuant to the OIB Law, insurers must be legal entities incorporated in accordance with Russian legislation and need a license in order to conduct insurance business. Reinsurance services may be provided by foreign reinsurers not licensed locally. Foreign investors may access the Russian market via their Russian subsidiaries.

About 800 insurance companies are currently listed as possessing an insurance license and because of the current economic situation this number is reducing. There is a tendency towards consolidation of the insurance market, including as a result of FISS policy which is aimed at strengthening the financial stability of domestic insurers and decreasing the number of providers of "false" insurance or insurers not in compliance with legislation.

In reinsurance matters, Russian insurers work closely with foreign insurers and integrate into the international insurance market by establishing affiliated companies abroad.

18.2. Restrictions on Foreign Investments

Russian law places restrictions on insurance companies that are subsidiaries of foreign investors or where more than forty-nine percent (49%) in their charter capital belongs to foreign investors (with an exception discussed below). They cannot conclude personal insurance contracts in relation to property interests connected with citizens surviving until a certain age or date, death, or other events in citizens' lives. They cannot provide mandatory liability insurance, mandatory state insurance or property insurance polices related to the performance or delivery of work under a contract for state needs as well as insurance of the property interests of state and municipal organizations.

A quota is established in respect of the foreign capital present in the aggregate capital of insurance companies operating in Russia. At present this quota is set at twenty-five per cent (25%) and is far from being exceeded. Should the foreign capital exceed this quota, the regulator must stop issuing licenses to insurance companies that are affiliates of foreign insurers or which are more than forty-nine percent (49%) foreign-owned.

An exemption from the above restrictions is provided in Clause 5 of Article 6 of the OIB Law. This exemption applies to subsidiaries of foreign companies and to companies with foreign capital exceeding the forty-nine percent (49%) limit, whose parent organizations are situated in member states of the European Communities. This exception is established in the "Agreement on Partnership and Cooperation Instituting Partnership between the Russian Federation on the One Hand and the European Community and the Member States Thereof on the Other" dated 24 June 1994.

According to various sources, there are legislative initiatives planned to allow foreign insurance companies to directly open branches in Russia. Incorporation and operation of such branches would be supervised by the FISS, and they would need to be permanent establishments for tax purposes. However, it is not clear when such legislation may be adopted.

18.3. Regulation of the Insurance Market and Products

The OIB Law contains a general description of the Russian insurance market organization, requirements in relation to licensing, operation and liquidation of insurance businesses, as well as regulation of other participants of the Russian insurance market, such as insurance brokers and dealers.

The Civil Code establishes the types of insurance, the concept and essential terms of insurance contracts, the rights and duties of parties to such contracts, rules for the change of parties and beneficiaries to insurance contracts, rules for termination of insurance contracts, as well as other fundamental insurance-related regulation. In particular, Article 934 of the Civil Code establishes the basis for personal (life and health) insurance and Article 929 the basis for property insurance (property insurance, liability insurance and business risks insurance).

18.4. Types of Insurance in Russia

Russian law provides for two basic types of insurance: personal insurance (such as life and health) and property insurance (property insurance, liability insurance and business risks insurance). The law also mentions the possibility of issuing insurance policies incorporating investment elements in the case of life insurance, however, because there is no further regulation of such instruments and for a number of other reasons, it is not clear how the investment provisions of such insurance policies would be treated in courts. A number of Russian major insurance carriers offer packages for life insurance with investment possibilities referred to as “elite”, however, no real market for such insurance products has been established so far.

19. PHARMACEUTICALS AND HEALTHCARE INDUSTRY

19.1 Legal Framework

Protection of citizens' health is one of the principles of the constitutional system of Russia declared by the Russian Constitution and the Russian healthcare system is built around this principle.

The basis of the Russian healthcare system is laid out in *Fundamentals of the Legislation of the Russian Federation on Citizens' Health Protection* No. 5487-1, dated July 22, 1993 (the "Fundamentals"). Federal Law No. 178-FZ *On State Social Care* dated July 17, 1999, as amended (the "Social Care Law") is also an important legislative act regulating the Russian healthcare system. The main legislative act specifically governing the pharmaceutical market in Russia is Federal Law No. 86-FZ *On Medicines*, dated June 22, 1998, (the "Law on Medicines"). Up until today no specific law was passed, which would separately regulate medical devices and medical equipment, even though an attempt to pass such a law was made.

Other laws that are also important for the pharmaceuticals and healthcare sector include Federal Law No. 184-FZ *On Technical Regulation*, dated December 27, 2002 governing technical regulation, namely declaration of the conformity of medicines and certification of medical devices and medical equipment (the "Law on Technical Regulation"), Federal Law No. 38-FZ *On Advertising*, dated March 13, 2006 (the "Law on Advertising") governing advertising of medicines, medical equipment, medical products and medical services, Federal Law No. 128-FZ *On Licensing of Certain Types of Activities*, dated August 8, 2001 (the "Law on Licensing") governing licensing in the Russian Federation.

19.2 Regulatory Bodies

The regulatory bodies governing the healthcare system and pharmaceutical market of the Russian Federation are the Ministry of Healthcare and Social Development (the "MOH") and the Federal Service for Surveillance in Healthcare and Social Development (the "Federal Service").

The MOH is responsible for drawing up state policy and regulation in the sphere of healthcare and social development. The MOH submits to the Government of the Russian Federation the drafts of federal constitutional laws, federal laws, acts of the

President and the Government in the sphere of healthcare, including on organization of medical assistance, related to pharmaceutical activity, quality, efficiency and safety of medicines.

The Federal Service grants licenses for manufacturing medicines, pharmaceutical activities (retail sale, wholesale of medicines and preparation of medicines), medical activities (medical works and services), manufacturing of prosthetic and orthopedic appliances, activities, related to circulation of narcotics and psychotropic substances, manufacturing of medical equipment and technical maintenance of medical equipment; keeps a register of licenses granted; exercises state control in the sphere of circulation of medicines; registers medicines and medical products; conducts accreditation and certification. Even though the Federal Service can not adopt legal rules itself (and due to this the most important documents initiated by the Federal Service are adopted by the MOH), documents issued by it in practice nonetheless should be taken into account by participants in the pharmaceutical market.

19.3 Clinical Trials of Medicines and Medical Tests of Medical Products

Registration (and thus circulation) of any new medicine on the Russian market is preceded by clinical trials of this medicine in Russia. Sometimes clinical trials are also conducted after the relevant medicine is registered.

According to Article 37 of the Law on Medicines, the purpose of the clinical trials of medicines is to obtain, through scientific methods, the evaluation and proof of the effectiveness and safety of medicines, data on possible side effects of the use of medicines and the effects of their interaction with other medicines. According to the Rules of Clinical Practice in the Russian Federation adopted by Order of the Russian Ministry of Healthcare No. 266 dated 19 June 2003, a clinical trial is a study of the clinical, pharmacological, pharmacodynamic effects of the studied medicine in humans, including processes of absorption, distribution, modification and excretion for the purposes of obtaining through scientific methods of assessment evidence of the efficacy and safety of the medicines, data on anticipated side effects of the medicines and on the effects of interaction with other medicines.

Besides the two documents already mentioned governing clinical trials in Russia, the following two documents are also relevant to this process: Industry Standard OST 42-511-99 Good Clinical Practice, adopted by the Russian Ministry of Healthcare December 29, 1998 and National Standard of the Russian Federation GOST R

52379-2005 Good Clinical Practice adopted by Order of the Federal Agency on Technical Regulation and Metrology No. 232-st dated September 27, 2005, both documents being the translations of ICH GCP with the latter being identical translation.

Each clinical trial may only be performed after its conduct is approved by the Ethics Committee of the Federal Service (operating in accordance with Order of the Federal Service No. 2314-Pr/07 dated August 17, 2007) and the Federal Service (given in accordance with the procedure established by Order of the Russian Ministry of Healthcare No. 103 dated March 24, 2000).

Registration of medical products also requires providing the Federal Service with the evidence of their quality, effectiveness and safety according to Administrative Regulation of the Federal Service *On Exercising the State Function of State Registration of Medical Products*, approved by Order No. 735 of the MOH, dated October 30, 2006. Such evidence is usually obtained in course of medical tests. State regulation of medical tests of medical products is less stringent compared to clinical trials of medicines.

19.4 Registration of Medicines

Registration of medicines is regulated by the Law on Medicines (Article 19) and Administrative Regulation of the Federal Service *On Exercising the State Function of State Registration of Medicines*, approved by Order No. 736 of the MOH, dated October 30, 2006.

Medicines can be manufactured, sold and used on the territory of the Russian Federation only if they are registered by the Federal Service. The following medicines (both Russian and foreign) are subject to state registration:

1) new medicines;

2) new combinations of medicines registered earlier;

3) medicines registered earlier, but manufactured with different dosages or different excipients;

4) reproduced medicines (i.e., generic medicines).

According to the Law on Medicines the application for the state registration of medicines may be submitted to the Federal Service either by the company-developer of the relevant medicine (holder of the patent rights for the medicine and of copyright to the results of preclinical trials) or its representative. In practice however the Federal Service also accepts applications from owners of rights to the intellectual property

with respect to the dossiers of medicines and with respect to the results of their pre-clinical trials (in the case of generic medicines) and from manufacturers of the relevant medicines (in all cases assuming they are duly empowered by the developers of the medicines to perform registration).

Even though the registration is performed by the Federal Service the usual process for registration of medicines in Russia starts not at the Federal Service itself, but at its subordinate organization FGU NC ESMP (Federal State Institution Scientific Center for Expert Examination of Means of Medical Use), which performs expert examination of application dossiers which are then submitted to the Federal Service.

Registration of medical products is also performed by the Federal Service and is regulated by Administrative Regulation of the Federal Service *On Exercising the State Function of State Registration of Medical Products*, approved by Order No. 735 of the MOH, dated October 30, 2006.

Registration process differs depending on the class of the medical device. There are four classes of medical products (1, 2a, 2b, 3) which are differentiated depending on the amount of risk their application entails.

The application for registration must be filed either by the manufacturer of the relevant medical product or by its representative.

19.5 Manufacturing

According to the Law on Licensing, manufacturing of medicines is a licensable type of activity. The licensing procedure is governed by the Regulation on Licensing the Manufacture of Medicines approved by Resolution of the Russian Government No. 415 dated July 6, 2006. A license for manufacturing medicines is valid for five years and then can be prolonged.

As a general rule, only registered medicines may be manufactured in Russia and manufacturing of medicines is prohibited in the following cases:

1) medicines have not undergone state registration in the Russian Federation with the exception of medicines intended for clinical trials;

2) the manufacturer does not have a license for manufacturing medicines;

3) manufacturing of medicines in breach of rules related to organization of the manufacturing of medicines and the control of their quality, approved by the MOH.

The legal entity - manufacturer of medicines - is liable for noncompliance with the rules for manufacturing medicines currently established in the National Standard of the Russian Federation Good Manufacturing Practice for Medicinal Products (GMP) GOST R 55249 - 2004 adopted by Decree of the Russian State Committee on Standardization and Metrology No. 160-st dated March 10, 2004.

Medical products in Russia are divided into two categories, medical equipment and products of a medical purpose. According to the Law on Licensing, manufacturing of medical equipment only is a licensable type of activity. The licensing procedure is governed by the Regulation on Licensing of Manufacturing of Medical Equipment approved by Resolution of the Russian Government No. 33 dated January 22, 2007. A license for manufacturing medical equipment is valid for five years and then can be prolonged.

It should be noted that in certain cases the license for manufacturing medical equipment alone will not be sufficient and other licenses may be additionally required in order to lawfully manufacture certain types of medical equipment. For example, a license for activities involving sources of ionizing radiation will also be required when, inter alia, X-ray equipment is being manufactured.

19.6 Importation

In accordance with the Law on Medicines, importation of medicines may only be performed by:

1) organizations manufacturing medicines for their own manufacturing purposes;

2) organizations carrying out wholesale of medicines;

3) scientific-research institutions and laboratories for development, studies and quality effectiveness and safety control, under the permission of the Federal Service;

4) foreign organizations-manufacturers and wholesalers of the medicines if such organizations have representative offices in Russia.

Importation of medicines into the Russian Federation is governed by the Procedure for Importation and Exportation of Medicines Intended for Medical Use adopted by Resolution of the Russian Government No. 438 dated July 16, 2005. This document establishes that importation of the medicines is performed on the basis of an importation license issued by the Russian Ministry of Economic Development and

Trade (the "MERT") on the basis of a positive conclusion issued by the Federal Service. However, due to liquidation of the MERT in 2008 its functions of regulation of foreign trade activities were transferred to the Russian Ministry of Industry and Trade.

Imported medicines are released onto the Russian market only after, inter alia, their conformity to applicable Russian requirements is confirmed. In this regard it is important to note that mandatory certification of medicines was replaced with declaration of their conformity. This change caused significant reaction in the Russian pharmaceutical market as the procedure aimed at minimizing state involvement in the pharmaceutical market turned out to be quite burdensome for foreign pharmaceutical manufacturers.

Importation of the medical products is not subject to the conditions and limitations applicable to medicines and is performed in the ordinary course of importation. Imported medical products are released onto the Russian market only after, inter alia, they are duly certified. It should be noted that certification of all medical products in Russia is performed according to the rules for certification of electrical equipment established in Decree of the Russian State Committee on Standardization and Metrology No. 36 dated July 16, 1999.

19.7 Wholesale

Pursuant to the Law on Licensing, pharmaceutical activity (including wholesale, retail sale and preparation of medicines) is a licensable type of activity. The licensing procedure is governed by the Regulation on Licensing of Pharmaceutical Activities approved by Resolution of the Russian Government No. 416 dated July 6, 2006. A license for performance of pharmaceutical activity is valid for five years and can be prolonged thereafter.

Wholesale of medicines is governed by the Rules for Wholesale of Medicines approved by Order No. 80 of the Russian Ministry of Healthcare dated March 15, 2002.

Wholesalers of medicines may sell medicines or place them at the disposal of the following legal entities and persons:

1) other organizations carrying out wholesale of medicines;
2) organizations manufacturing medicines for their own manufacturing purposes;
3) pharmaceutical institutions;
4) scientific-research institutions for research purposes;
5) individual entrepreneurs having medical activities licenses.

Only duly registered medicines can be sold on the territory of the Russian Federation. Russian law also explicitly prohibits the sale of medicines with an expired period of validity and counterfeit medicines.

Wholesalers should meet the requirements of state standards, sanitary, veterinary and fire-prevention rules, work safety, accident prevention and other regulatory requirements. Wholesalers should use proper premises, equipment and inventory which ensure the quality and safety of medicines during their storage and disposal and ensure compliance with wholesale procedures.

Wholesale of medical products is not a licensable activity in Russia.

19.8 Retail Sale

Retail sale of medicines is regulated by the Rules for Sale of Medicines in Pharmaceutical Institutions, Fundamental Provisions (OST 91500.05.0007-2003), approved by Order No. 80 of the Russian Ministry of Healthcare dated March 4, 2003 and by Order on the Sale of Medicines approved by Order of the MOH No. 785 dated December 14, 2005.

Retail sale of medicines is exercised by pharmaceutical institutions, which include pharmacies, pharmacy kiosks, pharmacy stores and pharmacy stations. These types of pharmaceutical institutions differ in the scope of activities that they can perform, for example, prescription medicines may only be sold through pharmacies and pharmacy stations, while over-the-counter medicines may be also sold in pharmacy stores and pharmacy kiosks.

The MOH establishes a list of over-the-counter medicines. All other medicines have the status of prescription medicines. The current list of over-the-counter medicines is established in Order of the MOH No. 578 dated September 13, 2005.

Notably, pharmacy institutions need to comply with a requirement of minimum assortment of medicines. The current minimum assortment of medicines is established by Order of the MOH No. 312 On Minimum Assortment of Medicines dated April 29, 2005.

Similar to wholesale activity, retail sale of medicines is subject to licensing and only registered medicines can be sold in the Russian Federation.

Retail sale of medical products is not a licensable activity in Russia.

19.9 Price Regulation

Generally, according to the Law on Medicines, prices of medicines may be subject to state regulation. Further, according to Decree of the Russian Government No. 239 On Measures for Improvement of State Regulation of Prices (Tariffs) dated March 7, 1995, as amended, trade margins to the prices of medicines may be established by the executive bodies of the regions of the Russian Federation.

Pursuant to Russian Federation Government Resolution No. 782 *On State Control of Prices of Medicines* dated November 9, 2001 ("Resolution No. 782"), the price of medicines included in the list of vitally necessary and most important medicines (the essential drug list or the "ED List") is controlled by the state and subject to mandatory state registration. Price control with respect to certain medicines is an important tool of the healthcare system ensuring that the most important medicines are accessible for all citizens. The price for other medicines (i.e., not included in the list of vitally necessary and most important medicines) is not regulated by the state and can, therefore, be freely established by the sellers. Currently the ED List is established by Government Ordinance No. 376-r dated March 29, 2007 while 24-th edition of the register of prices is published by Letter of the Federal Service No. 01I-24/09 dated January 26, 2009.

According to Resolution No. 782, the state regulation of prices of medicines included in the ED List is effected through the following measures:

- state registration of the maximum manufacturer's prices of medicines (done at the federal level), and
- establishing the maximum wholesale and retail trade margins applied to the prices of medicines (done at the regional level).

Under the Procedure for State Regulation of Prices of Vitally Necessary and Most Important Medicines introduced by Resolution No. 782 (hereinafter - the "Procedure") the manufacturer's price for medicines included in the ED List must be formally agreed and registered with the Federal Service. The internal procedures of the Federal Service with regard to price registration are governed by the Administrative Regulation of the Federal Service on Execution of the State Function of State Registration of Maximum Selling Price of Medicines adopted by Order of the MOH dated December 31, 2006 No. 907.

Under Resolution No. 782, the maximum wholesale and retail trade margins for medicines included into the ED List are established by the regional governmental authorities.

Since the wholesale/retail margins are defined on a regional level, it is not clear which region's margins are to be used for the purposes of inter-regional trade. According to the position of the Russian Ministry of Economics and the Ministry of Healthcare stated in their Letter No. MB-576/7-968, No. 2510/9695-99-32 dated September 6, 1999, where a wholesale distributor (*e.g.*, located in Moscow) sells medicines to a customer located in another region, the applicable margins should be defined under the rules of that other region.

19.10 Technical Maintenance of Medical Equipment

Technical maintenance of medical equipment is a licensable type of activity according to the Law on Licensing. The licensing procedure is governed by the Regulation on Licensing of Technical Maintenance of Medical Equipment (Except when such Activity is Carried out to Satisfy the Own Needs of a Legal Entity or Private Entrepreneur) approved by Resolution of the Russian Government No. 32 dated January 22, 2007. A license for maintenance of medical equipment is valid for five years and then can be prolonged.

It should again be noted that in certain cases (similar to the licensing of manufacturing of medical equipment) the license for technical maintenance of medical equipment alone will not be sufficient and other licenses may be additionally required in order to lawfully conduct technical maintenance of certain types of medical equipment (*e.g.*, a license for activities involving sources of ionizing radiation is necessary when, inter alia, X-ray equipment is being serviced).

19.11 Government-Run Programs for Medicinal Supply

The most important among government-run programs related to medicinal supply is the program for additional medicinal supply of specific categories of citizens lately refereed to as a program of supply of essential medicines (the so-called DLO program or ONLS program) under which certain categories of citizens (social security beneficiaries) receive certain medicines free of charge. This program was established in 2004 (the first year of operation was 2005) through the introduction of amendments into the Social Care Law. The last quarter of 2007 was marked by significant reform of the ONLS program.

The reform of the ONLS program abolished price regulation in this sphere, transferred the program to the regional level and subjected it to the usual government procurement rules, so that purchases of medicines within the ONLS program are organized as auctions on the regional level.

However, part of the ONLS program remains on the federal level (and no longer bears this name) and is set up for the purposes of supply of expensive medicines for treatment of certain nosologies (haemophilia, mucoviscidosis, hypophyseal nanism, Gaucher's disease, myeloleukemia, disseminated sclerosis and after transplantations). Expensive medicines are purchased through auctions by the MOH.

Purchases of medicines within both programs, as well any other purchases of medicines for state or municipal needs are carried out in accordance with Federal Law No. 94-FZ On placement of Orders for Supply of Goods, Performance of Works and rendering of Services for State and Municipal Needs dated July 21, 2005, as amended.

19.12 Promotion

The only type of promotional activity in the pharmaceuticals market that is specifically regulated by Russian law is "advertising". Russian legislation contains few provisions that specifically regulate practices (other than simple advertising) aimed at the promotion or marketing of medicines. This means that, in order to determine the rules applicable to such practices as seminars, hospitality, entertainment and similar activities, in most cases one has to refer to the generally applicable provisions of Russian law.

Advertising is defined in article 3 of the Law on Advertising as "as information spread by any means, in any form and by any media which is addressed to an indefinite circle of persons and aimed at drawing attention to the object advertised, at creating or maintaining interest in it and at promoting it in the market."

The Law on Advertising contains general restrictions on advertising that are as applicable to medicines and medical products as they are to any other product. The general requirement is that the advertising should be fair and true. However, the Law on Advertising also contains specific provisions applicable to medicines and medical products.

Under the Law on Advertising prescription medicines, as well as medicines that contain narcotic or psychotropic substances approved for medical use, treatment

methods, medical products and equipment that require special training for their use may only be advertised in specialized printed publications intended for medical and pharmaceutical professionals and at medical or pharmaceutical events.

The Law on Advertising contains a requirement that the advertisement of medicines, medical services and medical equipment must be accompanied by a warning regarding contraindications against their use and application, the necessity to read the instructions on their use or the necessity to consult a specialist. This requirement, however, does not apply to advertisements disseminated at medical or pharmaceutical events and contained in specialized printed publications for medical and pharmaceutical professionals and to other advertisements where the recipients are solely medical and pharmaceutical professionals.

The Law on Advertising further introduces a group of restrictions that apply to the advertising of medicines. Thus, the advertising of medicines should not:

1) be addressed to minors;

2) contain references to specific cases of recovery from disease or improvement of health as a result of the advertised object being used (except in advertising exclusively for medical and pharmaceutical professionals);

3) contain expressions of gratitude from individuals in connection with the use of the advertised object (except in advertising exclusively for medical and pharmaceutical professionals);

4) create an impression of the advantages of the advertised object by reference to the fact that the trials required for its state registration have been conducted;

5) contain statements or assumptions that consumers have certain diseases or impairments of health;

6) facilitate the impression that a healthy person needs to use the advertised object (this prohibition does not apply to medicines used for prevention of diseases);

7) create an impression that one does not need to consult a physician;

8) guarantee the positive effect of the advertised object, its safety, effectiveness and absence of side effects;

9) represent the advertised object as being a dietary supplement or other product that is not a medicine;

10) contain statements that the safety and/or effectiveness of the advertised object are guaranteed by its natural origin.

Please note that the restrictions in items 2 through 5 above are also applicable to the advertising of medical services, and the restrictions in items 1 through 6 above apply equally to the advertising of medical equipment.

The Law on Advertising contains an important general prohibition against using images of medical and pharmaceutical professionals in any advertisements, except for advertisements of medical services, personal care products, and in advertising exclusively for medical and pharmaceutical professionals.

20. TELECOMMUNICATIONS

20.1 Applicable Laws and Competent State Bodies

The general rules in the telecommunications sphere in the Russian Federation are established by the law "*On Communications*" dated 7 July 2003 (the "**Communications Law**"). The Communications Law governs communications activities in the Russian Federation and assigns certain policy and regulatory functions to various bodies. The Communications Law also establishes a separate procedure for licensing and certification in the sphere of telecommunications.

State regulations on the provision of services and other telecommunications activities are to be drafted by the President, the Government, and the Ministry of Information Technologies and Communications (the "**MITC**") - the federal governmental authority for communications.

The MITC is the state body responsible for the preparation of draft federal laws, presidential decrees and government resolutions in the area of communications and information technology. The MITC is also entitled to issue its own regulations, such as setting out requirements for the use of numbering capacity, regulations on the use of radio frequencies, rules for providing communications services to subscribers, etc.

The other state agencies in the sphere of telecommunications are: the Federal Service for Supervision in the Sphere of Telecommunications, Information Technology and Mass Communications ("**Roskomnadzor**"), the Federal Agency for Information Technology (the "**FAIT**"), and Rossvyaz - the Federal Communications Agency (the "**FCA**").

Roskomnadzor is responsible for exercising day-to-day control in the area of communications and mass media, monitoring the use of the frequency spectrum, registration of frequency allocations, mass media registration, issuance of licenses in the area of communications and mass media, and the protection of rights of personal data's subjects.

The FCA is responsible for coordination of international and federal programs in the area of information technologies and communications, numbering capacity of operators, certifying compliance of equipment, and organizing the operation, development and modernization of the federal communications and national information and telecommunications infrastructure.

The MITC also organizes the work of the State Commission for Radio Frequencies (the "SCRF"). The SCRF is made up of representatives of different ministries and state bodies. The main purposes of the SCRF are to coordinate use of the frequency spectrum by different state bodies, and frequency spectrum allocation. The SCRF is responsible for the allocation and use of the frequency spectrum, providing scientific and technical research in the area of use of the frequency spectrum, frequency spectrum demilitarization/ conversion, determination of technical policy for use of the frequency spectrum, and also with regard to electromagnetic compatibility.

Any decision of the MITC, Roskomnadzor or the FCA may be appealed in court.

Communications Networks

In terms of the networks available in Russia, the Communications Law establishes that the unified communications network of the Russian Federation consists of the following categories of communications networks, located on the territory of the Russian Federation:

- public switched telephone network ("**PSTN**");
- allocated communications networks;
- technological communications networks; and
- special purpose networks and other communications networks for data transfer with the use of electromagnetic systems.

The *PSTN* is designated for the provision of the telecommunication services for the fee for any user of the communication services on the territory of the RF. That communication network has the connection to the PSTN's of the foreign countries.

The *allocated communication network* is designated for the provision of the telecommunication services for the fee for the closed user circle or groups of such circles. Allocated communication network doesn't have the connection to the PSTN and to the communication networks of the foreign countries. The technological aspects of the allocated network's construction could be determined by the owner of the network. The allocated communication network could be connected to the PSTN with its transfer into the PSTN, if this allocated communication network complies with the requirements to the PSTN.

Technological communication network is designated for the execution of the manufacturing activity of the enterprise, management of the technological process at manufacturing. The technological communication network doesn't have the connection to the PSTN, and could be connected to the technological communication networks of the foreign enterprises only for the execution of the unified technological operation. The technological communication network could be connected to the PSTN with its transfer into the PSTN, if this technological communication network complies with the requirements to the PSTN.

Special purpose communication network is designated for the state needs, national defense, state security and law enforcement. That network couldn't be used for the provision of the services for the fee.

20.2 Telecommunications Licenses

Communications services can only be provided on the basis of a license. Among the communications services subject to mandatory licensing are the following:

- local telephone communications services (with or without services via public telephones, points of public access, or separate networks interconnected with the PSTN, provision of international and domestic long-distance communications services;
- telegraph communications services;
- personal calling services;
- radio, cellular, or satellite communications services;
- lease of communications channels services;
- communications services via data transmission networks (including or not including VoIP);
- telematics services.

A license may be obtained upon an application. If the communications service requires use of a radio frequency, numbering capacity or other limited resources, the license may be obtained only through a competitive procedure (auction or tender) for which Roskomnadzor is responsible.

A decision on whether to issue a license is taken by Roskomnadzor within 30 days after filing the application. Licenses are issued for terms from 3 to 25 years.

For considering an application for the issue of a license, a fee is collected in the amount of 300 rubles. The cost of a license for voice-over IP services, provision of communications channels, cable broadcasting, postal services or services that require the use of radio frequencies is 15,000 rubles (approximately US$ 420) per region. The cost of licenses for other communications services is 1,000 rubles (approximately US$ 27) per region. These amounts have to be multiplied by the number of regions of the Russian Federation where the services are to be provided (*e.g.*, if the coverage is Moscow, the Moscow Region, St. Petersburg and the Leningrad Region, a license for providing telecommunications channels would cost 60,000 rubles (approximately US$ 1,550). There are currently 83 regions in Russia in total.

The territory for which the license is valid is specified in the license. There are no restrictions on the number or type of communications licenses that a single licensee may hold.

The Communications Law does not permit the transfer of a license or any rights from the licensee to another person. The license can be re-issued by Roskomnadzor only to a legal successor of the licensee.

Roskomnadzor has the right to terminate a license without applying to the courts if the operator is liquidated, applies for termination of the license, or fails to pay the license fee within three months following the date of issuance of the license.

The license may be suspended if Roskomnadzor discovers a breach of a statute or of conditions of the license by the operator, or non-performance of services for more than three months.

20.3 Rights to Use Radio Frequencies

The Communications Law provides for transparent and open frequency allocation procedures and for the national frequency allocation table. Allocation of the frequency spectrum is organized in accordance with the Frequency Allocation Table, which has to be reviewed at least once every four years.

The procedure for allocation of frequency ranges, bands and channels is established by Roskomnadzor. A decision on frequency allocation is taken within 120 days following the date when an application is made. Radio frequency ranges, bands and channels are allocated for a term of up to ten years.

The agencies responsible for allocation of frequencies are the SCRF and Roskomnadzor.

Roskomnadzor allocates a developed broadcasting frequency to an applicant - either without a tender if the population of the settlements in the broadcasting area does not exceed 200,000, or with a tender if over 200,000. The use of the frequency spectrum is subject to a one-off fee for allocation of the radio frequency, plus an annual fee for use of the radio frequency.

The Communications Law does not provide for the transfer of the right to radio frequency use to another operator without the approval of such transfer by the SCRF.

If the SCRF discovers violations of the terms and conditions set forth in its decision for allocation of the frequency spectrum, the permit for frequency spectrum use can be suspended for the period required for remedying such violation, but not for more than 90 days.

20.4 Registration of Radio Frequency Emitters

Telecommunications facilities and equipment emitting radio frequencies are subject to registration. The responsible authority for such registration is Roskomnadzor. The respective legislation includes a list of equipment subject to registration (most radio transmitting equipment) and some exclusions from such registration procedure (for example, cellular phones, DECT phones, Bluetooth, etc.)

A necessary condition for issuance of a registration certificate is permission for the use of a frequency.

A decision on whether or not to issue a certificate should be taken within ten days. The term of the registration certificate corresponds to the term of the frequency allocation permit.

20.5 SORM Issues

Russian law obliges telecommunications providers (legal entities or individual entrepreneurs that provide telecommunications services on the basis of an

appropriate license) to provide the state authorities that perform criminal investigations with information regarding their clients and the services rendered to them, and to give these authorities the ability to perform investigative work.

On the basis of these provisions the authorities responsible for the security of the Russian Federation have developed a complex of technical devices for communications control facilities needed in order to intercept and/or interrupt communications (*e.g.*, SORM). SORM equipment is installed at a provider's premises and operated remotely by the authorities from a special control panel. SORM provides the opportunity to control communications without the participation of the provider. According to the law, such investigations are allowed only under a court order, or if there is an imminent threat that a crime may be committed.

These regulations affect communications schemes, especially the use of satellite communications channels. In some cases downlink equipment must be placed on Russian territory and equipped with SORM.

20.6 Technical Regulation Requirements

According to the Communications Law all communications devices are subject to the procedure of compulsory confirmation. The mandatory conformity acknowledgement is fulfilled by way of either compulsory certification or compulsory declaration of conformity. The list of devices subject to mandatory certification is approved by *Regulation of the Government No. 896 dated December 31, 2004*. All other devices are subject to a mandatory declaration of their conformity.

A declaration of conformity is a document in which the applicant confirms that the product it has manufactured corresponds to the conformity requirements. To be valid, a declaration of conformity for the relevant telecommunications device is subject to registration with the FCA. A declaration of conformity should be filed for registration by an applicant accompanied with the relevant evidence of the device's conformity available to the applicant and obtained with the help of accredited testing laboratories.

The competent authority for certification is the Certification Agency. A manufacturer or supplier of a device files an application with the Certification Agency, which carries out the certification test. A certificate on conformity should be issued for one or three years, depending on the certification scheme stipulated in the rules for carrying out the certification. The cost of the whole procedure varies significantly.

It is impossible to import telecommunications equipment that must be certified without a certificate, because the certificate is one of the documents required by customs for customs clearance of the equipment.

If equipment is not specified in the statutory certification list, such equipment may be imported without certification. For distribution of such equipment in Russia, a declaration of conformity is required. A declaration of conformity should be filed for registration by an applicant accompanied with the relevant evidence of the device's conformity available to the applicant and obtained with the help of accredited testing laboratories. The declaration of conformity should be registered with the FCA within three days. Applications for certificates of compliance may be submitted only by the manufacturers, sellers or the "legal entities or private entrepreneurs registered in the Russian Federation and providing for compliance of communications equipment with the established requirements on the basis of an agreement with the *manufacturer*" (the latter, the "**Manufacturer's Proxy**"). Declarations of conformity may be made, however, only by Manufacturer's Proxies, or by the manufacturer if registered in the Russian Federation.

Russian laws provide for sanctions for violating the certification rules: using uncertified communications equipment in communications networks, or rendering uncertified communications services where obligatory certification thereof is provided for by law, entails the imposition of an administrative fine with or without confiscation of the uncertified communications equipment.

21. CLIMATE CHANGE

21.1 Introduction

Russia ratified the Kyoto Protocol to the United Nations Framework Convention on Climate Change (the "**Kyoto Protocol**") by Federal Law No. 128-FZ dated November 4, 2004. However, the only Kyoto-related mechanism that was covered by a number of additional enactments is Joint Implementation ("**JI**"). Russia implemented JI-related regulations in several enactments. Of particular relevance are:

- Russian Government Resolution No. 332, "On the Procedure for Adopting, and Checking the Development of Projects Implemented Under Article 6 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change" (the "**Resolution**"); and

- Regulations "On Adopting, and Checking the Development of Projects Implemented Under Article 6 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change" (the "**JI Rules**").

21.2 Summary of the JI Rules

21.2.1 Parties Involved in the Implementation of JI projects

After much debate, the JI Rules assigned the respective competencies of Russian state bodies for regulation of JI projects, and also established rules for the private participants in JI projects.

State Bodies

The JI Rules foresee the interaction of the following four state bodies in the various activities required under the JI Rules (such as approval of a JI project, establishment of limits for emission reductions, etc.):

1. The Russian Government;
2. The Russian Ministry of Economic Development (the MED), performing the functions of a focal point (the Focal Point) pursuant to the Resolution;
3. Authorised bodies, whose functions, according to the Resolution, and depending on the sectors in which a project is to be implemented, are to be performed by the relevant federal ministries; and
4. A special Commission, to be established by the MED.

Investor in a Project

A Russian or foreign legal entity, individual entrepreneur or individual, may apply for approval of a JI project and provide financing for its implementation ("**Project Investor**"). Under the current version of the JI Rules, the possibility of the Project Investor to cover and participate only in the carbon part of the whole project is at least questionable.

To be eligible for a JI project, the Project Investor must have assets in an amount exceeding the anticipated costs of the project's implementation. According to the

Minutes of the Interagency Commission dated February 21, 2008, the following documents can, inter alia, be used as proof of the sufficiency of the Project Investor's funds:

- Extract from the bank account;
- Extract from the balance sheet and a profit and loss report (form No. 2) for the last reporting period - for legal entities and individual entrepreneurs registered in Russia;
- Copy of the decision of a credit organisation confirming provision of funds.

It is not yet clear whether and how authorities will deal with the danger of so-called "paper investments", for instance to prevent that the proof of investment is limited to transferring funds to the investors account only for the purpose of obtaining an extract confirming the availability of the funds, and immediate return the assets to their provider.

Project Host

According to the JI Rules the following entities may act as project host:

a. Owner of the site at which the project activity is to be implemented; or

b. Another person authorised in accordance with Russian legislation to perform such activity.

These somewhat unclear definitions raise at least two related questions:

- What factual conditions have to be met for an entity to be considered an emitter? A typical example of such an issue would be a pipeline where operation and ownership may be in different hands.
- What are the legal conditions that have to be in place for the project host to be considered as the person possessing the emissions: should it be the owner of land or buildings? May it be a lessee or a third party acting on the basis of a special agreement with the owner?

What is clear is that the legal position of the project host is subject to review for every JI project. In addition, according to the JI Rules, a document confirming the consent of the project host to the JI project's implementation is to be provided. The law is not clear as to the format of such consent. In particular, it is unclear whether simple consent is sufficient or whether an agreement is required.

21.2.2 Limits for Emission Reductions

Limits for emission reductions or greenhouse gas absorption are to be established on an annual basis to control the maximum amount of emission reductions and the amount of greenhouse gas absorption generated by JI projects, and transferred to the corresponding parties to the Kyoto Protocol.

Limits are to be established by the Focal Point for a particular sector or category of emitters and/or absorbers, but under certain circumstances they may be redistributed to other sectors or categories of emitters and/or absorbers.

With Order No. 422, dated November 30, 2007, the Focal Point approved a total limit of 300 million tCO2e for greenhouse gas emission reductions for 2008-2012. The following limits (in million tCO2e) were established for greenhouse gas emission reductions in particular sectors of emitters, and for greenhouse gas absorption by absorbers:

a. For greenhouse gas emission reduction:
   - energy sector - 205;
   - industrial processes - 25;
   - use of solvents and other products - 5;
   - agricultural sector - 30;
   - waste - 15.

b. For greenhouse gas absorption by means of use of land, change in use of land, and forestry - 20.

21.3 Implementation of a JI Project

According to the JI Rules, implementation of a JI project consists of the following stages:

1. Approval of the project (i.e. pre-approval of a project's application, including project design documentation, and final approval of the project); and
2. Development of the project and confirmation of emission reductions generated by the project.

21.3.1 Pre-Approval of a Project Application

Initially, the Project Investor provides the Focal Point with an application for approval of the project as a JI project, accompanied by a number of documents, including a validation report prepared by an expert organisation chosen by the Project Investor from the list of authorised organisations adopted by the Focal Point at the proposal of the Commission,[68] project-design documentation, etc. Some of the documents submitted together with the application are to be prepared in accordance with requirements adopted by the Focal Point.

The Focal Point rejects applications that either contemplate emission reductions and/or absorption before January 1, 2008 or after December 31, 2012, or are not prepared in compliance with the JI Rules. Non-rejected applications are to be transferred by the Focal Point to the relevant authorised bodies.

The authorised bodies are to consider the application and provide the Focal Point with a motivated positive or negative opinion on the JI project's implementation.

As the next stage, the application is to be considered by the Commission. The project application *will be* rejected by the Commission if:

- The application is not in accordance with the JI Rules;
- The anticipated efficiency indexes are not in compliance with the thresholds of the model efficiency indexes adopted for the relevant sector (category) of the emitter and/or absorber; or
- No positive validation report is presented.

The project application *may be* rejected by the Commission if:

- The JI project cannot be implemented by December 31, 2012;
- A negative opinion on the JI project was received from the relevant authorised bodies; or

[68] According to the Order adopted by MED on March 14, 2008, the following companies may act as such expert organisations in Russia: Det Norske Veritas Certification Ltd., Bureau Veritas Certification Holding SAS, TÜV SÜD Industrie Service GmbH, SGS United Kingdom Limited, and TÜV NORD CERT GmbH

- The planned amount of emission reductions to be generated by the JI project, in addition to the emission reductions whose transfer is contemplated by the adopted JI projects, exceeds the limits established for the relevant sector or category of emitters and/or absorbers.

21.3.2 Final Approval of a JI Project

Within 10 days of the date of a resolution reflecting the decision having been made by the Commission, but only once in a quarter, the Focal Point forms a list of JI projects recommended for approval, and submits it to the Russian government for final approval.

The Focal Point is authorised to communicate with the agencies maintaining Russia's national registry and to perform actions leading to the receipt, transfer or acquisition of Emission Reduction Units as prescribed by Article 6 of the Kyoto Protocol.

21.3.3 Withdrawal of a JI Project's Approval

The Russian government may exclude a JI project from the list of projects approved by the Russian government in the following cases:

1. Repeated missing of deadlines for submitting reports on project implementation by more than 30 days;
2. If during project implementation, non-compliance with the anticipated efficiency indexes was discovered;
3. If a Party to the Kyoto Protocol has not approved a project within 12 months from its approval by the Russian government;
4. If a Party to the Kyoto Protocol has withdrawn its approval of a JI project and such withdrawal has entered into force;
5. Liquidation of the legal entity, death of the individual or de-registration of the individual entrepreneur being the Project Investor; or
6. Upon other events as may be established by the Russian government.

21.4 Monitoring

The Project Investor is obliged to provide the federal state agency determined by the Russian government to control the project implementation with annual reports on project implementation for each project. Reports are to be prepared in accordance with the methodologies adopted by the Focal Point.

Upon the completion of the project's implementation, the Project Investor must provide the authorised state agency with a final report containing the final summary of the project results. This report is to be reviewed by the authorised state agency and forwarded by it to the Focal Point.

21.5 Contractual Instruments for JI Projects

The relationship between the project host and the Project Investor has been the subject of much debate. While in other countries, a so-called emission reductions purchase agreement (ERPA), being a type of a purchase and sale agreement, has been concluded, the JI Rules, furthering what the Kyoto Protocol provided for, pre-suppose an investment agreement for this relationship. Indeed, an ERPA would require that emission reductions are transferred from the Project Host to the Project Investor, which is typically not the case under the JI Rules. Also, the ERPA creates unfavorable tax consequences, and investment agreements allow the achieving of most of what is typically intended by the parties.

21.6 Taxation

The JI Rules do not contain any specific provisions on taxation of operations performed under agreements covering a JI project. Therefore, the general rules of Russian law should apply, depending on the particular agreements governing the relationship of the parties to a JI project.

In general, the applicable tax regime depends on the terms and conditions and on the nature of an agreement between the Project Investor and the project host. Typically, while under certain circumstances, the parties may avoid Russian VAT on transfer of ERUs to the Project Investor under the investment agreement, the project host may either be subject to the Russian profits tax on funds received from the Project Investor, if the Project Investor is Russian resident, or may avoid Russian profit tax, if the Project Investor is non-resident.

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