

# The Year in Review

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## Eurasia/Russia

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**AN ANNUAL PUBLICATION OF THE ABA/SECTION OF INTERNATIONAL LAW**

## **Eurasia/Russia<sup>1</sup>**

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This article highlights significant legal developments in Eurasia and Russia that took place in 2019.

### **I. UKRAINE**

#### **A. ARBITRATION**

In 2019, in the wake of reforms to Ukraine's arbitration system, mechanisms were further developed and important judicial decisions relating to arbitration were rendered.

##### *1. 2019 Law on Concessions*

The Law on Concessions (LOC) entered into force on October 20, 2019.<sup>2</sup> Under the LOC, parties to a concession agreement may choose their dispute resolution mechanism including mediation, non-binding expert determination, national or international commercial arbitration, investment arbitration (including arbitration located outside Ukraine), and the procedural rules for the dispute's resolution.<sup>3</sup> Further, the State may waive its immunity in a direct or concession agreement upon the demand of a concessionaire or creditor. Such a waiver will apply to the following: all court decisions, international commercial arbitration awards, decisions in proceedings about preliminary security of a claim, and enforcement of court and arbitration body decisions.<sup>4</sup>

##### *2. Crimean Investment Arbitrations in Ukraine*

Investment-related arbitral and court proceedings involving Ukrainian parties against the Russian Federation arising from Russia's 2014 annexation of Crimea stimulated great public interest both in Ukraine and abroad.

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2. See Про Концесію [Law of Ukraine "On Concession"] issued Oct. 3, 2019, effective Oct. 20, 2019, Law No. 155-IX (Ukr.), art. 45 *available at* <https://zakon.rada.gov.ua/laws/main/155-20> [hereinafter the Law].

3. *Id.*

4. *Id.*

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In January 2019, the Ukrainian Supreme Court issued a final and binding ruling that affirmed a Permanent Court of Arbitration award in favor of Everest Estate LLC and other Ukrainian investors against the Russian Federation relating to Crimean assets and ordered its enforcement.<sup>5</sup> For purposes of enforcement, the Supreme Court deemed that shares in Ukrainian banks directly owned by Russian state-owned banks are “Russian assets,” and allowed seizure of those shares.<sup>6</sup>

Even though details of enforcement measures are not publicly known, after years of ignoring the rulings and the resulting seizures, Russian banks have begun fighting against them.<sup>7</sup> For example, the Russian state-owned parent of Prominvestbank, Vnesheconombank (VEB), whose shares in a Ukrainian subsidiary were seized pursuant to a Ukrainian court ruling, has filed investment claims against Ukraine at the Stockholm Chamber of Commerce (SCC) under the Russian-Ukraine bilateral investment treaty.<sup>8</sup> The claims for alleged expropriation and destruction of VEB’s business in Ukraine (which have not yet been heard by the tribunal) reportedly total about US \$2.7 billion.<sup>9</sup> The SCC has imposed interim measures prohibiting Ukraine from selling the Prominvestbank shares pending its final decision.<sup>10</sup>

Ukrainian state-owned parties also are pursuing claims against Russia regarding Crimean assets. In July 2019 the Kiev Appellate Court recognized and enforced an arbitral award in favor of the Ukrainian state-owned Oshchadbank<sup>11</sup> against Russia, and in August 2019, Ukrenergo, the Ukrainian national energy company, initiated an investment arbitration against Russia for losses incurred during the Crimean annexation.<sup>12</sup> Additional state entities, such as the Ukrainian Sea Ports Administration<sup>13</sup> and the State Hydrographic Service of Ukraine,<sup>14</sup> seem prepared to begin similar arbitrations.

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5. *The Court Ordered Raiffeisen Bank Aval to Lift the Arrest of 100% of Sberbank Shares*, FINBALANCE (Oct. 17, 2019), <http://finbalance.com.ua/en/news/the-court-ordered-raiffeisen-bank-aval-to-lift-the-arrest-of-100-of-sberbank-shares>.

6. *Id.*

7. Sebastian Perry, *Russia challenges Crimea awards and changes strategy*, GLOBAL ARB. REV. (Jun. 6, 2019), <https://globalarbitrationreview.com/article/1193767/russia-challenges-crimea-awards-and-changes-strategy>.

8. *VEB v. Ukraine*, INV. POLICY HUB, <https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/973/veb-v-ukraine> (last updated Dec. 31, 2019).

9. *Id.*

10. *Stockholm Arbitration Court bars Ukraine from selling shares of VEB subsidiary*, INTERFAX UKR. (Aug. 28, 2019), <https://en.interfax.com.ua/news/economic/609693.html>.

11. Київський апеляційний суд [Kyiv Court of Appeal], Resolution of the Kyiv Appellate Court, July 17, 2019, No. 824/66/19 (Ukr.).

12. *Ukrenergo v. Russia* (Ukr.v. Russ.), UNCITRAL, <https://www.italaw.com/cases/7563>.

13. Anastasia Zanudna, *Ukraine sues Russia in international courts. Main cases*, BBC NEWS UKR. (Aug. 21, 2019), <https://www.bbc.com/ukrainian/features-49294741>.

14. See *The State Hydrographic Service of Ukraine Refreshes Its Campaign Against Russian Federation’s Actions*, HELLENIC SHIPPING NEWS (July 26, 2019), <https://www.hellenicshippingnews.com/the-state-hydrographic-service-of-ukraine-refreshes-its-campaign-against-russian-federations-actions/> (quoting Oleksandr Shchyptsov, the head of the State

### 3. *Enforcement of Unclear Arbitration Clauses*

Under the recently amended Ukrainian law, courts are to favor arbitration clause's validity and enforceability when interpreting any inaccuracies or ambiguities in an agreement's arbitration clause, or when settling any doubts as to its validity and enforceability.<sup>15</sup> Thus, they will typically recognize an arbitration clause as valid and enforceable even if the arbitral institution is misidentified or ambiguous, so long as the text allows the court to establish without a doubt that the parties meant and agreed on a particular institution.

In *Techcom GmbH v. Dniprovskiy Metallurgy Plant PJSC*, the dispute arose from a contract that provided for arbitration at the "International Commercial Arbitration Court at the Austrian Chamber of Commerce and Industry in Vienna."<sup>16</sup> Although there is no court by that name, the Supreme Court of Ukraine stated that because the only arbitral institution in Vienna is the Vienna International Arbitration Court, the parties clearly intended disputes between them to be considered there.<sup>17</sup>

But an arbitration clause was voided in *Velgevos Enterprises Limited v KMT LLC and United Trade Network LLC*.<sup>18</sup> The clause provided for arbitration to be conducted in Limassol, Cyprus under the Cyprus International Commercial Arbitration Law No. 101 of 1987. Because no particular court or arbitral panel was named, the court sought an institution in Limassol that would be competent to consider the dispute but found that no institution in Limassol contained "arbitration" in its name. Thus, the court reasoned, the parties had not agreed on an institution to hear the arbitration. To determine the intent of parties, the court looked for evidence that they may have agreed to *ad hoc* arbitration. To this end, the court obtained from the Cypriot Ministry of Justice a copy of Cyprus' "International Commercial Arbitration Law No. 101/1987." After reviewing it, the court established that the Law did not provide for a method to determine which arbitral body was competent to consider the case. Since the arbitration clause could not be enforced, the Court ruled that Ukrainian courts would decide the dispute on its merits.<sup>19</sup>

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Hydrographic Service, "At the earliest possible time we will initiate the procedure to file a request for arbitration against the Russian Federation to the Permanent Court of Arbitration in The Hague concerning the unlawful expropriation of the SHSU property in the Crimea.").

15. See Про міжнародний комерційний арбітраж [Law of Ukraine "On International Commercial Arbitration"], issued Dec. 15, 2017, Law No. 4002-XII (Ukr.), *available at* <https://zakon.rada.gov.ua/laws/show/4002-12>.

16. Resolution of the Supreme Court, Case No. 904/927/18 (Sept. 3, 2019) (Ukr.), *available at* <http://www.reyestr.court.gov.ua/Review/84094948> (last visited March 2020).

17. *Id.*

18. Resolution of the Supreme Court, Case No. 916/2591/16 (Sept. 5, 2019) (Ukr.), *available at* <http://www.reyestr.court.gov.ua/Review/84284486> (last visited March 2020).

19. *Id.*

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Another case before the Ukrainian Supreme Court dealt with an arbitration clause with a handwritten amendment made by the parties.<sup>20</sup> The original contract between Pelagia AS and Laran-07 LLC provided for arbitration at the International Commercial Arbitration Court at the Ukrainian Chamber of Commerce & Industry, but the parties agreed subsequently to amend the provision to name the Arbitration and Dispute Resolution Institute of the Oslo Chamber of Commerce.<sup>21</sup> The amendment was made only through handwritten corrections on each party's hard copy of the agreement. Based on the handwritten change, Pelagia brought an arbitration against the Laran-07 in Oslo and brought the resulting arbitral award to Ukraine to be enforced. The Ukraine Supreme Court noted that the versions of the contract provided by each party contained identical handwritten corrections and the signatures of both parties were present on the reverse side of the page, so there was no doubt that the parties intended the amendment to be binding. Although Laran-07 argued that enforcement of the foreign arbitral award would violate Ukrainian public policy, the Supreme Court dismissed this argument and upheld enforcement of the Norwegian arbitral award for Pelagia.<sup>22</sup>

Throughout 2019, the Ukraine Supreme Court set a high bar for proving that arbitral awards should be ignored as contrary to public policy. For example, the Supreme Court in *RN-France JSC v ITEK-Trance LLC*<sup>23</sup> upheld the enforcement of an arbitral award against such a challenge. The court stated unequivocally that although public policy protects the state from foreign arbitral awards that violate Ukraine's fundamental principles of justice and rule of law, no such violations (such as procedural unfairness, corruption, or incompetence of arbitrators) were present in this case.<sup>24</sup>

## II. RUSSIA

### A. FOREIGN AND STRATEGIC INVESTMENT LAWS

Attracting foreign investment has been a priority for the Russian Federation since 1991. Laws on foreign investment are constantly developing in order to improve Russia's investment climate and provide clear regulations for foreign companies doing business there, while also protecting Russian national security when an investment might affect the country's strategic interests. Encouraging foreign investment remains an important goal despite current global political tensions between Russia and the West. The most important cases and latest trends in foreign investment that impact Russia's national security regime are discussed below.

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20. Resolution of the Supreme Court, Case No. 796/41/2018 (Feb. 14, 2019) (Ukr.), *available at* <http://www.reyestr.court.gov.ua/Review/80330633> (last visited March 2020).

21. *Id.*

22. *Id.*

23. Resolution of the Supreme Court, Case No. 761/39565/17 (May 8, 2019) (Ukr.), *available at* <http://www.reyestr.court.gov.ua/Review/81753120> (last visited March 2020).

24. *Id.*

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1. *General Overview*

Foreign investment in Russia is generally regulated by the Foreign Investment Law (FIL),<sup>25</sup> which sets out the obligations, guarantees, and benefits for foreign investors in Russia.<sup>26</sup> There are few restrictions on private foreign investors in businesses that are not considered strategic. But public foreign investors, which are foreign states, international organizations, or entities under their control, who attempt to acquire more than twenty-five percent of voting shares of a Russian (non-strategic) commercial entity or other rights that can block the managerial body decisions, must obtain preliminary clearance for the transaction from the Government Commission on Control over Foreign Investments (the Commission).<sup>27</sup>

As in other developed countries, state authorities exercise greater restrictions and closer oversight over strategic investments (defined as investments in sectors having strategic importance for Russia's national security). The Strategic Investment Law (SIL)<sup>28</sup> defines forty-seven strategically important activities that are subject to the SIL's mandatory review process.<sup>29</sup> The SIL requires that a foreign entity seeking to acquire or otherwise gain the right to control a strategic Russian company must apply to the Commission for approval. Absent the Commission's approval, the transaction cannot be legally completed. If the foreign investor fails to file such an application, it may be subject to severe penalties, including voidance of the transaction, a one million ruble fine, and/or deprivation of the investor's rights to vote its shares or interest in the company.

Parties to a transaction approved by the Commission must notify the Commission of its completion. This obligation includes informing the Commission of the completion of any transaction in which foreign investors acquired between five and twenty-five percent of the shares in a strategic company.<sup>30</sup>

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25. Federal'nyi Zakon RF o Inostrannykh Investitsiyakh v Rossiyskoy Federatsii [Federal Law of the Russian Federation on Foreign Investment in the Russian Federation], SOBRANIE ZAKONODATEL'STVA ROSSIYSKOI FEDERATSII [SZ RF] [Russian Federation Collection of Legislation] 1999, No. 160 [hereinafter Foreign Investment Law].

26. See Kimberly Reed et. al., *Russia/Eurasia*, 53 INT'L. LEGAL DEV. YEAR IN REVIEW 573, 582 (2019).

27. Foreign Investment Law, *supra* note 25.

28. Federal'nyi Zakon RF o Poryadke Osushchestvleniya Inostrannykh Investitsiy v Kompanii, Imeyushchiye Strategicheskoye Znachenie dlya Natsional'noy Bezopasnosti i Oborony [Federal Law of the Russian Federation on the Procedure for Foreign Investments in Companies having Strategic Importance for the National Security and Defense], SOBRANIE ZAKONODATEL'STVA ROSSIYSKOI FEDERATSII [SZ RF] [Russian Collection of Legislation] 2008, No. 57 [hereinafter Strategic Investment Law].

29. *Id.*; see also *The Law on Foreign Investments in Russian Strategic Companies*, HOGAN LOVELLS, [https://www.hoganlovells.com/~media/hogan-lovells/pdf/publication/law-on-foreign-investments-in-russian-strategic-companies\\_pdf.pdf](https://www.hoganlovells.com/~media/hogan-lovells/pdf/publication/law-on-foreign-investments-in-russian-strategic-companies_pdf.pdf) (last visited June 1, 2020).

30. See Strategic Investment Law, *supra* note 28 (Generally, "control" is considered to be ownership of over 50% of the voting rights in a company, the right to appoint a CEO or

2. *Process for Assessing Applications*

The procedures for clearance of foreign investment transactions are very similar under the FIL and the SIL. The Commission reviews the transaction for clearance and the Federal Antimonopoly Service (FAS) acts as an intermediary between the applicant and the Commission, communicating the Commission's questions and decisions to the applicant. If a deal requires both foreign and strategic investment clearances, the applicant need only make a single filing.

The Commission may either grant or reject an application outright or it may impose changes or conditions before allowing the transaction to proceed. Although Article 12 of the Strategic Investment Law sets forth a short list of actions that can be taken when an application is not approved outright, in practice, this list is not exclusive and the Commission has wide discretion to set any conditions on a transaction that it decides is appropriate.<sup>31</sup> For example, the Commission has the power to order customized remedies if it deems it necessary to protect Russian national interests. Indeed, Commission decisions have been influenced by the desire to protect Russian business from the impact of American and European economic sanctions; to prevent economic isolation; and to spur the replacement of foreign technology and imports with domestically produced technology and goods.<sup>32</sup>

For example, in reviewing the Schlumberger/Eurasia Drilling Company (EDC) transaction,<sup>33</sup> the Commission and the FAS, acting as an intermediary between the parties, closely cooperated with other industry regulators and explicitly linked the conditions for approval to the possibility of further economic sanctions on Russia.<sup>34</sup> Schlumberger was required to agree that if new sanctions were imposed that made EDC's business activities impossible, Schlumberger would transfer control of the company to Russian management and leave its proprietary technologies integrated

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collective executive body, and/or the unconditional right to elect the majority of the board of directors. However, if the target company is involved in mining activities or other subsoil usage (e.g., drilling or mining), "control" requires ownership of only 25% or more of the voting shares).

31. *Id.* at art. 12.

32. *Id.*

33. Interview with Andrei Tsyganov, Deputy Head, Federal Antimonopoly Service of Russia by TASS (Jan. 24, 2019).

34. See *Schlumberger Withdrew Application for Purchase of Oilfield Service Eurasia Drilling Company*, VEDOMOSTI (Feb. 4, 2019), <https://www.vedomosti.ru/business/articles/2019/02/04/793265-schlumberger>.



into the company.<sup>35</sup> In the end, Schlumberger withdrew its application and did not continue with the transaction.<sup>36</sup>

### 3. *Broad Interpretation of the Strategic Investment Law*

Russian authorities interpret the SIL's 47 industries and activities rather broadly, especially in the oil and gas sector. As shown in the Nabors/Tesco Corporation transaction, the authorities may regard work that is only related or tangential to a strategic activity as within the purview of the SIL.<sup>37</sup> In the Nabors deal, a foreign investor, without the approval of the Commission, had established indirect control over a Russian company, Ocset LLC, which provided running casing services for drilling under federal land.<sup>38</sup> The FAS declared that even though Ocset was not performing either the drilling or extraction, Ocset's "geological research of subsoil and/or exploration and extraction of minerals" made it a "strategic" entity.<sup>39</sup> Consequently, the FAS sued to strip the foreign investor of its voting rights in Ocset.<sup>40</sup> Although the foreign investor claimed that the definition of "strategic activities" in the current law did not include entities not performing any strategic services, the courts still supported the position of the Russian competition authority.<sup>41</sup>

Even more broadly, due to the lack of limitations on the Commission's power, the Russian Prime Minister, who serves as the Chairman of the Commission, may order *sua sponte* any transaction involving a foreign investor to be brought to the Commission for clearance, even if it does not involve any of the forty-seven identified strategic activities. Generally, the Prime Minister is interested in three categories of transactions:

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35. *Schlumberger to abandon Russia's EDC bid if approvals not met soon*, REUTERS (Jan. 18, 2019), <https://www.reuters.com/article/us-schlumberger-edc/schlumberger-to-abandon-russias-edc-bid-if-approvals-not-met-soon-idUSKCN1PC1QI>.

36. *Schlumberger to Withdraw Russia EDC Bid If No Approval Granted*, RUSSIA BUS. TODAY (Jan. 19, 2019), <https://russiabusinesstoday.com/energy/schlumberger-to-withdraw-russia-edc-bid-if-no-approval-granted/>.

37. *Postanovlenie Arbitrazhnny Sud Goroda Moskvy ot 18 iyulya 2019 g. No. A40-53454/18-57-251* [Ruling of the Arbitration Court of the City of Moscow of July 18, 2019, No. A40-53454/18-57-251] 2019, *available at* [https://kad.arbitr.ru/Document/Pdf/b8648545-93cd-4ce2-9cc8-3bf3e8e84db5/72376c53-4b44-4155-a059-601a10f556c4/A40-53454-2018\\_20190718\\_Reshenija\\_i\\_postanovleniya.pdf?isAddStamp=True](https://kad.arbitr.ru/Document/Pdf/b8648545-93cd-4ce2-9cc8-3bf3e8e84db5/72376c53-4b44-4155-a059-601a10f556c4/A40-53454-2018_20190718_Reshenija_i_postanovleniya.pdf?isAddStamp=True).

38. *Rig Site Tips: Running Casing Procedures and Instructions*, DRILLING COURSE (Oct. 14, 2017), <http://www.drillingcourse.com/2017/10/rig-site-tips-running-casing-procedures.html> (noting that "Running casing" is the process of screwing together pieces of pipe for oil drilling and lowering them into the drilling hole).

39. See Strategic Investment Law, *supra* note 28, at art. 6.

40. See *FAS Watches Whether The Law On Foreign Investments Is Observed*, FAS.GOV (Mar. 5, 2018), <http://en.fas.gov.ru/press-center/news/detail.html?id=52874>.

41. *Otkazat' v priznanii nenormativnogo akta polnost'yu deystvitel'nym* [To refuse to declare a non-normative act fully valid] Arbitrazhnny sud goroda Moskvy [Arbitration Court of the City of Moscow] Oct. 29, 2018 (Russ.), *available at* <https://kad.arbitr.ru/Card/2d1f2008-1b92-42b4-b101-f26751391563>.

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- a) transactions relating to Russian companies that are not directly engaged in strategic activities but are active in a manner that may be connected to an activity of strategic importance. For example, following the Nabors/Tesco Corporation transaction, the Prime Minister has decided that companies engaged in activities related to the extraction of minerals (even if not directly engaged in the extraction) must obtain a strategic clearance;<sup>42</sup>
- b) large cross-border transactions involving the transfer of assets or subsidiaries located in Russia and on which the economic well-being of Russia might depend. For instance, while considering the Bayer/Monsanto transaction,<sup>43</sup> which formally required only merger control clearance, the FAS indicated repeatedly that the transaction could influence food security and, though unrelated to strategic activities, could still be subject to strategic clearance; and
- c) transactions with public investors (such as a foreign government) who are from very different cultural and legal environments. According to the FAS, this concern primarily relates to eastern countries (e.g., the acquisition of Russian companies that are important economically but not strategically by Chinese companies, usually controlled by the Government of the People's Republic of China).<sup>44</sup>

4. *FAS Request for Disclosure of Information on Beneficiaries*

New rules approved in December 2018<sup>45</sup> (the Disclosure Rules) establish when and how the FAS may request that a foreign investor provide information on its beneficiaries, beneficial owners, and controlling persons as part of the investor's application to the Commission under the SIL.<sup>46</sup> Entities that decline to disclose such information upon the FAS's request will be penalized by being treated the same as foreign public investors (foreign states and international organizations), which are subject to stricter regulation and lower thresholds than generally prescribed by the SIL.<sup>47</sup> If a foreign investor needs the Commission's clearance within a short period, it should disclose information on its beneficial owners (up to the very top) as

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42. See Case No. A40-53454/18-57-251, *supra* note 37.

43. See *Innovations & Mergers: Threat or Development?*, FAS.GOV (June 3, 2019), <http://en.fas.gov.ru/press-center/news/detail.html?id=54087>.

44. See *Multidirectional Trends in the Russian Strategic legislation: toughening the regulation while attracting investment*, WOLTERS KLUWER (Oct. 9, 2018), <http://competitionlawblog.kluwer.com/2018/10/09/multidirectional-trends-russian-strategic-legislation-toughening-regulation-attracting-investment/>.

45. Postanovleniye Pravitel'stva Rossiyskoi Federatsii ? 1456 [Decree of the Government of the Russian Federation No. 1456], SOBRANIE ZAKONODATEL'STVA ROSSIYSKOI FEDERATSII [SZ RF] [Russian Federation Collection of Legislation] 2018, No. 1456, *available at* <https://www.garant.ru/products/ipo/prime/doc/72019144/>.

46. See Foreign Investment Law, *supra* note 25; Strategic Investment Law, *supra* note 28 (noting that the FAS also requires such disclosures in merger control cases).

47. See Strategic Investment Law, *supra* note 28, at art. 7, points 3, 5.

part of its initial submission rather than waiting for the FAS to make a request.

*5. The Commission's Procedures for Review*

The consideration process is less predictable and riskier for foreign investors because the strategic investment review is complicated, time-consuming, and lacks transparency. Under the SIL the Commission's decision on a transaction must be made within three to six months, but this deadline is not often met.<sup>48</sup> The Commission is not a standing body, meeting only every two or three months.<sup>49</sup> Additionally, the Commission may postpone consideration of a transaction without cause. Although the Commission Chair has the right to allow final decisions to be made without the presence of all Commission members,<sup>50</sup> this rarely happens. Given these circumstances, the review process normally takes at least a year.<sup>51</sup>

*6. Further Efforts to Clear Impediments to Foreign Investment*

Prior to 2019 the SIL had caused a number of difficulties for foreign investors, especially due to its lack of clear regulations for the process and timing of the Commission's and the Prime Minister's actions. In an effort to address this problem, in 2019 the FAS established a formal procedure and timetable for the Prime Minister to bring "non-strategic transactions" for the Commission's review.<sup>52</sup>

Other amendments were aimed generally at liberalizing foreign investors' access to strategic sectors of the Russian economy and making the strategic clearance process more transparent. For example, the Strategic Investment Law previously prohibited offshore companies from acquiring control of Russian strategic companies. The FAS has drafted and is promoting a law

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48. *Id.* at art. 11, ¶ 4.

49. The dates of the Commission's meetings are neither announced nor published. The only way to ascertain the scheduled meeting dates is to contact the FAS Department for Control over Foreign Investments directly (which may not be reliable) or to monitor the mass media (which may or may not have such information).

50. See Andrei Tsyganov: *We Need to Regulate the Timing of the Consideration of Applications Falling under the Law on Foreign Investment in Strategic Sectors*, FAS.GOV (Oct. 28, 2019), <http://fas.gov.ru/news/28709> (Decisions of the Commission are not formally published; instead, they are only provided to the applicants. Interested persons may find whether a transaction has been cleared or not from briefings given by the Head of the FAS after the Commission's meetings).

51. See *id.* (the FAS has recently proposed to resolve this problem but thus far has not decided on any specific steps to be taken).

52. Olesya Milchakova: *The Regulation on the Performance of the Functions for the Consideration of Applications Will Provide Guarantees for the Rights of Foreign Investors and Increase the Efficiency of Government Agencies*, FAS.GOV (Mar 1, 2019), <https://fas.gov.ru/news/27057>; *Postanovleniye Pravitel'stva Rossiyskoi Federatsii No. 711* [Decree of the Government of the Russian Federation No. 711], SOBRANIE ZAKONODATEL'STVA ROSSIYSKOI FEDERATSII [SZ RF] [Russian Federation Collection of Legislation] 2019, No. 711 available at <http://publication.pravo.gov.ru/Document/View/0001201906130006?index=0&rangeSize=1>.

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cancelling this restriction, but the draft law has yet to be introduced into the Russian Parliament.<sup>53</sup>

*7. 2018 Foreign Investment Statistics*

While the requirements detailed above may suggest that Russia rejects many foreign investments, in fact, in 2018 the Commission approved foreign investment amounting to RUB 400 billion (almost US \$5.7 billion).<sup>54</sup> The most popular strategic industries for foreign investment in 2018–2019 were mining, transportation, and services at Russian seaports.<sup>55</sup> The most common jurisdictions of the foreign investors were Cyprus, the Netherlands, and Luxemburg.<sup>56</sup>

From 2008 to 2018, the FAS received 516 strategic investment notifications. The Commission rejected only thirteen out of 229 notifications due to threats to national security and defense. For the remaining 287 submitted notifications, clearance under the Strategic Investment Law was found unnecessary. These numbers indicate that ambiguities and uncertainty in the Law have led many investors to notify the Commission of their transactions even when their transactions are not strategic, just to ensure they are not caught within its web.

It should be noted that American companies Archer Daniels Midland,<sup>57</sup> General Electric,<sup>58</sup> Halliburton,<sup>59</sup> and Abbott<sup>60</sup> were cleared for strategic

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53. See *Andrei Tsyganov*, *supra* note 50.

54. See *The Central Bank Estimated the Growth of Foreign Direct Investment in Russian Companies at 38%*, VESTIFINANCE (July 9, 2019), <https://www.vestifinance.ru/articles/121849>.

55. *Id.*

56. *External Sector Statistics*, CENT. BANK RUSS., [https://www.cbr.ru/statistics/macro\\_itm/svs/](https://www.cbr.ru/statistics/macro_itm/svs/) (last visited June 5, 2020); Leonid Bershidsky, *Where Russia's Foreign Investment Really Comes From*, BLOOMBERG (Nov. 5, 2019), <https://www.bloomberg.com/opinion/articles/2019-11-06/where-russia-s-foreign-investment-really-comes-from?srnd=new-economy-forum>. (While this statistic is technically true, the investment amounts reported for these three countries have long been assumed to come from Russian businesspeople who keep their money outside Russia and thus use foreign entities to invest in Russia. The United Nations Conference on Trade and Development (UNCTAD) found that 6.5% of foreign investors' stock in Russia (about \$28.7 billion, based on 2017 data) was of Russian origin. In its 2019 World Investment Report, UNCTAD attributed the 2018 drop in Russia's foreign investment inflow to the government's effort to force Russian business owners to re-domicile their holdings); Kenneth Rapoza, *Most Foreign Capital Flowing into Russia Stock Market is American*, FORBES (Oct. 22, 2019), <https://www.forbes.com/sites/kenrapoza/2019/10/22/most-foreign-capital-flowing-into-russia-stock-market-is-american/#3784e6a799e1> (Nonetheless, the Moscow Stock Exchange recently reported that North American (predominantly U.S.) investors currently account for more than 50% of all foreign capital in the Russian stock market (about \$79.3 billion)).

57. See *American ADM to buy 50% of Starch-Flow Plant in Vladimir Region – Authorities*, INTERFAX-RUSSIA (June 19, 2019), <http://www.interfax-russia.ru/Center/print.asp?id=1039328&sec=1679&type=news>.

58. See *Brifing rukovoditel'ia Federal'noi antimonopol'noi sluzhby Igoriia Artem'eva po zavershenii zasedaniia Pravitel'stvennoi komissii po kontroliu za osushchestvleniem inostrannykh investitsii* [Briefing by the head of the Federal Antimonopoly Service Igor Artemyev at the end of the meeting of the Government Commission for the Control of Foreign Investment], GOVERNMENT.RU (June 9, 2016), [http://government.ru/dep\\_news/23366](http://government.ru/dep_news/23366).

transactions without imposition of onerous conditions. Authorities are looking at the overall impact of deals on a case-by-case basis and may view positively transactions that may result in increased local employment, the building of local production facilities, or positive economic impact within Russia.

Even though the foreign investment regime in Russia appears on paper to be getting tougher, in practice the Commission rarely rejects an application, although, as noted above, it may impose conditions. While the clearance process remains a challenge, foreign investors can complete their transactions with patience, proper planning, and early and regular communication with the regulators.

## B. TAX

### 1. *Beneficial Ownership for Tax Treaty Benefits under the Russian Tax System*

Foreign companies receiving income from Russian sources must prove their beneficial ownership in order to receive reduced withholding tax rates under any applicable double tax treaty with the foreign company's home country. In an advisory letter dated April 12, 2018,<sup>61</sup> the Russian Federal Tax Services (FTS) had defined the term "entrepreneurial activities" very narrowly. Consequently, foreign companies acting primarily as a holding or treasury company will be found lacking the independent entrepreneurial activity necessary to be deemed beneficial owners, even if their activities were

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59. See *Briefing rukovoditel'ia Federal'noi antimonopol'noi sluzhby Igora Artem'eva po zavershenii zasedaniia Pravitel'stvennoi komissii po kontroliu za osushchestvleniem inostrannykh investitsii* [Briefing by the head of the Federal Antimonopoly Service Igor Artemyev at the end of the meeting of the Government Commission for the Control of Foreign Investment], (July 13, 2017), [http://government.ru/dep\\_news/28431/](http://government.ru/dep_news/28431/).

60. See *Pravitel'stvennaia komissia razreshila Abbott kupit' "Verofarm" za \$650 mln* [Government Commission allows Abbott to buy Veropharm for \$ 650 million], VEDOMOSTI (Sep. 2, 2014), <https://www.vedomosti.ru/business/news/2014/09/02/pravitelstvennaya-komissiya-razreshila-amerikanskoj-abbott>.

61. O praktike rassmotreniia sporov po primeneniuiu kontseptsii litsa, imeiushchego fakticheskoe pravo na dokhod (benefitsiarnogo sobstvennika) [On the Practice of Dealing with Disputes on the Application of the Concept of a person with a de facto Right to Income (Beneficial Owner)], letter, written by the Russian Federal Tax Service to territorial tax authorities, April 28, 2018, published by the Russian Federal Tax Service, May 31, 2018, No. SA-4-9/8285@; Dominique Tissot & Maria Kabanova, *VAT for Foreign E-Services Providers: the Russian Tax Authorities' New Approach*, LEXOLOGY (June 28, 2019), <https://www.lexology.com/library/detail.aspx?g=2aaf3f45-82e0-45a0-91da-91446691a59c> (FTS Letters are not legally binding, but because they represent the view of the tax authorities at the time of their issuance, abiding by FTS Letters reduces the risk of a dispute with these authorities. If a dispute is brought in Russian courts, the court is not bound by the Letter. At the same time, though, the FTS has created an online form where taxpayers can report regional tax authorities for failure to comply with an FTS Letter).

performed entirely in good faith and were non-tax driven.<sup>62</sup> This ruling has led to numerous disputes with the international business community on the tax treatment of income distributions within international groups of companies, because investors worldwide commonly use holding company structures.<sup>63</sup>

In response to these complaints, the FTS issued an updated advisory letter on August 8, 2019,<sup>64</sup> modifying the requirements for foreign holding companies to be regarded as beneficial owners pursuant to double tax treaties with Russia.<sup>65</sup> The August 2019 letter clarified that a holding company will not automatically be disqualified from tax treaty exemptions and reduced withholding tax rates. Instead, the FTS will focus on whether the income recipient holding company is, in reality, just an artificial entity that lacks independent decision-making power regarding management of its assets in Russia.<sup>66</sup>

This determination is a positive change for foreign companies that are within multinational groups and that serve as holding or treasury/investment entities. In seeking to take advantage of this new interpretation of double tax treaties, such foreign companies must ensure that their non-Russian holding company has both physical and economic substance, its own business operations, and independent decision-making authority. In addition, even if it meets these criteria, a foreign holding cannot enjoy tax treaty benefits if it is merely a transit channel for withdrawal of Russian-sourced income, i.e., if the received funds are quickly transferred to another person or entity.

## 2. *Valued Added Tax for Foreign Providers of “E-services”*

Until January 1, 2017, foreign companies rendering Business-to-Business (B2B) electronic services (e-services<sup>67</sup>) over the internet in Russia did not

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62. Artemis Kyriakou, *Beneficial Ownership Concept New Interpretation from the Russian Tax*, LEXOLOGY (Oct. 9, 2019), <https://www.lexology.com/library/detail.aspx?g=9d6f40d2-b573-4986-a738-ad87e99e2e6b>.

63. Dominique Tissot & Maria Kabanova, *Russia’s Tax Service Issues Clarification on Beneficial Ownership in Favour of the Business Community*, LEXOLOGY (Sep. 11, 2019), <https://www.lexology.com/library/detail.aspx?g=4ea1b057-b91e-432b-a407-4e09261ef9b2>.

64. O fakticheskom prave kholdingovykh kompanii na dokhod ot istochnikov v Rossiiskoi Federatsii [On the Actual Right of Holding Companies to Income from Sources in the Russian Federation], letter, written by the Russian Federal Tax Service to territorial tax authorities, Aug. 8, 2019, published by the Russian Federal Tax Service, Aug. 13, 2019, No. ED-4-13/15696.

65. *Id.*

66. Sergei Zhestkov, Kirill Vikulov & Maxim Kalinin, *Russia’s Federal Tax Service Eases Requirements for Applying Tax Treaty Benefits for Foreign Holding Companies*, LEXOLOGY (Sep. 19, 2019), <https://www.lexology.com/library/detail.aspx?g=5b9ce7c2-51c6-4d94-8c55-1165afd61ad0>. (Commentators have noted that this approach is closer to the actual text of the Russian Tax Code and to global business practice than was the previous treatment).

67. *VAT on Electronically Supplied Services in Russia: Status and Prospects*, CLIFFORD CHANCE (Dec. 4, 2018), <https://talkingtech.cliffordchance.com/en/industries/e-commerce/vat-on-electronically-supplies-services-in-russia.html> (Article 174.2(1) of the Tax Code lists the 14

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register with Russian tax authorities. If the buyer of the e-services was a Russian entity or individual entrepreneur, the buyer was responsible for reporting and paying value added tax (VAT), acting as the “tax agent” for the foreign e-services provider.<sup>68</sup> But foreign suppliers of Business-to-Customer (B2C) e-services to Russian consumers (i.e., individuals not registered as private entrepreneurs) were required to register with the Russian tax authorities and to collect, report, and pay VAT on those e-services.

Beginning January 1, 2019, foreign B2B e-services companies became subject to the same VAT registration, reporting, and payment requirements as B2C e-services companies.<sup>69</sup> All foreign companies affected by the new law were required to apply for tax registration by February 15, 2019. Because VAT registration is not separate from the regular tax registration with local tax authorities, undertaking registration exposes foreign e-service providers to all kinds of taxes in Russia and subject them to increased tax inspections and scrutiny.<sup>70</sup> As a result, many foreign companies stopped taking cross-border payments for e-services, reportedly resulting in a large drop in VAT revenues.<sup>71</sup>

After consultations with the business community, the FTS issued another advisory letter<sup>72</sup> in April 2019 to clarify the rules that took effect on January 1, 2019. First, it stated that all foreign companies providing B2B e-services in Russia are required to register with the tax authorities or pay a penalty of ten percent of the company’s income earned while unregistered.<sup>73</sup> Second, all foreign companies who register must also pay VAT on *non*-electronic supplies sold or services performed<sup>74</sup> (e.g., accounting, legal, marketing,

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broad categories comprising “e-services,” including internet advertising services, providing access to e-books or e-publications, information/educational materials, images, music, audiovisual content and cloud services. Certain services are expressly excluded from the list of e-services, such as goods ordered over the internet but delivered to a customer offline, provision of consulting services by e-mail, and provision of internet access).

68. *Id.*

69. Nalogovyi Kodeks Rossiiskoi Federatsii [NK RF] [Tax Code] Art. 335-FZ (Russ.).

70. Dominique Tissot, *New Rules on VAT Reporting and Payment for Foreign Companies Providing E-Services to Russian Businesses*, CMS (May 2018), <https://cms.law/en/rus/publication/new-rules-on-vat-reporting-and-payment-for-foreign-companies-providing-e-services-to-russian-businesses>.

71. *Id.*

72. O poriadke primeneniia NDS pri okazanii inostrannymi organizatsiiami uslug v elektronnoi forme s 1 ianvaria 2019 goda [On the Application of VAT in the Provision of Services by Foreign Organizations in Electronic form from January 1, 2019], letter, written by the Russian Federal Tax Service to territorial tax authorities, April 24, 2019, published by the Russian Federal Tax Service, April 24, 2019, No. SD-3-3/7937.

73. *Russian Tax Authorities Clarify Application of VAT to B2B Supplies of E-Services*, CLIFFORD CHANCE (April 2019), [https://talkingtech.cliffordchance.com/content/micro-cctech/en/industries/e-commerce/russian-tax-authorities-clarify-application-of-vat-to-b2b-suppl/\\_jcr\\_content/text/parsysthumb/download/file.res/1904\\_Client\\_briefing\\_\\_VAT\\_on\\_E\\_Services\\_\\_ENG\\_\\_6041368.pdf](https://talkingtech.cliffordchance.com/content/micro-cctech/en/industries/e-commerce/russian-tax-authorities-clarify-application-of-vat-to-b2b-suppl/_jcr_content/text/parsysthumb/download/file.res/1904_Client_briefing__VAT_on_E_Services__ENG__6041368.pdf).

74. *Id.*; Dominique Tissot & Maria Kabanova, *VAT on Electronic Services: a New Approach of Russian Tax Authorities*, LEXOLOGY (June 27, 2019), <https://www.lexology.com/library/>

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advisory, consulting, etc.) for customers in Russia.<sup>75</sup> Third, Russian buyers are not required to withhold and pay VAT for purchasing e-services; but if they do so anyway, the foreign supplier need not pay the VAT again but should file a “zero” VAT return<sup>76</sup> enabling the Russian buyer to claim back (or offset) the VAT that it paid. The FTS has not clarified how a foreign e-services supplier may report and pay VAT on its own.<sup>77</sup>

Some of the clarifications in the April 2019 Letter are controversial and possibly inconsistent with the Russian Tax Code.<sup>78</sup> For example, allowing the Russian buyer of e-services to withhold and pay the VAT as a withholding agent for the foreign supplier technically violates the Tax Code,<sup>79</sup> yet the April 2019 Letter expressly provides for such a possibility.

### III. Uzbekistan

#### A. INTERNATIONAL ARBITRATION

Since its independence from the Soviet Union in 1990, the Republic of Uzbekistan has set about to radically improve the country’s business environment and investment climate. The goal is to transform the formerly closed Soviet-style economy into a market economy that attracts foreign investors.<sup>80</sup> Recent efforts have included the introduction of generally accepted global criteria for assessing business conditions and the resulting improvement of the country’s international ranking for doing business.<sup>81</sup> But until recently, Uzbekistan lacked a sufficient alternative dispute

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detail.aspx?g=e38a8b1c-4f0f-42d5-b564-68021667072b (The Russian Ministry of Finance has agreed with this position in Ministry of Finance Letters No. 03-07-08/17231 (March 15, 2019); No. 03-07-08/21484 (March 28, 2019) and No. 03-07-08/23760 (April 4, 2019)).

75. Tissot & Kabanova, *supra* note 61 (Further Details are to be set out in future regulations or interpretations).

76. Clifford Chance, *supra* note 67.

77. Alexander Chmelev, Sergei Zhestkov & Arseny Seidov, *Russia “Relaxes” VAT Rules on E-Services*, LEXOLOGY (April 29, 2019), <https://www.lexology.com/library/detail.aspx?g=2398ea b7-24b5-46c1-a552-632f758ce6f9>.

78. Letter No. SD-4-3/7937@ from the Federal Tax Service of Russia (Apr. 24, 2019) (noting that the Russian Tax code must be amended to conform to the new VAT regime for B2B e-services, but so far, no amendments have been announced).

79. Chmelev et al., *supra* note 77 (“The proposed FTS approach represents a ‘gentlemen’s agreement’ between the tax authorities and the [foreign] business, under which the FTS promises to disregard formal violation of the law [i.e., the customer paying the VAT instead of the supplier] as long as applicable VAT is fully paid to the Russian budget. However, the FTS guidance is legally non-binding for the Russian taxpayers and courts and may not provide full protection against potential tax claims.”).

80. *Frontier Markets: Oltin Fund to be First Internationally Listed Uzbek Security*, INTELLINEWS (July 16, 2019), <https://www.intellinews.com/frontier-markets-oltin-fund-to-be-first-internationally-listed-uzbek-security-164469/?source=uzbekistan>.

81. *See Doing Business 2020: Reforms Propel Uzbekistan to Place Among World’s Top 20 Business Climate Improvers*, THE WORLD BANK (Oct. 24, 2019), <https://www.worldbank.org/en/news/press-release/2019/10/24/doing-business-2020-reforms-propel-uzbekistan-to-place-among-worlds-top-20-business-climate-improvers>.



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resolution (ADR) system to develop the country's economy and attract foreign investors.<sup>82</sup> Recent legislative initiatives have attempted to address this need, including through the establishment of a new international arbitration center and implementation of a new law on international commercial arbitration.<sup>83</sup>

In mid-2017 the President of Uzbekistan issued a decree<sup>84</sup> providing for, *inter alia*, the creation of an international commercial arbitration court. On November 5, 2018, the Tashkent International Arbitration Center was created under the Chamber of Commerce and Industry of Uzbekistan (TIAC).<sup>85</sup> The TIAC is a non-governmental, nonprofit organization designed to support the TIAC Court of Arbitration, a fully autonomous body within the TIAC.<sup>86</sup> The Court of Arbitration will administer arbitration proceedings in accordance with the TIAC Rules of Arbitration, completely independent from the TIAC's founders, directors or any other entities.

The TIAC's main tasks are to:

- a) administer, through international arbitration, the settlement of commercial disputes arising from contractual and other civil law relations between commercial organizations, including foreign investors located in different countries (the commercial disputes may be those on investment, intellectual property and block chain technologies);
- b) develop and improve dispute resolution mechanisms through international arbitration and other ADR methods;
- c) establish cooperation with leading foreign arbitrators, learning from their experiences in resolving disputes through international

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82. See Sherzodbek Masadikov, *Mediation In Uzbekistan*, WOLTERS KLUWER (Feb. 10, 2020), [http://mediationblog.kluwerarbitration.com/2020/02/10/mediation-in-uzbekistan/?doing\\_wp\\_cron=1590766259.6749060153961181640625](http://mediationblog.kluwerarbitration.com/2020/02/10/mediation-in-uzbekistan/?doing_wp_cron=1590766259.6749060153961181640625).

83. Alexander Korobeinikov & Alissa Inshakova, *The Baker McKenzie International Arbitration Yearbook: Uzbekistan*, BAKER MCKENZIE, <https://globalarbitrationnews.com/wp-content/uploads/2019/04/Uzbekistan-1.pdf> (last visited May 29, 2020).

84. Decree of the President of the Republic of Uzbekistan No. DP-5490 "On measures to further improve the system of protection of rights and legitimate interests of business entities" (July 27, 2018)

(ПРЕЗИДЕНТА РЕСПУБЛИКИ УЗБЕКИСТАН, "О МЕРАХ ПО ДАЛЬНЕЙШЕМУ СОВЕРШЕНСТВОВАНИЮ СИСТЕМЫ ЗАЩИТЫ ПРАВ И ЗАКОННЫХ ИНТЕРЕСОВ СУБЪЕКТОВ ПРЕДПРИНИМАТЕЛЬСТВА").

85. Decree of the president of the Republic of Uzbekistan No. DP-4001 "On the establishment of the Tashkent International Arbitration Center (TIAC) at the Chamber of Commerce and Industry of the Republic of Uzbekistan" (Nov. 5, 2018)

(ПОСТАНОВЛЕНИЕ ПРЕЗИДЕНТА РЕСПУБЛИКИ УЗБЕКИСТАН "О СОЗДАНИИ ТАШКЕНТСКОГО МЕЖДУНАРОДНОГО АРБИТРАЖНОГО ЦЕНТРА (ТИАС) ПРИ ТОРГОВО-ПРОМЫШЛЕННОЙ ПАЛАТЕ РЕСПУБЛИКИ УЗБЕКИСТАН").

86. Dr. Islambek Rustambekov & Diana Tsutueva, *Contemporary Reforms in the Development of the Institute of International Arbitration in the Republic of Uzbekistan*, EURASIA/RUSS. COMM. NEWSLETTER, (ABA Section of Int'l Law), Jan.-Mar. 2019 at 2.

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- arbitration, and engage foreign arbitrators in resolving disputes at the TIAC;
- d) perform research, further develop, and participate in the implementation of measures for training specialists in international arbitration and out-of-court dispute settlement, including those relating to investments; and
  - e) provide consulting services for domestic and foreign entities, including State parties and foreign investors, related to preventing investment disputes.<sup>87</sup>

International experts are participating in the TIAC's formation and development.<sup>88</sup> TIAC's Supervisory Board includes leading experts in arbitration and arbitrators from world-recognized arbitration centers, who are assisting with establishing and maintaining international standards in the TIAC's work.<sup>89</sup> The TIAC promises to be an attractive venue for the arbitration of disputes arising, in particular, in the CIS and Central Asia.<sup>90</sup>

Although the Law "On Arbitration Courts" from October 16, 2006, is still in force, the passage of a new law on international commercial arbitration is considered critical for TIAC's development.<sup>91</sup> Therefore, in 2019 Uzbekistan developed a draft law "On International Arbitration," based on the UNCITRAL model law. As of late 2019, Parliament was still discussing it.<sup>92</sup> The Uzbek Government is preparing to complete the legal framework for conducting international commercial arbitration proceedings.<sup>93</sup>

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87. Decree of the president of the Republic of Uzbekistan No. DP-4001 "On the establishment of the Tashkent International Arbitration Center (TIAC) at the Chamber of Commerce and Industry of the Republic of Uzbekistan" (Nov. 5, 2018) (ПОСТАНОВЛЕНИЕ ПРЕЗИДЕНТА РЕСПУБЛИКИ УЗБЕКИСТАН "О СОЗДАНИИ ТАШКЕНТСКОГО МЕЖДУНАРОДНОГО АРБИТРАЖНОГО ЦЕНТРА (ТИАС) ПРИ ТОРГОВО-ПРОМЫШЛЕННОЙ ПАЛАТЕ РЕСПУБЛИКИ УЗБЕКИСТАН"); Rustambekov & Tsutueva, *supra* note 86.

88. Rustambekov & Tsutueva, *supra* note 86, at 3.

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*; see *Uzbekistan: International Arbitration Reform for Better Investment Climate*, ADB, <https://www.adb.org/projects/53296-001/main#project-pds%20and%20https://uzbekistannewsgazette.com/ministry-of-justice-and-asian-development-bank-to-carry-out-international-arbitration-reform/> (last visited May 30, 2020) (This effort is partially funded by a grant from the Asian Development Bank (ADB)); see *Prospects for development of international arbitration in Uzbekistan*, UZBEKISTAN NEWS GAZETTE (Sept. 17, 2019), <https://uzbekistannewsgazette.com/prospects-for-development-of-international-arbitration-in-uzbekistan/> (And it is being supported by, *inter alia*, the United National Development Programme (UNDP) and the United States Agency for International Development (USAID)); see *Issues of improving mechanisms for resolving international commercial disputes discussed in Tashkent*, UZBEKISTAN NEWS GAZETTE (Aug. 26, 2019), <https://uzbekistannewsgazette.com/issues-of-improving-mechanisms-for-resolving-international-commercial-disputes-discussed-in-tashkent/>; see *Cooperation Agreement signed between Hong Kong and Tashkent International Arbitration Centers*, UZ DAILY (Sept. 18, 2019), <https://www.uzdaily.uz/en/post/51895>.

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The new Uzbek arbitration laws are designed to provide additional guarantees to foreign companies and ensure the availability of consistent, legal means to resolve international commercial and investment disputes.<sup>94</sup> Notably, the Uzbek Constitution enshrines the guarantees of freedom of economic activity and entrepreneurship, equality and legal protection of all forms of ownership. These fundamental protections underpin the effective implementation of ongoing economic reforms.<sup>95</sup>

#### **IV. KAZAKHSTAN**

##### **A. NEW CURRENCY CONTROL LAW**

On July 1, 2019, the majority of Kazakhstan's new Law "On Currency Regulation and Currency Control" came into force,<sup>96</sup> replacing the previous currency control and exchange statute.<sup>97</sup> The new law states that:

[The] goals of the currency exchange regulation include facilitation [of] the government policy in achieving a sustainable economic growth and developing international cooperation [by] the Republic of Kazakhstan, promotion of a strong balance of payments, and stability of the

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94. Dr. Islambek Rustambekov & Diana Tsutueva, *Contemporary Reforms in the Development of the Institute of International Arbitration in the Republic of Uzbekistan*, EURASIA/RUSS. COMM. NEWSLETTER, (ABA Section of Int'l Law), Jan.-Mar. 2019 at 3.

95. *Id.*

96. Валюталык айырбастауды реттеу және валюталык шарттар туралы [On Currency Control and Currency Exchange Control] 2018, No. 167-VI ARK [hereinafter New Currency Law]; Curtis Masters, *Kazakhstan Adopts New Currency Law*, BAKER MCKENZIE (Dec. 15, 2018), <https://www.bakermckenzie.com/en/insight/publications/2018/12/kazakhstan-adopts-new-currency-law> (Under the 1995 Kazakhstan-EU Bilateral Trade Agreement, whenever Kazakhstan passes new legislation that would restrict conditions for branches and subsidiaries of European Community (EC) companies to operate in Kazakhstan, such legislation shall not apply to EC entities until three years following the entry into force of the relevant act. The Baker & McKenzie law firm submitted an interpretation request to the National Bank of Kazakhstan ("NBK") in this regard, and the NBK confirmed that branches of EU companies may apply the three-year grace period provided under the 1995 Agreement. In a public statement, the law firm stated that "While not addressed in the NBK Letter, we believe that the three-year grace period generally should extend to branches of companies from other countries (including the U.S. and Japan) based upon the most favored nation provisions contained in their bilateral investment treaties with Kazakhstan.").

97. Валюталык айырбастауды реттеу және валюталык шарттар туралы [On Currency Control and Currency Exchange Control] 2005, No. 57 [hereinafter Old Currency Law]; Masters, *supra* note 96 (According to the Kazakhstan Civil Code Article 383.2, if a new law sets out different rules than those previously applicable to a contract, the terms of the concluded contract shall remain in force unless the new law specifically states otherwise. Because the New Currency Law has no such clause, it will not apply retroactively to currency contracts and transactions executed prior to July 1, 2019. However, where a pre-July 1, 2019 agreement is amended after that date (such as by an assignment of the agreement or amendment to its text), the New Currency Law will take precedence thenceforward.).

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domestic foreign exchange market and economic security of the Republic of Kazakhstan.<sup>98</sup>

In the past two decades, and especially since Kazakhstan's entry into the World Trade Organization (WTO), the number of branch offices of foreign companies operating in the country has exploded, and beginning in December 2020, foreign banks and insurance companies will be able to operate through branches in Kazakhstan.<sup>99</sup> The New Currency Law appears intended to limit foreign currency transactions in Kazakhstan and force the use of the Kazakh currency, the tenge,<sup>100</sup> which has lost value over the past several years. Therefore, instituting strict rules on foreign currency transactions and exchange is timely.

Some of the New Currency Law's most important changes are set out below.

1. *Currency Residents and Non-Currency Residents*

Under the Old Currency Law, branch and representative offices of foreign companies were considered "non-currency residents" and allowed to transact business with Kazakhstan residents in foreign currency. But under the New Currency Law, branch (but not representative) offices,<sup>101</sup> which are not engaged in banking or insurance activities in Kazakhstan, have become "currency residents."<sup>102</sup> This change prohibits them from entering into transactions with other Kazakhstan residents using foreign currency.<sup>103</sup> Branches must now complete these transactions in tenge only.<sup>104</sup> Beginning December 16, 2020, branches of foreign financial companies that engage in

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98. New Currency Law, *supra* note 96, at art. 4, §. 1; *Kazakh parliament adopts law on currency control*, AZ NEWS (June 22, 2018), <https://www.azernews.az/region/133761.html> (In an explanatory note to the Kazakhstan Parliament, the NBK reported that the New Currency Law was intended, *inter alia*, to improve "statistical monitoring of foreign exchange transactions," whereas the NBK Chairman stated to the press that the "main task" of the New Currency Law was to "expand the monitoring of foreign exchange operations and reduce foreign exchange in settlements in Kazakhstan.").

99. *Doing Business in Kazakhstan*, BAKER MCKENZIE, <https://www.bakermckenzie.com/-/media/files/insight/guides/2019/doing-business-in-kazakhstan-2019.pdf?la=en> (last visited May 20, 2020).

100. *Kazakhstan-Foreign Exchange Control*, EXPERT.GOV (July 1, 2019), <https://www.export.gov/article?id=Kazakhstan-Foreign-Exchange-Controls> ("The National Bank of Kazakhstan controls the Tenge, which is fully convertible with the U.S. dollar . . . Kazakhstan has joined Article 8 of the International Monetary Fund Charter, which" mandates "full convertibility and the removal of all" restrictions "on current account transactions.").

101. New Currency Law, *supra* note 96, at art. 4, §§ 3–4, 8.

102. *Id.*; Masters, *supra* note 96.

103. Masters, *supra* note 96.

104. *Id.* (Exceptions are made for transactions between branches of different foreign companies and those between a branch and its home office outside Kazakhstan. However, the latter seems legally impossible because according to the Kazakhstan Civil Code, Article 43, a branch (or representative office) cannot enter into transactions on its own because it is not considered to be a separate entity from its home office).

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banking and/or insurance activities in Kazakhstan will also be considered “currency residents.”<sup>105</sup>

The New Currency Law exempts branches of foreign subsoil (oil, gas and mining) companies from being “residents” if their non-currency residence status is specifically stated in the terms of the pre-July 1, 2019 profit-sharing (or other subsoil use) agreements with the Republic of Kazakhstan. This exemption does not extend to sub-contractors of the branch or its parent.<sup>106</sup>

## 2. *Currency Exchange Regulations*

The currency exchange sections of the New Currency Law set out the procedure for the circulation of currency and “currency valuables”<sup>107</sup> in Kazakhstan and the mechanisms for obtaining and keeping information on foreign exchange (forex) operations in the country.<sup>108</sup> The National Bank of Kazakhstan (NBK) is the main authority for currency exchange regulation in Kazakhstan.<sup>109</sup>

Beginning January 1, 2020, currency exchange operations between Kazakhstan residents will be prohibited except in:

- (a) activities where one of the parties is the NBK, Ministry of Finance, foreign establishment of the Government, or a resident entitled by law to conduct forex operations with residents;
- (b) banking operations with currency valuables;
- (c) payment for banking services related to the conduct of forex operations;
- (d) operations associated with the purchase, sale, payment of interest and/or redemption of securities where their par value is denominated in foreign currency;
- (e) payment of bills denominated in foreign currency;

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105. New Currency Law, *supra* note 96, at art. 1, § 3, ¶ 7; Shaikenov et al., *Kazakhstan: New Currency Control Law in Kazakhstan*, DENTONS (May 21, 2019), <http://www.mondaq.com/x/792680/Financial+Services/New+currency+control+law+Kazakhstan>.

106. *See id.*

107. New Currency Law, *supra* note 96, at art. 1, § 1, ¶ 7 (“Currency valuables” is defined as “foreign currency; securities and payment instruments where their par value is denominated in foreign currency; unvalued securities issued by non-residents of the Republic of Kazakhstan; refined gold in bullions; domestic currency, securities and payment instruments where their par value is nominated in the domestic currency, in instances when operations with such securities and instruments are conducted by residents of the Republic of Kazakhstan and non-residents of the Republic of Kazakhstan and between non-residents of the Republic of Kazakhstan, as well in cases of their export (transfer) from the Republic of Kazakhstan or import (transfer) to the Republic of Kazakhstan; unvalued securities issued by residents of the Republic of Kazakhstan, in cases of operations conducted with such securities by residents of the Republic of Kazakhstan and non-residents of the Republic of Kazakhstan and between non-residents of the Republic of Kazakhstan as well as their export from the Republic of Kazakhstan or import to the Republic of Kazakhstan.”).

108. *Id.* at art. 4, § 1.

109. *Id.* at art. 5, § 1.

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- (f) operations between branch (or representative) offices of foreign organizations;
- (g) payment of travel expenses of an individual associated with his/her business trip outside Kazakhstan;
- (h) transfers of currency valuables by individuals to charity;
- (i) operations between securities professionals that conduct forex operations at their clients' instructions; or
- (j) payments by individuals for goods, works and services on transactions entered into and executed within the territory of a special economic zone that borders any part of the Eurasian Economic Union.<sup>110</sup>

Foreign exchange operations between residents and non-residents, or between non-residents, are allowed in domestic and/or foreign currency,<sup>111</sup> but only authorized banks may sell or buy foreign currency.<sup>112</sup>

3. *Creation of Registry of Foreign Currency Contracts*

Under the New Currency Law, the NBK must more carefully monitor foreign currency transactions by maintaining a registry of currency contracts related to "capital transactions," which are defined as operations between Kazakhstan residents and non-residents associated with the transfer of title and other rights in exchange for currency, and which involve:

- (a) financial loans;
- (b) equity participation;
- (c) transactions involving securities, participation interests and financial derivatives;
- (d) acquisition of ownership title to real estate;
- (e) acquisition of exclusive rights to intellectual property;
- (f) transfer of money or property in the execution of the obligations of a joint venture participant, as well as such transfer to a fiduciary management or trust;
- (g) transfer of money and financial instruments to professional securities market participants who conduct forex operations at the instruction of clients; or
- (h) free transfer of money or other "currency valuables."<sup>113</sup>

4. *Payment of Salaries in Foreign Currency*

While the Old Currency Law allowed both resident and non-resident entities to pay salaries to their employees (whether domestic or expatriate) in any currency, the New Currency Law is silent on salary payments in foreign

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110. *Id.* at art. 6, § 1.

111. *Id.* at art. 6, §§ 2, 5.

112. *Id.* at art. 10, § 2.

113. New Currency Law, *supra* note 96, at art. 1, § 1.

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currency.<sup>114</sup> The Labor Code of Kazakhstan<sup>115</sup> mandates that all salary payments in Kazakhstan must be in tenge, so the New Currency Law is now consistent with the Labor Code.<sup>116</sup> All salary payments in Kazakhstan must be paid in local currency. This includes salaries for employees who are expatriates from other countries and only temporarily in Kazakhstan. Even subsoil companies that are considered non-currency residents under the New Currency Law will be subject to this requirement.

### 5. *Reporting Requirements*

The New Currency Law expands the NBK's monitoring of currency operations by requiring reports on all currency transactions performed through a bank (i.e., involving money from a bank account or bank loan).<sup>117</sup> The NBK is tasked with drafting rules for:

- (a) conducting foreign exchange operations in Kazakhstan;
- (b) monitoring foreign exchange operations in Kazakhstan;
- (c) arranging currency exchange operations with foreign cash in Kazakhstan;
- (d) exercising export and import currency control in Kazakhstan;
- (e) information being provided by branches and representative offices of foreign non-financial organizations which are carry out activities in Kazakhstan; and
- (f) monitoring the sources of supply and demand in the Kazakhstan's domestic foreign exchange market.<sup>118</sup>

Parties carrying out currency transactions, as well as the banks involved in moving the currency, will be responsible for reporting details to the NBK.<sup>119</sup> Branches and representative offices of foreign non-financial organizations that have been operating in Kazakhstan for more than one year must regularly report to the NBK on foreign currency transactions with residents and non-residents.<sup>120</sup> The NBK (and other authorized banks) will assign accounting numbers to all currency contracts involving the movement of capital or export/import of goods.<sup>121</sup>

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114. *Id.*

115. Қазақстан Республикасының Еңбек кодексі [Labor Code of the Republic of Kazakhstan] Nov. 23, 2015, No. 414-V ZRK.

116. *Id.* at art. 113, § 1.

117. New Currency Law, *supra* note 96, at art. 10, §§ 5–7.

118. *Id.* at art. 5, § 4.

119. *Id.* at art. 13, § 1 and art. 15, §§ 1–2 (It is not yet clear exactly what information these reports will require because the NBK has not yet written the regulations).

120. *Id.* at art. 17, § 1.

121. Tanasheva et al., *Legislative Alert: Guide to recent changes in the legislation of the Republic of Kazakhstan*, EY (July 2018), [https://www.ey.com/Publication/vwLUAssets/ey-la-currency-legislation-2018-eng.pdf](https://www.ey.com/Publication/vwLUAssets/ey-la-currency-legislation-2018-eng/$FILE/ey-la-currency-legislation-2018-eng.pdf).

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Resident legal entities wishing to purchase foreign currency in the Kazakh domestic market may be required to report to the NBK the purposes for which it intends to buy the foreign currency, and then prove that the currency was actually used for those purposes.

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