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Russian Legal Update

In this issue

WTO Membership Will Provide Needed Boost to Investment Climate in Russia

by **Laura M. Brank**

On December 16, 2011, after 18 years of negotiations, the Russian Federation was officially invited to join the World Trade Organization (WTO) during the WTO Ministerial Conference in Geneva. The official invitation marks an important milestone for integrating Russia into the global economy, requiring Russia's adherence to international business and trade standards, while opening its markets in many segments to foreign companies. Once the State Duma ratifies the resolution for accession, trade relations will be normalized under the WTO member framework. Russia is the last major world economy to join the organization.

Timeline

The Russian Ministry of Economic Development estimates that the membership documents will be ratified in July. Once ratified, Russia will be subject to the negotiated rules and regulations after 30 days. However, in order to protect certain segments of the Russian economy, not all of the regulations will take immediate effect, which is typically the case when new members join the WTO.

For certain industries, Russia has negotiated staggered accession of 5–7 years for the WTO conditions to take effect, allowing companies time to adjust to the increased competition and regulations.

Benefits: Reduction of Tariffs and NTBs to Trade

As a member of the WTO, Russia will be subject to WTO rules and procedures for fair trade with member countries, preventing it from arbitrarily raising tariffs and reducing the likelihood of it invoking nontariff barriers (NTB) to trade by subjecting it to the WTO dispute settlement procedures. Russia will also need to follow WTO safeguard, countervailing duty, and anti-dumping duty procedures, observing established procedures with open hearings.

Russia has committed to immediately lowering and binding its tariff rates on over one third of all tariff lines and over 80% of tariff lines within three years of accession. As a whole tariffs will decrease to 7.8% from 10%.[1]

More specifically, the key industry average tariffs will be cut for:

- aerospace (from 20% to 8.3%, on the sale of civil aircraft; tariffs on civil aircraft parts will drop to an average of 5%)
- agriculture (from 13.2% to 10.8%)
- automobiles (from 15.5% to 12%)
- chemicals (from 6.5% to 5.3% or less)
- electrical machinery (from 8.4% to 6.2%)
- high technology (tariffs will be bound at zero for products listed under the WTO's Information Technology Agreement)
- manufacturing (from 9.5% to 7.3%) and
- wood and paper (from 13.4% to 8%)[2]

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1 USRBC, Russia's WTO Accession: What it Means for U.S. Businesses, December 2011.

2 The Peterson Institute for International Economics Policy Brief, The United States Should Establish Permanent Normal Trade Relations with Russia, November 2011.

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Russia has also agreed to reduce its export duties on steel scrap to 1/3 of their current levels.

In addition to reducing tariffs, immediately after membership, Russia will allow one hundred percent foreign ownership of securities firms and nonlife insurance firms. Wholly foreign-owned companies will be able to operate in wholesale, retail and franchise sectors immediately after membership. By 2016, Russia agreed to open its telecommunications services market to all foreign suppliers and allow companies to operate as one hundred percent foreign-owned enterprises.

Agriculture trade will also be significantly affected. In Russia, consumer spending on food grew by 70 percent between 2002 and 2008[3] and is predicted to continue its rapid growth. Russia is the world's second largest import market for beef and pork and has historically been one of the largest importers of U.S. poultry, which has led to a number of high profile trade disputes over the years between Russia and the United States. WTO accession will ensure that all member countries will enjoy the same access to Russian agricultural markets as current leading importers such as Brazil and the EU. Imports will be subject to standardized sanitary and phytosanitary (SPS) standards to ensure that any restrictions are based on scientific criteria. Analysts estimate that U.S. agricultural exports to Russia will double or triple within a few years of WTO accession.

Related Agreements

In becoming a member of the WTO, Russia will become a party to a number of agreements which should present more transparent trade and investment in Russia. Among other agreements, Russia will become part to the Customs Valuation Agreement, the Government Procurement Agreement and the Technical Barriers to Trade Agreement.

The Customs Valuation Agreement (CVA), outlines the procedure and principles that countries must use to value imported goods for taxation purposes. Becoming a party to this agreement is important to establishing a system for conforming the pricing and valuation of goods for customs purposes to be applied in all member countries.

The Government Procurement Agreement (GPA), is designed to promote more open and transparent procurement by the government of goods and services, encouraging fairness and non-discrimination with respect to suppliers, goods and services. The GPA requires state-owned enterprises (SOEs) to base their purchases and sales strictly on commercial considerations. Upon accession, Russia would become an observer to the GPA, negotiating membership within four years of joining the WTO.

The Technical Barriers to Trade (TBT) Agreement outlines the standardized regulations, standards, testing and certification procedures for trade. Countries adhering to the standardized regulations ensure to exporters and governments that their technical trade regulations are free from unnecessary obstacles to trade and protectionist measures.

In addition, WTO members will be able to challenge any conflict in respect of Russia's WTO commitments through the WTO's dispute settlement process, which should add greater stability and transparency to trading and investing in Russia. The Dispute Settlement Body of the WTO has clearly defined rules and timetables for settling trade disputes and if a member country is believed to be violating trade rules or not living up to obligations, the dispute will be settled by a third group of countries through the established dispute resolution process. By signing on to join the WTO, Russia is demonstrating its commitment to becoming part of the international trading community and taking steps to increase investor confidence.

Once it becomes a member of the WTO, Russia will need to bring its legislation into compliance with the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement, which is the fundamental agreement protecting intellectual property rights for WTO member countries. Intellectual property protection has been one of the main obstacles inhibiting foreign investment in Russia. While Russia has the legislation in place to protect and enforce intellectual property, in practice enforcement has been difficult, especially without international cooperation to help eradicate such violations. Aligning its laws with TRIPS should help boost investment by technology and life science companies, which heavily rely on strong intellectual property protection.

Challenges

In order for U.S. companies to benefit from Russia's accession to the WTO, Congress will need to graduate Russia from the Jackson-Vanik Amendment, and grant Russia permanent normal trade relations (PNTR) status. The outdated Jackson-Vanik amendment was passed by the U.S.

[3] Ibid.

Congress in 1974 as part of the Trade Agreement Extension Act, to restrict normal trade relations with nonmarket and communist countries unable or unwilling to assure free emigration to its citizens; in the case of the Soviet Union this applied to the free emigration of Russian Jews. Passing legislation to grant Russia PNTR status is vital to allowing U.S. companies to enjoy the benefits of Russia's accession to the WTO and to be on the same playing field as their global competitors.

Conclusion

The fact that the Russian government considers joining the WTO an important step in Russia's economic growth and has shown its willingness to subject itself to the WTO rules demonstrates its commitment to becoming part of the international trading community. The Russian government appears to have learned an invaluable lesson from the global economic recession: that it is deeply interconnected with the rest of the world and that its policies and attitudes with respect to business and its application of the rule of law will directly impact investment in the country and, ultimately, its economic security.

Russia will become the 154th nation to join the WTO. Analysts estimate that implementing global trade rules and reducing protectionist practices will lead to an estimated 3% to 4% in additional annual growth to the Russian economy.

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UPDATED – Russian Foreign Strategic Investments Law: a Step Forward on the Way to Liberalization or a Decorative Dash?

by **Alexander Egorushkin**

At the Berlin forum of German business leaders held in November 2010, Russian Prime Minister Vladimir Putin declared that the clearance procedure for foreign investments in Russian strategic sectors would be simplified in the near future. This procedure is governed by Russian Federal Law No. 57-FZ "On the Procedure for Foreign Investments in Business Entities Having Strategic Significance for State Defense and National Security" (the Foreign Strategic Investments Law). The Foreign Strategic Investments Law has been heavily criticized by foreign investors and Russian business as it creates excessive administrative barriers, which de facto have no social benefits, to investment in Russian businesses. The Russian government responded to this criticism by introducing amendments to the law, which were adopted by the State Duma, the Federation Council and signed by the President into law in November 2011 (the Amendments). The Amendments came into force on December 18, 2011. This article examines the main changes contained in the Amendments and assesses their possible implications for foreign investors.

New Exemption for International Financial Institutions

According to the Foreign Strategic Investments Law, acquisitions of more than 25% of Russian companies qualifying as "strategic" (Strategic Companies) and more than 5% in Russian Strategic Companies carrying out activities associated with subsoil research and/or the exploration and extraction of certain minerals from federal-level subsoil property (Strategic Subsoil Companies) by a foreign state or an international organization are subject to prior consent by the Russian Federal Government Commission for Control over Foreign Investment (the Governmental Commission).

The Amendments introduce a partial exemption from this rule for international financial institutions (IFIs) in which the Russian Federation participates or with which the Russian Federation has entered into an international agreement. However, this exemption does not exclude all transactions involving IFIs from the scope of the Foreign Strategic Investments Law.

First, under the Amendments, the Russian government approves the list of such IFIs (the List). The Amendments are silent as to the legal status of those IFIs that the Russian government does not include in the List; however, it seems reasonable to assume that the exemption will only apply to IFIs on the List. As a result, any acquisition of qualifying stakes in Russian Strategic Companies by IFIs will still be subject to control by the Russian government, but the control mechanism will change from a formal one-shot clearance as currently envisaged in the Foreign Strategic Investments Law to "permanent exemption" for IFIs on the List, albeit without any clear and formal criteria for initial inclusion of IFIs on the List.

Second, this exemption does not affect the absolute ban on acquisition of qualified control (i.e., more than 50% of Strategic Companies and more than

10% of Strategic Subsoil Companies) by IFIs set out in the Foreign Strategic Investments Law. As a result, any acquisition of qualified control over Russian Strategic Companies by IFIs will still be restricted. Note (discussed in more detail below) that the 10% threshold will be increased to 25% of Strategic Subsoil Companies.

New Treatment of Transactions Involving Russian Beneficiaries

When the Foreign Strategic Investments Law came into force it was heavily criticized for applying to transactions where the acquirer of a Russian Strategic Company is a foreign entity controlled by a Russian beneficiary. While the Amendments were being prepared, Russian government officials declared that this issue would be addressed, and, according to the Amendments, the Foreign Strategic Investments Law will not apply to "relationships related to transactions" between companies "controlled by the Russian state or Russian individuals who are Russian tax residents."

Unfortunately, the term "relationships related to transactions" is not defined and the Amendments do not specify whether only such relationships – but not the transactions themselves – are outside the scope of the Foreign Strategic Investments Law. Neither do the Amendments specify whether simple oral pre-transaction negotiations between parties or written non-binding documents signed by the parties and reflecting their intentions (such as a Memorandum of Understanding) qualify as "relationships related to transactions."

In any case, it seems clear from the Amendments that transactions between a seller having a foreign beneficiary and an acquirer having a Russian beneficiary would still be subject to clearance requirements, since these relationships are not between Russian beneficiaries alone, as is required by the Amendments in order for the exemption to apply.

Finally, it is also not clear whether and how this exemption would apply to transactions between parties controlled by a Russian joint stock company whose shares are dispersed among many shareholders and where no shareholders unilaterally or jointly control the Russian joint stock company. This is because the Amendments refer to companies that are controlled by the Russian state or Russian individuals, which would likely not apply in such case.

Size of Stakes in Strategic Subsoil Companies Subject to Clearance Increased

According to the Foreign Strategic Investments Law prior to the Amendments, any transaction entered into by a private foreign investor was subject to prior consent by the Governmental Commission, to the extent that such transaction results, *inter alia,* in:

- the exercise, whether directly or indirectly, of the rights attached to 10% or more of the voting shares in a Strategic Subsoil Company by a private foreign investor; or

- the possession by a private foreign investor of the right to appoint 10% or more of the collegial executive body and/or the unqualified right to elect 10% or more of the board of directors or other collegial managing body of the Strategic Subsoil Company.

The Amendments increase the 10% thresholds mentioned above to 25%, which represents a positive step forward in liberalizing investment in Russian subsoil companies.

Number of Strategic Activities Decreased

The Foreign Strategic Investments Law expressly lists 42 types of strategic activities to which it applies. It is important to note that simply carrying out any of the enumerated activities is sufficient grounds for a Russian company to be considered a Strategic Company, regardless of whether the activity in question is a core activity for the company. Due to such a formalistic approach, many Russian companies are considered Strategic Companies simply because an ancillary activity of theirs is on the list of strategic activities set out in the Foreign Strategic Investments Law. For example, many banks involved in encryption activities are regarded as Strategic Companies under the Foreign Strategic Investments Law. However, these encryption activities are carried out by banks for the purpose of ensuring the safety and security of their clients' personal data, not as a core profit-generating activity. Accordingly, the Amendments exclude from the list of strategic activities, encryption activities carried out by a 100 percent privately-held private bank. The Amendments also exclude from the list of strategic activities, the placement, construction, operation and decommissioning of nuclear plants, radiation sources, and nuclear material and radioactive waste storage sites, provided that these are ancillary activities of a company operating in the private sector.

It is important to note that the initial version of the Amendments introduced by the Russian government to the State Duma also excluded activities related to the use of any agent of infection belonging to the fourth pathogen group (i.e., an agent that is highly unlikely to cause human disease) from the list of strategic activities. However, after the second reading, the exemption was removed from the Amendments.

Additional Issuance of Shares in Strategic Subsoil Companies

According to the Foreign Strategic Investments Law prior to the Amendments being adopted, any acquisition by a foreign investor of shares in a Strategic Subsoil Company resulting in 10% of the shares in such a company being held by a foreign party needed to be cleared by the Governmental Commission. Based on a literal interpretation of this rule, arguably, even if a foreign shareholder already holding more than 10% of the shares in a Strategic Subsoil Company acquired more shares in the company as a result of an additional issuance of shares and the foreign shareholder's percentage shareholding remains unchanged or even decreases but did not fall below 10%, then such an acquisition would still be subject to the clearance requirements of the Foreign Strategic Investments Law.

The Amendments address this issue by providing that clearance requirements do not apply to any acquisition of shares in Strategic Subsoil Companies if the shareholder's percentage shareholding does not increase.

Procedural Changes

The Amendments also slightly change the clearance procedure. For example, it is proposed that in addition to the Russian Federal Security Service (FSB), the Ministry of Defense of the Russian Federation will also be involved in the review process. In addition, detailed regulations were introduced with respect to entering into an agreement, setting out the acquirer's obligations related to the clearance procedure.

In summary, the Amendments introduce largely technical changes and do not substantially change current rules. Unfortunately, the Amendments sometimes are poorly drafted and raise more questions than provide answers, but the new exemptions for IFIs and the changes with respect to subsoil companies should hopefully result in increased foreign investment in subsoil companies.

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Legislation to Increase the Protection of Creditors in the Case of Decreases to the Charter Capital of a Company

by **Andrey Dukhin**

The procedure for decreasing the charter capital of a limited liability company (LLC) and certain regulations regarding monitoring and calculating net assets of LLCs and joint stock companies (JSC) were recently significantly modified. As amended, the LLC procedure for decreasing charter capital aligns with the procedure established for JSCs. The regulations regarding net assets of LLCs have also been revised similar to the relevant provisions applicable to JSCs, however, certain issues remain unclear. In particular, it is not clear whether the tax inspectorate or creditors will have the right to initiate the liquidation of an LLC.

The amendments were introduced by the Federal Law "On Amending Several Legislative Acts of the Russian Federation in Part Regarding Revision of the Means of Creditors' Protection During Decrease of a Charter Capital, Change of Requirements to Commercial Entities in Case of Inconsistency of Charter Capital with the Value of Net Assets" No. 228-FZ (the Amending Law). Most amendments entered into force on January 1, 2012; however, a few will be delayed from entering into force until January 1, 2013. The amendments affect the Law on Joint Stock Companies (JSC Law), the Law on Limited Liability Companies (LLC Law), the Law on Registration of Legal Entities and Individual Entrepreneurs (Registration Law) and other acts.

Procedure for Decreasing the Charter Capital of an LLC

As amended by the Amending Law, the LLC Law provides for a new procedure to decrease the charter capital of an LLC. Within three (3) working days from the date of a decision to decrease the charter capital of an LLC, the Unified State Register of Legal Entities (USRLE) should be notified by the LLC about such decision and two announcements should be published in the press (one per month in

the course of two months). The Amending Law removes the requirement of notifying creditors of an LLC in writing, in case of a decrease in the charter capital and providing confirmation of such notification to USRLE in order to register the decrease of the charter capital. This provision always has been inconvenient for LLCs decreasing their charter capital, since a single company could have hundreds of creditors. However, the benefit of this change to creditors appears questionable since now they will need to monitor the press in order not to miss information on a decrease of charter capital of their obligors instead of simply being notified of the same.

The notification filed with USRLE to decrease the charter capital should, *inter alia*, contain information on the procedure and conditions for creditors to file claims for early fulfillment of obligations by the LLC or if such fulfillment is not possible, termination of the obligation and recovery of the resulting damages. It should also contain the addresses where relevant claims can be filed and the means of contacting the LLC.

Creditors' claims for early fulfillment or early termination and compensation of losses can be satisfied only in cases where obligations became known before information was published on the decrease of the charter capital, such claim should be submitted not later than 30 (thirty) days after the date the notification was last published, in accordance with the procedure described in the paragraph above. The court has the right to deny a creditor's claim if the LLC proves that: (i) the rights of the creditor are not affected by the decreases in the charter capital; and (ii) the provided security covers the due performance of the relevant obligation of the LLC. The statute of limitations for filing such claims by creditors is six (6) months after the date when the last notification on decreasing the charter capital was published.

Monitoring and Calculating Net Assets

The procedure for calculating net assets applicable both to LLCs and JSCs (except for credit institutions) is established in "The Order of Estimation of Net Assets of JSCs" approved by Order of Ministry of Finance of RF No. 10n, Federal Commission for the Securities Market of RF No. 03-6/pz, dated January 29, 2003. As for credit institutions, their capital is taken into account instead of their net assets. The procedure for calculating capital is set forth by the RF Central Bank in the Decree of the Central Bank of the Russian Federation No. 2332-Y "On the List, Forms and Order of Drafting and Submitting of Records of the Credit Institutions in the Central Bank of the Russian Federation," dated November 12, 2009.

The Amending Law introduces a new provision regarding monitoring net assets of an LLC. According to the Amending Law, an annual report of an LLC will now need to contain a clause on the condition of its net assets.

Another important change concerns the term when an LLC is allowed to have the amount of its net assets fall below its charter capital. Within six (6) months after the end of a fiscal year, following the second fiscal year, or each consecutive fiscal year at the end of which the company's net assets were less than its charter capital, the company is required to: (i) declare a decrease in its charter capital to an amount not exceeding the value of its net assets; or (ii) liquidate the LLC. Currently, such actions should be undertaken if the amount of net assets of the company has been below its charter capital for at least two (2) fiscal years and every subsequent fiscal year, i.e. the term when the company can have its net assets below its charter capital has been extended for one (1) year.

The Amending Law does not allow a creditor or relevant governmental bodies to initiate liquidation of a company as previously was the case. Thus it is unclear how this provision will be enforced under Russian law.

Amendments to the Registration Law (effective as of January 1, 2013)

The Amending Law provides for establishing a Unified Federal Register of Information About the Activity of Legal Entities (Register). The purpose of the Register is to maintain information about legal entities and their activity. Information contained in the Register will be subject to publication on the Internet.

The Amending Law provides for a list of information that should be included in the Register. Among other things, it includes information on: (i) decreasing or increasing the charter capital; (ii) the value of the net assets of a JSC, as of the latest reporting date; and (iii) the value of net assets of an LLC in cases provided by the LLC Law.

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Russia on Its Way to Establishing a Specialized IPR Court


by **Timur Djabbarov** and **Elvira Danilova***

"The United States encourages Russia to pass legislation establishing a specialized IPR court. The United States looks forward to working together with Russia on continuing education opportunities for judges with respect to IPR."

Ron Kirk, U.S. Trade Representative
Special 301 Report. April 2011

Protection and enforcement of intellectual property (IP) rights in the Russian Federation has been one of the main obstacles inhibiting foreign investment in Russia. Notwithstanding the steady development of modern IP legislation in accordance with the World Intellectual Property Organization (WIPO)[4] directives and provisions of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS),[5] the practical application of laws by Russian state authorities (courts, investigative bodies, antimonopoly authorities, etc.) in this area has left much to be desired. Drowning in piles of cases to be heard daily and lacking the required qualifications in science, technology or art, the judges of Russian state commercial (*arbitrazh*) courts and courts of common jurisdiction[6] hearing IP cases usually adopted a formalized approach. As a result, the lawful interests of rightholders often went unprotected. An initial wrongful court judgment on an IP case would create precedent for further defective court practice.[7] As one solution to this problem, a separate court is proposed to be established specializing exclusively in intellectual property issues.

On December 6, 2011, Federal Constitutional Law No. 4-FKZ was adopted creating a single specialized court for intellectual property rights (the IPR Court) within the system of state commercial (*arbitrazh*) courts.[8]

As a court of first instance, the IPR Court will rule on cases with respect to establishing and validating IP rights, in particular:

(i) cases on challenging actions of federal executive authorities in the area of patent rights and rights to new varieties of plants, topologies of integrated circuits, know-how, means of individualization of legal entities, goods, works, services, enterprises, and use of the results of intellectual activity incorporated in unified technology;

(ii) cases on granting or terminating legal protection of the results of intellectual activity and their equivalents in the form of means of individualization of legal entities, goods, services, and enterprises (excluding copyrights and associated rights, and topologies of integrated circuits). In particular, challenging actions of a federal executive authority for new varieties of plants and its officials, as well as bodies authorized by the RF Government to consider patent applications for secret inventions; challenging rulings of a federal antimonopoly authority on recognizing as unfair competition actions related to the acquisition of exclusive rights to the means of individualization of legal entities, goods, works, services, and enterprises; determining a patentholder; recognizing the invalidity of a patent to an invention, utility model, industrial design or selection achievement, of a decision on granting legal protection to a trademark, name of the place of origin of goods and on granting

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4 The World Intellectual Property Organization (WIPO) is a specialized agency of the United Nations that was established by the WIPO Convention in 1967 with a mandate from its Member States to promote the protection of IP throughout the world through cooperation among states and in collaboration with other international organizations.

5 TRIPS provisions were reflected in the fourth part of the Civil Code of the Russian Federation governing IP matters in 2006. TRIPS as a part of WTO protocol was signed by the Russian Federation on December 16, 2011, and is expected to be ratified by summer 2012.

6 IP disputes with regard to submission of applications with regard to and/or state registration of patent rights, rights to a utility model; industrial designs, selection achievements, trademarks or names of the place of origin of goods are deemed to be connected with public order in the Russian Federation, and for this reason are not arbitrable.

7 Formally, court precedent is not considered as a source of law in the Russian Federation, yet, by virtue of the "conformity of court practice" principle, Russian judges rarely deviate from the established approaches formed by prior court judgments.

8 State commercial (*arbitrazh*) courts of the RF hear economic disputes between legal entities and/or individual entrepreneurs.

exclusive rights to such name; and on premature termination of legal protection of a trademark due to its non-use.

As a court of second (cassation) instance, the IPR Court will review: (i) cases judged by the IPR Court from the first instance; (ii) cases connected with IP rights infringement judged by state commercial (*arbitrazh*) courts of constituent territories of the Russian Federation in the first and appellate instances.

Decrees adopted by the IPR Court in the cassation instance may still be reviewed by the Supreme Commercial (*Arbitrazh*) Court of the Russian Federation (supervisory instance).

The main differences between the IPR Court and a traditional state arbitrazh (commercial) court are that:

(i) there is no appellate instance within the IPR Court;[9]

(ii) both first and cassation instances of the IPR Court will consist of a panel of three judges;[10] and

(iii) all judges in the IPR Court will have special qualifications in spheres relating to IP: science, technology or art.

The IPR Court will be guided by the State Commercial (*Arbitrazh*) Procedural Code of the Russian Federation, which has been amended accordingly.

The IPR Court will officially start hearing cases not later than February 1, 2013. The planned location for the IPR Court is in the Innovation Center Skolkovo (Moscow Oblast, Skolkovo village, please see our Russian Legal Update from December 2010 setting out the legal framework for Skolkovo). Access for residents from other regions of the Russian Federation will be ensured by video conferencing, saving parties to a dispute from traveling to another city to participate in court proceedings.

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Unfair Competition in Connection with the Use of Stolen or Misappropriated Information Technology in Business Operations: Russian Regulatory Norms and International Legal Aspects

by **Alexander Egorushkin**

Unfair competition laws adopted by the state of Washington and Louisiana in the U.S., are the first in a growing trend of legislation meant to penalize manufacturers or related third parties for using stolen or misappropriated information technology in any part of the sales process; the laws will have cross border implications for offenders.

The general grounds for regulating unfair competition are provided for by international law. The Paris Convention for the Protection of Industrial Property of 1883 (Paris Convention), established the first set of regulations for unfair competition, defining unfair competition as an act of competition contrary to honest practices in industrial or commercial matters (Article 10.bis). This notion was further developed in different legal systems. In Russia, unfair competition is regulated by the Federal Law On Protection of Competition (the Competition Law).

The Competition Law defines unfair competition as any illegal act by a business entity (groups of entities) that is aimed at obtaining a competitive advantage in the course of doing business, contradicting usual business practices, principles of integrity, reason and fairness, having caused or which may cause damages to competitors or having caused or which may cause damage to a competitor's reputation.

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9 Traditional state commercial (*arbitrazh*) courts have four instances: first, appellate, cassation and supervisory.

10 Cases in the first instance of the traditional state commercial (arbitrazh) courts are heard by one judge and by three judges in appellate and cassation courts.

The definition of unfair competition covers production, sale, exchange, or marketing involving the illegal use of information technology. However, not all acts of misusing information technology result in unfair competition, only cases of production, sale, exchange, or marketing involving the use of stolen or misappropriated information technology, resulting in a competitive advantage for the infringer, while the owner of the exclusive rights or a party legally using exclusive rights suffers damages. The goods must be introduced into circulation for the act of information technology infringement to be qualified as unfair competition.

As a rule, regulation of unfair competition has extraterritorial application, thus affecting foreign relations. In this respect, it is important to note that regulation of unfair competition in many foreign countries may directly apply to affected Russian companies.

In 2011, as noted, two states in the U.S. passed laws on unfair competition. The state of Washington and Louisiana are seeking to promote fair competition, by making those guilty of infringing competition laws, through the use of stolen or misappropriated information technology, legally accountable for their actions. The laws make product manufacturers legally accountable for the use of stolen or misappropriated information technology, irrespective of the country of their registration, if their products circulate in the territory of the relevant states. If the information technologies used in the manufacture, distribution, marketing or sale of such products were used illegally, the product manufacturer may be held liable for unfair competition practices.

The laws provide for a two-step procedure for eliminating unfair competition. A manufacturer illegally using information technologies first receives a warning from the owner of the information technology, notifying the manufacturer of the alleged infringement. If the warning is ignored, the following judicial measures may be taken against the infringer and its products: (i) reimbursement of damages in favor of the competitor; (ii) interim measures in the form of prohibiting the manufacturer from using the information technologies in the production of its products illegally and from selling or offering such products in the territory of the states; and (iii) seizure of the product inventory, located in the territory of the applicable states.

As a result of these laws, not only manufacturers engaging in unfair practices, but also contracting third parties may be held responsible for using stolen or misappropriated information technology. If it is proven that a manufacturer violated the law, the aggrieved competitor may claim reimbursement of actual direct losses from the third party selling the infringer's products in the territory of the relevant states.

Consequently, Russian manufactures that directly or indirectly (e.g. through distributors) export their products to the U.S. and who have used stolen or misappropriated information technology in their business operations may be subject to legal liability under the abovementioned unfair competition laws, resulting in a possible ban from selling or offering such company's products in the territory of the respective state, fines (compensation for damages) or even attachment of their products circulating in the United States.

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Legislative Update

by **Elvira Danilova***

Banking

Banks to increase their internal funds (capital)

On January 1, 2012, new internal funds (capital) requirements came into force, requiring the amount of internal funds (capital) to open a new bank to be 300 million rubles. In addition, to obtain a license to perform banking operations with rubles and foreign currencies, as well as to raise funds in rubles and foreign currency, banks will be required to have not less than 900 million rubles in internal funds (capital).

Comments: operating banks may gradually increase internal funds (capital) to 300 million rubles, but must meet the new requirements by January 1, 2015.

Financial Reporting

Russian companies to report their financial figures in accordance with international financial reporting standards (IFRS)

From January 1, 2012, certain Russian companies are required to report their financial results according to international standards.

On December 12, 2011, the Ministry of Finance officially recognized IFRS. All public joint stock companies, insurance companies and banks must report under IFRS starting from January 1, 2012.

All companies in Russia will be subject to IFRS starting from 2015.

This is a positive step for Russian companies, given that IFRS is recognized around the world and is perceived as an important indicator of management transparency, credibility and stability. Local standards are often ignored by investors and foreign credit institutions as they are considered uncertain and sometimes irrelevant. Using international standards should improve the investment climate and make it easier for companies to attract financing.

Franchising Regulations

Franchising regulations have undergone major changes. The stated goal of these changes is to remove barriers to development of franchising operations in Russia.

Main changes:

- granting the franchisor the right to determine the resale price and the territory on which the franchisee is entitled to sell goods, perform work or render services;

Under Russian competition law, the franchisor already has this right, but prior to the amendments, such right was not recognized by the RF Civil Code. The amendments to the RF Civil Code have eliminated the discrepancy between antitrust and civil law regulation of franchise agreements.

- providing parties the right to alter the terms and conditions of a franchise agreement when executing an agreement for a new term;

Prior to the amendments, parties were entitled to execute an agreement on new terms using only the same terms and conditions, although in practice amendments were often re-negotiated.

- providing for the possibility of unilateral termination of the franchise agreement executed for a fixed term by either party;

Such right may be applied by the parties at any time, subject to the following conditions: 1) prior notification of the counterparty in writing, no later than 30 (thirty) days before termination; 2) franchise agreement shall provide parties the right to terminate an agreement by paying a termination fee ("*otstypnoe*").

Taxation

Amendments to transfer pricing rules

On January 1, 2012, new transfer pricing rules came into force requiring taxpayers to notify the tax authorities of all controlled transactions, including cross-border transactions involving oil, oil products, certain metals, fertilizers, as well as transactions involving foreign entities registered in special-tax districts (as determined by the Finance Ministry).

The purpose of such rules is to prevent the loss of taxable earnings from transactions when earnings and expenses are reallocated between the parties to a transaction, which are interdependent only for the purposes of tax savings.

Transactions that don't exceed 3 billion rubles ($100 million) in 2012 and 2 billion rubles ($71 million) in 2013 will be exempt from reporting rules. Starting from 2014, the threshold will be 1 billion rubles ($35 million) in a calendar year.

** Elvira Danilova is a paralegal in Dechert's Moscow office.*

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Recent News

Recent Promotions

We are happy to report the promotion of Senior Associate Olga Watson to the position of Counsel, Olga's promotion was effective January 1, 2012. Olga has been assisting clients with cross-border transactions including mergers and acquisitions, private equity, joint venture and equity finance transactions in Russia, throughout Eastern Europe and the former Soviet Union since 1999. Olga graduate from Lomonosov Moscow State University with honors in law and from the BPP University College (UK) with a graduate diploma in law and an LPC, she is currently qualifying as an English solicitor. She has represented leading companies in the banking, mining, telecommunications and consumer products sectors and was a member of the Dechert team working on recent deals for PepsiCo, Kinross Gold Corporation, EBRD, Rusnano

and Dufry, among others. She is currently qualifying as an English solicitor and divides her time between Dechert's London and Moscow offices.

December 1, 2011: Maryana Batalova was promoted to an Associate. Maryana is a member of the dispute resolution team in the Moscow office. Maryana graduated from the Higher School of Economics with honors in law, and is currently working on her PhD in the sphere of international private law.

Recent Major Deals

A team from Dechert is advising the European Bank for Reconstruction and Development (EBRD) and Rusnano, the Russian state corporation set up to kick-start the development of innovative technologies, on their joint agreement signed in Moscow on December 6 to finance a new production line that will manufacture energy-saving glass.

The industrial partners in this project, which will use state-of-the-art technology to launch a new float glass line and glass coating facility in the Moscow region, are Japan's publicly listed NSG Group — Nippon Sheet Glass Co. Ltd., a global leader in the glass industry — and the privately-owned STiS processing group, Russia's leading producer of insulated glass units.

Under the terms of the agreement, the EBRD will contribute the equivalent of €35 million in common equity while Rusnano will contribute the rouble equivalent of €70 million in common equity and and the rouble equivalent of €80 million as an equity contribution in preference shares.

This is the first equity investment made by the EBRD with Rusnano and follows up on a Memorandum of Understanding on co-financing opportunities signed between the two institutions in December 2009.

The Dechert team advising EBRD and Rusnano is being led by Moscow managing partner Laura Brank, assisted by counsel Olga Watson, and associates Alexander Volnov and Ruslan Koretski.

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A team from Dechert is advising Auburn Investments Limited (Auburn) on its proposed sale of shares in its 100% subsidiary PJSC EMAlliance (EMAlliance), one of Russia's largest power machine-building companies, to OJSC Silovye Mashiny (Power Machines), the leading Russian producer and supplier of products and solutions for the power-plant industry.

EmAlliance and Power Machines announced on December 23 that they had signed a share purchase agreement. Closing of the deal is subject to the approval of the Federal Antimonopoly Service of the Russian Federation and the antimonopoly authorities in a number of other countries.

The Dechert team advising Auburn is led by Moscow partner Shane DeBeer and includes national partner Evgenia Korotkova and associate Irina Kulyba.

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A team from Dechert advised CJSC Chukotka Mining and Geological Company (CMGC), the 100% owner of the Kupol gold and silver mine in the Chukotka Autonomous Okrug of the Russian Federation's Far East Region and the 100% indirect subsidiary of Canada-headquartered Kinross Gold Corporation (NYSE: KGC) (TSX: K), on a U.S.$200 million non-recourse project financing from a group of international financial institutions to finance the increase in Kinross's ownership of the Kupol mine from 75% to 100%. Kinross announced on December 21 that the loan had been funded. Dechert previously advised Kinross on the acquisition of the 25% remaining stake in CMGC, which closed on April 4, 2011 and Dechert lawyers also advised it several years ago when it acquired its 75% interest in CMGC.

The non-recourse loan carries a term of five years, with annual interest of LIBOR plus 2.5%. Lead arrangers and lenders are Export Development Canada, BNP Paribas, HSBC Bank PLC, ING Bank N.V. and Société Générale.

The Dechert team advising CMGC is led by Moscow managing partner Laura Brank and included associates Olga Watson, Alexander Volnov, Ruslan Koretski, Liselot Ronz and Andrey Dukhin.

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A team from Dechert LLP advised Dufry, the global travel retailer with operations in 46 countries, on its acquisition of 51% of a local travel retail operator at Moscow's Sheremetyevo International Airport.

On January 2010, Dufry concluded the transaction to acquire 51% of a joint venture with Regstaer Group, which holds Regstaer's duty free operations at Sheremetyevo Airport and generates annual sales in excess of U.S.$50 million.

Sheremetyevo International Airport is Russia's second busiest airport with 14 million international passengers per year. It is also one of the fastest

growing airports in Europe and recorded a passenger growth of close to 20% in the last twelve months.

The Dechert team advising Dufry was led by Moscow managing partner Laura Brank and included partner Igor Panshensky, counsel Olga Watson, and associates Alexander Egorushkin, Elena Ivankina, Irina Kulyba, Svetlana Kuzovkova, and Kirill Skopchevskiy.

Recent Dispute Resolution Matters

Dechert successfully represented a Russian subsidiary of a well known German automotive manufacturer in a complex tax case before the State Arbitrazh (Commercial) Court of the city of Moscow.

The Dechert team was led by national parter Oxana Peters and included associates Timur Djabbarov and Alexander Lazarev.

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Dechert successfully represented a Russian construction company in a tax dispute before the State Arbitrazh (Commercial) Court of the City of Moscow. The court acknowledged the invalidity of a decision by the tax inspectorate, resulting in a refund of approximately 50 million Russian rubles (approximately US$1.7 million) on VAT paid by the construction company in the course of a major investment contract relating to the construction of a residential complex in Moscow.

The Dechert team was led by national partner Oxana Peters and included associates Timur Djabbarov and Maryana Batalova.

Recent Honors

Dechert is the first law firm to receive the Star of Excellence Award from The Eurasia Center and The Eurasian Business Coalition in association with The Russian Federation Chamber of Commerce and Industry in the USA, the Russian Trade Representation and the Russian Cultural Centre. The award recognizes businesses that contribute significantly to U.S.-Eurasian trade and development.

Laura Brank accepted the award at the Russian Trade Representation on December 5 in Washington, DC. Other recipients of the 2011 Star of Excellence included Almaz Capital Group, The Boeing Company and Caterpillar Inc.

Dr. Gerard Janco, the President of the Eurasian Center, commended Laura's contributions to improving U.S.-Russian relations and increasing knowledge of the Russian legal system before presenting Dechert's award, which was inscribed "in special recognition of Dechert's monumental work, through Laura Brank, to provide excellent legal services for doing business with Russia."

Recent/Upcoming Events, Seminars and Speaking Engagements

October 28, 2011: Laura Brank presented on "Investing In Russia — Minimizing the Legal Risks and Navigating Through the Legal Landscape" at the Russia Business and Investment Summit organized by NYSE Euronext and International Roundtable Inc. and held at the New York Stock Exchange.

November 24, 2011: Shane DeBeer presented on "Mergers and Acquisitions in Russia and CIS: Legal Risks and Mitigation" at the international conference "Corporate Financing in Russia & CIS" organized by IC Energy and held in London.

December 5, 2011: Laura Brank presented on "Recent Legal Developments Affecting Foreign Investment and Trade in Russia" at the 4th Annual Conference: "Doing Business with Russia" organized by The Eurasia Center and The Eurasian Business Coalition in cooperation with The Russian Federation Chamber of Commerce and Industry in the USA and held at the Russian Trade Mission in Washington, D.C.

December 8, 2011: Alexander Egorushkin presented on "Aspects of Antimonopoly Requirements/ Regulations on Intellectual Property from the Perspective of Russian and International Law" at the "Expopriority-2011" event held at Expocentre in Moscow.

December 13, 2011: Laura Brank participated in a panel discussion titled "Russia: the New Frontier" at the 2011 M&A Advisor Summit at the New York Athletic Club in New York.

In the News

Laura Brank recently published an article on CNBC.com titled "Embracing Russia's WTO Entry." In the article, Laura discussed not only what Russia will gain from joining the WTO, but also what it says about the willingness of the Russian government to fully engage with the international community and play by the same rules as other developed economies. The article was published on January 23 and is available here.

Alexander Egorushkin gave an interview that formed the basis of an article titled «Экспортерам запрещено применять нелицензионное ПО» ("Exporters Are Forbidden from Using Unlicensed Software") in which he discussed how unfair competition arises from the use of stolen or misappropriated information technology in business operations; how this is reflected in Russian and international regulatory frameworks; and best practice for Russian exporters in light of these regulations. The interview was published in Russian in *PC Week* on December 26 and is available in Russian here.

Oxana Peters gave an interview that formed the basis of an article titled «На коррупцию пеняют неудачники» ("Losers Blame Corruption"), which was published on the *BigRussia* website on January 18. Among other things, the article discusses how the relationship between the various tiers of the Russian court system is an effective check on possible abuses and describes recent examples of foreign companies successfully litigating in Russia. The article is available in English, Russian and German for iPad users here.

Dechert Expands Presence in Germany with Opening of Office in Frankfurt

Dechert announced on January 17 that it has expanded its presence in Germany with the opening of an office in Frankfurt. Achim Pütz, who joined the firm in 2010, will serve as the managing partner for the office. He will be joined by Dr. Carsten Fischer and Dr. Benedikt Weiser, who have been elected as partners in the Financial Services Group.

Dechert's presence in Germany has steadily grown since 2004 when the firm's first office was opened in Munich. The Frankfurt office will work closely with our seasoned team in Munich that focuses on private equity and venture capital transactions, mergers and acquisitions, leveraged finance and acquisition finance, financial services and asset management, securities, banking, capital markets, labor, tax, finance and real estate as well as Islamic Finance and other business law for various industries.

Recent Appointments

Oxana Peters was selected to the position of the Deputy Head of the Legal Commission of the Russo-German Chamber of Commerce.

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We welcome your feedback. Please let us know if there are any topics you would like to see covered in future issues.

If you or your colleagues would like to receive Dechert's *Russian Legal Update*, other *DechertOnPoints*, or copies of the articles or presentations referred to herein, please contact Anastasiya Shaposhnik (+7 499 922 1163; anastasiya.shaposhnik@dechert.com) or Kieran Morgan (+44 20 7184 7853; kieran.morgan@dechert.com). You can also subscribe at www.dechert.com.

Practice group contacts

For more information, please contact the authors, the Dechert lawyer with whom you regularly work or Moscow Managing Partner Laura Brank. Visit us at www.dechert.com.

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