

# Client Alert

March 2013

## Russia - Investment

### A Snapshot of Recent Developments in Russia affecting the Investment Environment

In 2011/2012, there have been a number of legal reforms and regulatory changes in the Russian Federation which have implications for foreign investors proposing to invest or who are already doing business in the country.

Major developments include ratification of Russia's protocol of accession to the World Trade Organisation ("WTO"), which is likely to create enhanced opportunities for investment and trade. Changes to Russia's tax regime and several judicial decisions (including a case suggesting foreign court judgments may be enforceable in Russia) are also relevant to foreign investors.

The Client Alert contains a summary of notable developments in Russia.

#### INTERNATIONAL TRADE

##### Russia joins WTO - enhanced opportunities for trade & foreign investment

The accession of the Russian Federation to the WTO was officially approved by its members in December 2011 after a protracted period of negotiations, spanning some 18 years.

In July 2012, the Russian State Duma ratified the *Protocol of Accession of Russia to the WTO*, making Russia the 153rd member of the WTO.

Russia's accession to the WTO represents a substantial step towards the full integration of the country within globalised trading markets, and will bind Russia to the WTO's regulations and underlying principles such as market access, 'national' treatment and '*most favoured nation*' treatment.



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This will lead to restrictions on Russia's imposition of import tariffs, which will be reduced in a number of sectors to bring the average tariff ceiling to 7.8% (compared to the 2011 average of 10% across all products). However, for certain industries transitional periods have been agreed, which will allow the local market to prepare for the new, more competitive, conditions.

Substantial changes will also be introduced to the services industry. Russia's commitments include allowing market access to WTO members in 11 service sectors and 116 sub-sectors. For example:

- Upon accession Russia will allow fully foreign owned companies to engage in wholesale, retail and franchise operations.
- In telecommunications, the 49% foreign equity limit will be eliminated within 4 years.
- In the insurance industry, foreign providers of life and non-life insurance as well as reinsurers will initially be allowed to establish a commercial presence in Russia in the form of a subsidiaries (with a foreign capital cap of 51% in the case of life insurers), and 9 years after accession, Russian branches will be permitted.
- Foreign credit institutions will be permitted to establish 100% subsidiaries, subject to a cap of 50% foreign participation in the banking sector as a whole.

No commitments were made with respect to 39 sectors. These include railroad, internal water transport, medical services and scientific research activities. Further, priority will be maintained for Russian companies to participate in exploration, development and production of mineral raw materials.

## FOREIGN INVESTMENT REGULATION

### Amendments to strategic investment law

A new federal law amending the Russian regulations on foreign investments and investments in strategic sectors was adopted in November 2011. The amendments entered into force in December 2011.

Among other provisions, the new law introduced the following exemptions from the list of strategic activities subject to State control:

- Licensed data-encryption activities of banks in which the Russian government holds no equity;
- The use of radiation sources by companies in the civil sector as an ancillary activity.

The new law also increased the threshold for the presence of control over a strategic subsoil company from 10% to 25%. Consequently, foreign private investors will be required to make a filing only when acquiring 25% or more in a strategic subsoil company and foreign state investors may acquire a share of up to 25% in a strategic subsoil company (instead of the current 10% threshold). Approval from the State commission is still required for foreign-state investors acquiring above 5% in a strategic subsoil company.

## COMPETITION

### Amendments to competition protection law

The "third antimonopoly package" Amending the *Federal Law No. 135-FZ of 26 July 2006 "On Competition Protection"* came into force in January 2012. The main changes to the law are:

#### 1. *The thresholds for merger control have been amended*

- In case of the acquisition of shares of Russian or foreign commercial or non-commercial companies whose sales in Russia during the year preceding the acquisition were more than RUB 1 billion (about EUR 25 million), the prior approval of the Russian competition authorities is required.
- The threshold for the approval of the reorganization and creation of Russian legal entities has been increased from RUB 3 billion (approximately EUR 75 million) to 7 RUB billion (approximately EUR 175 million) with respect to the total value of assets. , The threshold in relation to the total turnover has been



increased from RUB 6 billion (approximately EUR 150 million) to RUB 10 billion (approximately EUR 250 million).

- The list of documents to be submitted to the Federal Antimonopoly Service has been amended.
- 2. *The legal definition of "group of persons" has been significantly amended. The list of companies forming a "group of persons" has been significantly reduced*
- 3. *The provisions on restrictive agreements have been modified*
  - The concept of a "cartel" (a prohibited form of horizontal agreement) has been introduced and is defined as follows: an "agreement between competing economic entities, which means, between economic entities which sell their goods on the same market." A list of per se violations which are only applicable to "cartels" has also been added.
  - Issues relating to the prohibition of coordination of economic activity and concerted action have been clarified.
  - Certain types of vertical agreements and concerted practices have also been decriminalized.

## CORPORATE

### Changes to corporate disclosure rules

Several changes in Russian corporate disclosure rules which expand the obligation to provide notification of the persons exercising managing rights, in relation to Russian open joint stock companies and other companies subject to the obligation of public disclosure of information, have recently come into force.

In particular, the Russian Federal Financial Markets Service (FSFM) has introduced regulations imposing an obligation on the major shareholders of these companies to file notifications in a prescribed form which contain certain information on shareholders. Failure to comply with these rules is punishable with fine up to RUB 4,000 for individuals, RUB 30,000 and disqualification for executives and RUB 500,000 for the companies.

## DISPUTE RESOLUTION

### "Unilateral option" dispute resolution clauses struck down by Russia's Supreme Court

Russia's Supreme Commercial Court ruled that "unilateral option" dispute resolution clauses, which grant one party the option to bring a claim either via arbitration or in court while limiting the other party to arbitration procedures, are invalid under Russian law.

Unilateral option arbitration clauses are commonly included in commercial contracts between Russian and foreign counterparties, particularly in the context of financing agreements. Such clauses are intended to achieve the twin objectives of: creating an enforceable undertaking of a Russian counterparty to submit to arbitration; and erecting a shield protecting a foreign company against proceedings in the Russian courts.

Upon the release of the court's full decision and legal reasoning, it became clear that not only are unilateral option dispute resolution clauses invalid as a matter of Russian law, but existing court decisions on enforcement of arbitration awards are now expressly open to challenge in, and reconsideration by, the Russian courts.

Parties to financing agreements and other commercial contracts containing unilateral option arbitration clauses should strongly consider amending these clauses to provide for exclusive resolution of disputes through international arbitration in order to ensure they remain valid as a matter of Russian law.

### Foreign court judgments may be enforceable in Russia

Until recently, with very few exceptions, Russian courts did not enforce judgments of foreign courts unless there was a treaty between the Russian Federation and the relevant foreign jurisdiction on mutual recognition and enforcement of court judgments. At present, Russia does not have such treaties with most western jurisdictions, including the UK (covering the English courts), the US, France and Germany. This made enforcement of foreign court judgments in Russia an almost impossible exercise.



In July 2012, the Supreme Court adjudicated a claim brought by a party seeking to invalidate a judgment rendered against it in the English courts. The Supreme Court stated that once parties accept the jurisdiction of a foreign (in this case, English) court, they accept the consequent risks of submitting to foreign proceedings. They may not subsequently seek to invalidate a judgment merely because they are not satisfied with the outcome.

In view of this judgment of the Supreme Court, it may now be possible for banks and companies to pursue Russian companies via proceedings in foreign courts as their judgments may now be enforceable in Russia. However, caution should nevertheless be exercised when agreeing dispute resolution mechanisms with Russian counterparties, as this judgment may prove not to be of general applicability.

### **Simplified Resolution of Commercial Disputes**

In September 2012, amendments to Russian procedural legislation became effective and the existing simplified procedure for resolution of commercial disputes was streamlined.

Creditors now have additional options in pursuing simplified commercial proceedings in Russia, which are now available for certain cases with a small claim value (not exceeding RUB 100,000 or 300,000 depending on the litigants involved), as well as for claims to recover debt that has been acknowledged but not paid by the respondent. Simplified commercial proceedings do not apply to corporate disputes (such as disputes between shareholders of a company, or between shareholder and the company itself).

The amendments also set out more detailed procedures for simplified commercial proceedings, including requiring parties to a dispute to exchange information and materials via the official website of the relevant arbitral court. They also provide for a shortened window for appealing a judgment, requiring that an appeal be lodged within 10 days of the date the judgment is issued.

As a result of the amendments, certain claims may now be pursued through a simplified procedure and thus in certain circumstances it may be advisable to pursue such claims in the Russian courts rather than to go through lengthy arbitration procedures or proceedings in foreign courts.

## **TAXATION**

### **Amendments to Russian Tax Code**

There are several recent amendments to the Tax Code of the Russian Federation. Amendments which came into force in January 2012 including changes relating to "*investment partnership agreements*" and consolidated groups of taxpayers for profit tax purposes. A number of additional amendments also came into force in January 2013, including in relation to interest income arising in connection with the placement of tradable bonds by foreign legal entities and an expansion of the VAT exemption for financial services.

### **Tax registration of foreign legal entities**

In February 2012, the Russian Ministry of Finance and the Federal Tax Service adopted new forms and procedures for the registration and de-registration) of foreign legal entities with tax authorities. These came into force in May 2012.

### **Currency Regulation**

In June 2012, the Central Bank of Russia introduced new rules (which came into force in October 2012) relating to the forms of certain documents required for currency regulation purposes and amended the activities in which a passport of transaction is required (in particular, the rent/lease of immovable property between residents and non residents will now require a passport of transaction, while loans between residents and non residents for amounts exceeding USD 50,000 USD (instead of USD 5,000) will also require a passport of transaction).

### **Court changes rules for deduction of expenses incurred by foreign company's head office in Russia**

In April 2012, Russia's Supreme Commercial Court ruled that a recommendation issued by the Russian Tax Ministry relating to the deductibility of expenses was inconsistent with the Tax Code of the Russian Federation.

The recommendation stipulated that expenses transferred by a foreign company to its permanent establishment in the Russian Federation should be deducted for profit tax purposes in the period when such expenses were



actually transferred by the head office. The Tax Code, by contrast, provides for deductibility of expenses for profit tax purposes, based on the accrual method, in the reporting (tax) period to which the expenses relate.

The Court's judgment brings clarity to this area, removing the risk for a foreign company to be held in violation of tax law simply through following the rule in the Tax Code. All foreign companies must now deduct Transferred Expenses in the reporting (tax) period to which such expenses relate, not in the period when the expenses were actually transferred.

### **Obligatory pension, social and medical insurance contributions - including for foreign individuals**

New Government regulations have introduced significant amendments, which came into force in January 2012, relating to pension, social and medical insurance contributions to non-budgetary state funds, including the rate of contribution. It also provides that remuneration accrued to foreign individuals temporarily living or temporarily residing in the Russian Federation (and employed on the basis of a labour agreement for an indefinite period or a fixed-term labour agreement for a period of not less than 6 months) are subject to insurance contributions to the Russian Pension Fund.

## **BANKING & FINANCE**

### **Changes to the security enforcement procedure under Russian law**

In March 2012, a number of important amendments introducing revisions to the Civil Code and legislation on pledge, mortgage and notary activities and affecting procedures for both the execution and enforcement of pledge and mortgage agreements took effect. The new rules contemplated by the amendments may also impact out-of-court enforcement under existing pledge and mortgage agreements.

## **REAL ESTATE & CONSTRUCTION**

### **Immovable Property to be Built or Acquired in the Future**

In 2011, Russia's Supreme Commercial Court adopted Decree No 54 "*On Certain Issues Regarding the Resolution of Contractual Disputes Related to Immovable Property to be Built or Acquired in the Future*". The Decree explains the matters to be taken into consideration by courts examining contractual disputes related to immovable property which will be built (or acquired) in the future.

## **LICENSING**

### **Reduction in activities requiring a license**

In recent years, in order to conform to WTO standards, Russia has massively shortened the list of activities that have to be licensed, i.e. whose compliance to national standards should be approved by a relevant Russian authority.

A new law regarding licensing, which entered into force in November 2011, shortened the list of activities that have to be licensed from 87 to 49 activities. This includes activities providing for aviation security, activities concerning the construction of game machines, the construction of measuring instruments, the renovation of cultural heritage buildings and also exposition and collection of weapons.

While some activities no longer need to be licensed, they may now need an insurance against civil damages and may be subject to sector specific regulation.

Experts have commented that, although the list of activities has been significantly shortened, there has not been a very big change. The new law is simply more general and an activity that previously needed several licenses now just needs one, although it still needs to be licensed. ■



Building on more than 20 years of experience in the Russian Federation, Gide Loyrette Nouel has developed unique expertise as legal and tax counsel to investors and international institutions in all areas of Russian and international business and financial law, especially as it applies to foreign investors.

GLN Russia can assist Chinese clients anywhere in Russia, and in most of the former Soviet states with, where required, the assistance of a network of local legal agents with whom it has established long-standing relationships.

In Russia, Gide Loyrette Nouel currently has 55 members of staff including more than 40 lawyers and legal consultants whose working languages include Russian, English, French, Spanish and German. The team works regularly with other offices in Gide Loyrette Nouel's wide international network.

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