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Doing Business in the New Russia: Rebirth of the Russian Nation

BRUCE W. BEAN*

For sixty-nine years the Russian Soviet Federal Socialist Republic (RSFSR) was the keystone of the Union of Soviet Socialist Republics¹ (USSR). The USSR, for much of this time, was the epitome of a command economy. The first steps toward a Russian market economy were taken by the USSR in the five years immediately preceding the formal dissolution of the USSR on December 31, 1991. These bold, early steps, which were widely disregarded² or discredited in the West at the time, included decrees authorizing the first joint ventures,³ a series of laws aimed at developing cooperatives and introducing liberalized

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1. The Union of Soviet Socialist Republics was formally established on Dec. 30, 1922. It originally consisted of four republics: Russia, Byelorussia, Ukraine, and the Caucasus Republic, the latter encompassing Azerbaijan, Georgia, and Armenia. In 1925, Uzbekistan and Turkmenistan were included in the USSR; in 1929, Tajikistan was added. In 1936, Kazakhstan and Kyrgyzstan were transformed into soviet socialist republics from autonomous republics and the Caucasus Republic was split into Azerbaijan, Georgia, and Armenia. In 1940, the Baltic States, comprised of Latvia, Lithuania and Estonia, were forcibly added to the USSR, and the Moldavian autonomous republic was joined as a soviet socialist republic completing the formation of the USSR as it existed until Dec. 31, 1991.

2. An early believer was Richard N. Dean, an associate in the Sydney office of Coudert Brothers in the mid-1980s. In early 1988, he established the first Western law office in Moscow.

3. Postanovlenie SM SSSR No. 48, Jan. 13, 1987, *Sobr. Postanovlenyi Pravitel'stva SSSR*, 1987, No. 8, Item 38 (last amended Sept. 26, 1990; on joint ventures involving partners from member-countries of the Council of Mutual Economic Assistance); Postanovlenie SM SSSR No. 49, Jan. 13, 1987, *Sobr. Postanovlenyi Pravitel'stva SSSR*, 1987, No. 9, Item 40.

privatization of apartments,⁴ the Yavlinsky 500-day program,⁵ the laws on property,⁶ and the revolutionary Law on Enterprises and Entrepreneurial Activity.⁷

In the seeming chaos wrought by the combination of Chairman Gorbachev's⁸ *perestroika*,⁹ electoral reforms,¹⁰ the introduction of economic reforms, and the re-emergence of nationalist identification of the constituent republics of the USSR,¹¹ the RSFSR declared its sovereignty on June 12, 1990.¹²

4. E.g., Zakon SSSR No. 8998-XI, May 26, 1988, Vedomosti Verkh. Soveta SSSR, 1988, No. 22, Item 355 (last amended June 19, 1992; on cooperation in the USSR); Ukaz Prezidiuma Verkhovnogo Soveta SSSR No. 10401-XI, May 10, 1989, unpublished (on expanding the rights of collective farms and agricultural cooperatives in dealing with residential premises); Postanovlenie SM RSFSR No. 331, June 14, 1991, Zakonod. I Ekon., 1991, No. 11, at 24-26 (on additional measures to develop farms and agricultural cooperatives in the RSFSR); Postanovlenie SM RSFSR No. 9, Jan. 4, 1991, Sobr. Postanovleniyi Pravitel'stva RSFSR, 1991, No. 7, Item 105 (amended Apr. 9, 1992; on supporting development of farms and their cooperatives); Postanovlenye SM SSSR No. 1132, Nov. 2, 1990 (on relationships between state enterprises and cooperatives); Postanovlenie TsK KPSS i SM SSSR No. 406, Mar. 31, 1988, Sobr. Postanovleniyi Pravitel'stva RSFSR, 1988, Div. 1, No. 16, Item 43 (amended Sept. 26, 1990; on measures for accelerating the development of residential cooperation); Zakon RSFSR No. 1541-I, July 4, 1991, Ross. GAZETA, Jan. 10, 1995, No. 5 (last amended May 1, 1999; on privatization of the residential fund); Postanovlenie Pravitel'stva RSFSR No. 67, Dec. 26, 1991, Sobr. Postanovleniyi Pravitel'stva RSFSR, 1992, No. 6, Item 27; Postanovlenie Kollegii Goskomiteta ZhKH RSFSR No. 7, Oct. 18, 1991, Biull. Norm. Akt. RSFSR, 1992, Nos. 2-3, at 23 (on approval of temporary regulation for the privatization of the residential fund).

5. The 500-day program was developed on joint instruction from Mikhail Gorbachev and Boris Yeltsin on July 27, 1990, by a team of Russian politicians and economists including G. Yavlinsky, S. Shatalin, B. Fedorov, and others. The program addressed the steps for the transition from a command economy to a market economy and was presented to the Supreme Council of the RSFSR in early Sept. 1990.

6. Zakon SSSR "O Sobstvennosti v SSSR" [On Property in the USSR], Mar. 6, 1990, Vedomosti Verkh. Soveta SSSR, 1990, No. 11, Item 164 (this law authorized private ownership by individuals of residential premises, the retention by enterprises of net profit and its distribution to employees, whether as stock or cash.); Zakon RSFSR "O Sobstvennosti na Territorii RSFSR" [On Property in the RSFSR], July 14, 1990, Vedomosti S'yezda Narodnih Deputatov Rossiyskoi Federatsii i Verkh. Soveta Rossiyskoi Federatsii, July 18, 1990, No. 7, Item 101 (by reference to the resolutions on the state sovereignty of the RSFSR and on the separation of authority to manage organizations in the RSFSR, this law instituted the regulation by the laws of the RSFSR and its regions of the ownership of land and other natural resources, fixed assets, and other property; and guaranteed the protection of ownership rights of citizens and organizations in the RSFSR).

7. Zakon RSFSR No. 445-I, Dec. 25, 1990, Vedomosti S'yezda Narodnykh Deputatov RSFSR, Dec. 27, 1990, No. 30, Item 418 (last amended Nov. 30, 1994; on enterprises and entrepreneurial activity).

8. Mikhail Sergeyevich Gorbachev succeeded Konstantin Ustinovich Chernenko as the General Secretary of the Political Bureau of the Central Committee of the Communist Party of the Soviet Union (CPSU) on Mar. 11, 1985. Chernenko had served just thirteen months in that position, having succeeded Yuri Vladimirovich Andropov in Feb. 1984. Andropov had been in office only since Nov. 1982 when he succeeded Leonid Brezhnev.

9. Perestroika, the Russian word for *restructuring*, was the term adopted in the former USSR for the course of reforms initiated by Mikhail Gorbachev.

10. Popular elections to the Congress of People's Deputies of the USSR were first held in the USSR on Mar. 26, 1989. In Mar. 1990, elections for republic and local administrations were held in the republics of the USSR. In May 1990, the Russian Congress of People's Deputies was convened and elected Boris Yeltsin, the Communist Party member from Ekaterinburg, as its Chairman.

11. On Nov. 16, 1988, a sovereignty declaration was adopted in Estonia; this was followed by adoption in Latvia of a sovereignty declaration (on July 28, 1989 and a declaration on independence on Feb. 15, 1990); the act of independence in Lithuania of Mar. 1990; the declaration of sovereignty of Russia on June 12, 1990. See *infra* note 20.

12. The Declaration of Sovereignty of June 12, 1990 also announced the supremacy of the laws of the RSFSR over those of the USSR.

The eighteen tumultuous months that followed this declaration of sovereignty by the RSFSR and concluded with the formal dissolution of the USSR were characterized by almost constant confrontation between President Boris Yeltsin¹³ and President Mikhail Gorbachev.¹⁴ The climax of this period was the attempted coup by so-called hard liners,¹⁵ which was staged at a time designed to prevent the signing of a new All Union Treaty¹⁶ intended to preserve the USSR but in a more liberal form. The immediate collapse of the coup must be credited in large part to the bold resistance to the coup offered by President Yeltsin¹⁷ and the admirable reluctance of elite KGB¹⁸ forces to use force against the civilians assembled in support of Yeltsin.

The immediate results of the abortive coup were the discrediting of the Communist Party¹⁹ and the acceleration of independence movements in the constituent republics of the USSR.²⁰ In the RSFSR, the Congress of People's Deputies granted President Yeltsin extraordinary powers to implement radical economic reforms.²¹ On December 25, 1991, the Congress of People's Deputies changed the name RSFSR to the Russian Federation (Russia)²² and a dramatic, if not drastic, economic reform plan, developed by Egor Gaidar, Alexander Shokhin, Anatolii Chubais, Andrei Nechayev, and Alexei Golovkov,²³ was introduced in January 1992.

13. Boris Nikolayevich Yeltsin was elected president by popular vote in Russia on June 12, 1991.

14. Mikhail Sergeyevich Gorbachev had been elected president of the USSR, not by popular vote, but by the Congress of People's Deputies of the USSR on Mar. 13, 1990.

15. Aug. 18–21, 1991, "The Coup with Trembling Hands" is wonderfully described in YEYENGY YEVTUSHENKO, *DON'T DIE BEFORE YOU'RE DEAD* (1st ed. 1995). The hard-liners included Gennadii Ignatievich Yanaev, vice president of the USSR; Boris Karlovich Pugo, minister for internal affairs of the USSR; Vladimir Aleksandrovich Kryuchkov, chairman of the Committee for State Security of the USSR; and Dmitri Timofeevich Yazov, minister of defense of the USSR.

16. The signing of the All Union Treaty was prevented by the coup of Aug. 1991.

17. President Yeltsin declared the actions of the self-styled State Committee for the State of Emergency unconstitutional and called for a general strike. The only fatalities of these events were three men who died in a confrontation with tanks in the center of Moscow on Aug. 20–21, 1991, Vladimir Usov, Dmitrii Komar, and Ilya Krichevsky. The coup leaders were arrested on Aug. 21, 1991 with the exception of Boris Pugo, who committed suicide.

18. KGB is a Russian abbreviation for the Committee for State Security.

19. On Aug. 23, 1991, President Yeltsin suspended the CPSU by decree throughout Russia and its offices in Moscow were sealed. On Aug. 24, 1991, President Gorbachev resigned as General Secretary of the Communist Party. On Aug. 29, 1991, the USSR Supreme Soviet suspended the CPSU throughout the USSR.

20. Declarations of sovereignty were adopted by Ukraine on July 16, 1990, and Belarus on July 27, 1990; Oct. 25, 1990 Kazakhstan declared state sovereignty. On Apr. 9, 1991, the Parliament of Georgia adopted its declaration of independence. Estonia declared its independence from the USSR on Aug. 20, 1991. Ukraine declared independence on Aug. 24, 1991; on the same day, Russia recognized the independence of Estonia and Latvia. On Aug. 25, 1991 Belarus declared its independence and the Communist Party of Belarus was suspended. On Aug. 27, 1991 Moldova (formerly Moldavia) declared its independence. On Aug. 30, 1991, Azerbaijan declared its independence. Leningrad was renamed St. Petersburg on Sept. 6, 1991. On Oct. 26, 1991 Turkmenistan declared its independence. On Aug. 31, 1991, Kyrgyzstan and Uzbekistan each declared their independence. *See also* note 12.

21. Decree of the Congress of the People's Deputies No. 1831-I, Nov. 1, 1991, *Vedomosti S'yezda Narodnykh Deputatov RSFSR*, Oct. 31, 1991, No. 44.

22. *Zakon RSFSR No. 2094-I*, Dec. 25, 1991, *Vedomosti S'yezda Narodnykh Deputatov Rossiyskoy Federatsii i Verkhovnogo Sovieta Rossiyskoy Federatsii*, Jan. 9, 1992, part 2, at 62, § 1 ("the State of the Russian Soviet Federal Socialist Republic shall hereafter be called the Russian Federation (Russia)").

23. President Yeltsin signed ten edicts accelerating the transition to a market economy in Russia on November 15, 1991, e.g., Decree No. 210, On Cancellation of Restrictions on Wages and on the Increase of

Since that time, Russia has been going through wrenching changes as it develops a consumer-oriented economy. Foreign investment has played a modest role in this process with American and German companies having the leading positions by far. As investment in Russia continues to grow, American lawyers may benefit from an introduction to the legal basis for the development of the new Russia.

I. Constitutional Framework

The Russian Federation is a civil law jurisdiction with a written constitution that lays down the fundamentals of Russian state governance and its regulatory framework. The current Russian Constitution was adopted after months of intense, ultimately violent, confrontation²⁴ between the legislative branch, the Congress of People's Deputies, and President Boris Yeltsin. Following a bloody confrontation in early October 1993, a new constitution was adopted on December 12, 1993 by a nationwide referendum.²⁵ The constitution establishes Russia as a presidential republic comprised of (1) a president,²⁶ (2) a ministerially organized government, (3) a legislature,²⁷ and (4) a judiciary.²⁸ The constitution also outlines the powers of the regional governments, which make up the constituent elements of the Russian Federation.²⁹

The president occupies a standalone, if not superior, place among these branches of state power. The president is the head of the state,³⁰ the guarantor of the constitution and of human and civil rights and freedoms,³¹ and the commander-in-chief of the Russian armed forces.³²

The Federal Assembly³³ constitutes the legislative branch. It consists of the State Duma, the lower chamber, and the Council of the Federation, the upper chamber.³⁴

Funds Directed to Consumption; Edict No. 211, On Increasing Salaries of Employees of Budget Organizations and Institutions; Edict No. 212, On Social Partnership and Resolution of Labor Disputes (Conflicts); Edict No. 213, On Liberalization of Foreign Economic Activity in the RSFSR.

24. On Sept. 21, 1993, President Yeltsin dissolved the Russian Parliament and announced the holding of pre-term parliamentary elections on Dec. 12; Edict No. 1400, On Stage-by-Stage Constitutional Reform in the Russian Federation. The legislature went into emergency session, appointed Alexander Vladimirovich Rutskoi president and formed an alternative government. On Oct. 3, demonstrations escalated into armed uprising. President Yeltsin declared a state of emergency. On Oct. 4, on orders of the president, the military deployed around the White House, the seat of the Congress of People's Deputies at the time, and ultimately fired on the building. The leaders of this legislative group, including Ruslan Imranovich Khasbulatov, Alexander Vladimirovich Rutskoi, Albert Mikhailovich Makashov and others were temporarily arrested. The publication of some newspapers including Pravda, Sovetskaya Rossiya, and some political movements, including the Russian Communist Workers' Party, the National Salvation Front and others, were suspended by Decree of the President No. 1578, On Emergency Measures to Secure the State of Emergency in Moscow and the Ordinance of the Mayor of Moscow No. 552-RM, On Suspending the Activity of a Number of Periodicals.

25. As reported, the constitution was supported by 58.43% of the vote, while 50% was required for adoption.

26. KONST. RF, ch. 6.

27. See *id.* ch. 5, art. 94.

28. See *id.* ch. 7, art. 118.

29. See *id.* ch. 8.

30. See *id.* art. 80(1).

31. See *id.* art. 80(2).

32. See *id.* art. 87(1).

33. See *id.* art. 94(1).

34. See *id.* art. 95(1).

Executive powers are vested in the government,³⁵ consisting of the prime minister, appointed by the president with the consent of the State Duma,³⁶ and heads of an array of ministries, state committees and state agencies.³⁷

Judicial power is vested in the court system,³⁸ which includes (1) the Constitutional Court,³⁹ the primary function of which is to (a) ensure the conformity to the constitution of legislation enacted by the various legislative bodies within Russia,⁴⁰ (b) resolve jurisdictional disputes between various state bodies,⁴¹ and (c) interpret the constitution;⁴² (2) the Supreme Court, which heads regular civil courts and deals with civil, criminal, and administrative matters;⁴³ (3) the Supreme Arbitrazh Court, which oversees the arbitrazh courts which, despite the name, are indeed courts, not arbitral bodies, that deal with business disputes;⁴⁴ and (4) the military courts, which handle disputes involving the Russian military.⁴⁵

The powers of regional governments arise from the federal structure of Russia, which is comprised of eighty-nine subjects of the Russian Federation. The subjects include twenty-one republics, six *krais*, ten autonomous *okrugs*, forty-nine *oblasts*, one autonomous *oblast*, and two cities, Moscow and St. Petersburg.⁴⁶ Each of these subjects has its own legislature and governmental administration.⁴⁷ Just as the U.S. Supreme Court has had an important role in the development of the United States as a federal republic, so the Russian Constitutional Court has regularly held that a number of regional authorities have acted in ways inconsistent with the constitution, federal legislation or both.⁴⁸ With the announced view of better ensuring that federal policy is implemented as appropriate by the subjects of the federation, Vladimir Putin, within a week of his inauguration as the second president of Russia,⁴⁹ issued a decree establishing seven supra-regional districts and appointed his own representatives to supervise them.⁵⁰

35. See *id.* art. 110(1).

36. See *id.* art. 111(1).

37. See *id.* art. 110(2).

38. See *id.* art. 118(2).

39. See *id.* art. 125.

40. See *id.* art. 125(2).

41. See *id.* art. 125(3).

42. See *id.* art. 125(5).

43. See *id.* art. 126.

44. See *id.* art. 127.

45. Federal'nyi Konstitutsionnyi Zakon No. 1-FKZ (on the court system of the Russian Federation), Dec. 31, 1996, ROSS. GAZETA, Jan. 6, 1997, art. 22(1).

46. KONST. RF, art. 65(1).

47. Federal Law of the Russian Federation No. 154-FZ, On General Principles of Local Self-Government in the Russian Federation, Aug. 28, 1995 (last amended Aug. 4, 2000), art. 19.

48. For example, the Constitutional Court held unconstitutional statutory provisions adopted by the local legislature in the Krasnodar region, which prevented the allocation of plots of land and the notary certification of purchase and sale contracts for residential premises for Russian citizens before they had obtained the right of permanent residence in Krasnodarskiy krai. This ruling was based on the limitation of the constitutional freedom of choice of the place of residence. *Opredeleniye Konst. Suda RF No. 116-O*, Oct. 7, 1998, *Sobr. Zakonod. RF*, Oct. 19, 1998, No. 42, Item 5210.

49. Vladimir Putin, Prime Minister of Russia since Aug. 9, 2000, had been designated acting-president by former President Yeltsin, on Dec. 31, 1999, when President Yeltsin resigned from office; Putin was elected president on Mar. 26, 2000, and formally inaugurated on May 7, 2000.

50. Ukaz Prezidenta RF No. 849, May 13, 2000 (last amended Jan. 30, 2001) (on authorized representatives of the president of the Russian Federation in a federal *okrug*.)

Russian legislation represents a structurally sophisticated system of hierarchically organized statutory acts issued at the federal and the local level. To understand them it is necessary to examine these first by considering the terminology used in English.⁵¹ While this is to some extent an academic issue, it is one any legal practitioner looking at Russian legislation must understand.

The constitution is the highest form of legislation in Russia.⁵² Amendments to the constitution, depending on their nature, may be adopted either by the legislature with subsequent ratification by local legislatures or through a national referendum.⁵³

In the hierarchy of federal legislation, a law (in Russian, *zakon*) is the highest form of legislation under the constitution. The constitution distinguishes between federal constitutional laws⁵⁴ and federal laws.⁵⁵ Federal constitutional laws are adopted on a limited range of matters indicated by the constitution (for example, the organization of the government and the fundamentals of the court system).⁵⁶ Unless specifically designated as a constitutional law, a law has the status of a federal law. As between these two, a federal constitutional law takes priority.⁵⁷ The general procedure for the adoption of laws includes passage by the legislature, signing by the president, and publication.⁵⁸

The president is empowered by the constitution to adopt normative acts (edicts) in the form of *ukaz* and *rasporiazheniye*.⁵⁹ The constitution establishes that presidential edicts are effective throughout Russia⁶⁰ but may not contravene the constitution or federal laws.⁶¹

51. English translations of Russian legislation vary widely, if not wildly. Some translators go to great lengths to ensure that terms are translated as literally as possible and to find different corresponding English words to distinguish different Russian terms that might otherwise be translated into the same word in English. Their concern is that the use of the natural English equivalent word in such a situation risks the loss of a Russian legal or linguistic distinction. The practice in this article, however, particularly with concepts that have been borrowed from outside Russia, is to use the closest English language conceptual equivalent without necessarily seeking linguistic precision. Clifford Chance Puender—Moscow, like most major Western law firms, relies principally upon its own translations of Russian statutes.

52. KONST. RF, art. 15(1) ("[t]he Constitution of the Russian Federation has supreme legal force and is direct-acting and applies throughout the territory of the Russian Federation. Laws and other legal enactments adopted in the Russian Federation may not contradict the Constitution of the Russian Federation").

53. The procedures for amending the constitution vary depending on who initiates the amendment and on the nature of amendment. Detailed procedures are set out in KONST. RF, arts. 135–137.

54. See *id.* art. 108.

55. See *id.* arts. 105–107.

56. See *id.* art. 108(1).

57. See *id.* art. 76(3).

58. The procedures for adoption of federal laws and federal constitutional laws are different. A federal constitutional law must be adopted by an absolute 75% majority vote of the Federation Council and a two-thirds absolute majority vote of the State Duma. A federal law is normally adopted by a simple majority vote of each chamber of the legislature. Federal laws (with limited exceptions) may also be adopted if the Federation Council fails to review them within fourteen days of submission by the State Duma. This leeway is not available for the federal constitutional laws. See KONST. RF, arts. 105–108. Article 15(3) states that "[l]aws are subject to official publication; unpublished laws are not applied. Any normative legal enactments affecting human and civil rights, freedoms and duties cannot be applied unless they have been officially published for universal information." See *id.* art. 15(3).

59. See *id.* art. 90(1).

60. See *id.* art. 90(2).

61. See *id.* art. 90(3).

Next are statutory acts issued by the government, for which the Russian terms are *postanovleniye* and *rasporiazheniye*.⁶² In this article, the term *decree* is used to distinguish them from edicts issued by the president. In terms of legal standing, governmental decrees are effective throughout Russia⁶³ but may not contravene the constitution, federal laws, or presidential edicts.⁶⁴ The president is empowered to cancel government decrees that contradict these higher forms of legislation.⁶⁵

Occasionally edicts or decrees adopt more detailed rules or regulations, *polozhenie* usually translated into English as *regulations* but sometimes as *statute*. The legal standing of regulations follows the standing of the act that adopted them. There are also instructions, orders, directions, and others that are issued by particular government agencies and that are subordinate to the acts described above. At the level of local legislation, there is a similar structure. Local legislation derives its force from the constitutional division of powers at the federal and local level⁶⁶ and may not contravene federal legislation.⁶⁷

The time of enactment of a statutory act is also important. The general practice in Russia is to indicate the date on which a statute was signed as the date of such act. This date, however, must be distinguished from the date on which such act becomes effective. Publication is a condition precedent to the effectiveness of federal constitutional laws and federal laws.⁶⁸ A general rule is that federal constitutional laws and federal laws are effective from the time indicated in such acts or, absent such indication, ten days following their publication.⁶⁹ Similar rules apply to presidential edicts and government decrees.⁷⁰ These likewise must be published before they become effective.⁷¹ Procedures for acts issued by federal executive bodies are generally similar with a ten-day lag time between publication and effectiveness, but acts that contain statutory norms must also be registered with the Ministry of Justice prior to becoming effective.⁷² There are exceptions to these general principles established by federal legislation (for example, acts in relation to taxes, criminal laws, and acts referring to state secrets). Similar principles apply to local acts.

II. The Russian Civil Code – The Heart of the System

Like most of Europe, the legal system in Russia is a civil law system largely built upon a civil code, which was codified three times during the course of the twentieth century,

62. See *id.* art. 115(1).

63. See *id.* art. 115(2).

64. See *id.* art. 115(3).

65. See *id.*

66. *Id.* art. 76(4) (“[o]utside the compass of the Russian Federation’s jurisdiction and the joint jurisdiction of the Russian Federation and the subjects of the Russian Federation, the republics, krais oblasts, cities of federal significance, the autonomous oblast and the autonomous okrugs exercise their own legal regulation, including the adoption of laws and other normative legal enactments”); see also *id.* art. 76(2).

67. See *id.* arts. 76(5), (6).

68. Federal’nyi Zakon No. 5-FZ, June 14, 1994 (on publication and enactment of federal constitutional laws, federal laws and acts of chambers of the federal assembly) (amended Oct. 22, 1999), arts. 1, 4.

69. See *id.* art. 6.

70. Ukaz Prezidenta RF, May 23, 1996, No. 763 (on the procedure for the publication and enactment of the acts issued by the president of the Russian Federation, government of the Russian Federation and normative acts of federal bodies of executive power) (last amended Aug. 13, 1998).

71. See *id.* §§ 5–7.

72. See *id.* §§ 8–10, 12.

initially to accommodate the command economy⁷³ and most recently to adapt to a market economy.⁷⁴

In the USSR, there were two tiers of civil legislation: all-union or USSR level and union republic. The former acted as guidelines on the basis of which more detailed codes were enacted in the constituent republics of the USSR. The civil code of the RSFSR was adopted in 1964 (the 1964 civil code).⁷⁵ In May 1991, new civil law guidelines, the Fundamental Principles of Civil Legislation of the USSR and Republics (fundamentals) were introduced in the USSR. These were to become effective throughout the USSR on January 1, 1992. The fundamentals were adopted by Russia in 1992⁷⁶ and have applied where appropriate, pending the introduction of a comprehensive new Russian civil code.⁷⁷

A new Russian three-part civil code is in the process of being introduced. Part 1 generally took effect on January 1, 1995.⁷⁸ It addresses basic legal principles, in particular (1) principles of ownership,⁷⁹ (2) types of legal entities that may be established,⁸⁰ (3) general principles relating to the law of obligations,⁸¹ and (4) provisions relating to the creation of security interests and guarantees.⁸² Part 2 of the civil code, effective March 1, 1996,⁸³ deals with individual types of contractual relationships. Part 3 of the civil code remains to be enacted. Pending for more than five years, it has made significant progress in the State Duma during 2001, although the timing of its adoption remains unknown. Part 3 addresses such issues as wills, copyright, and international law, including the very important question of waiver of sovereign immunity. These areas currently remain governed by the 1964 civil code and the fundamentals.

For the most part, the civil code is a consolidation of basic legal principles deemed necessary to underpin a market economy, which were introduced in the first generation of reform legislation in 1990 and 1991. It is therefore more in the nature of reinforcement of changes previously introduced than radical innovation.

III. Doing Business in Russia

More than 1,000 American businesses successfully operate in one way or another in Russia. The Russian legal operating environment is different, but common-law attorneys

73. The Civil Code of the RSFSR 1922 approved by the Decree of Central Executive Committee of Russia dated Oct. 31, 1922; the Civil Code of the RSFSR approved by the Law of the RSFSR dated June 11, 1964, On Approval of the Civil Code of the RSFSR.

74. See *infra* notes 78 and 83.

75. The Civil Code of the RSFSR approved by the Law of the RSFSR dated June 11, 1964 On Approval of the Civil Code of the RSFSR.

76. The Fundamental Principles of the USSR and the Republics approved by the Decree of the Supreme Soviet of the USSR on May 31, 1991 and effective from Jan. 1, 1992 [hereinafter Fundamentals].

77. The Fundamentals apply alongside the 1964 civil code to the extent that the latter does not conflict with the Fundamentals. See *Postanovlenie VS SSSR*, No. 2212-I, May 31, 1991, *Vedomosti S'yedz Narodnykh Deputatov SSSR i Verkh. Soveta SSSR*, June 26, 1991, No. 26, Item 734, art. 2.

78. *Federal'nyi Zakon* No. 52-FZ, Nov. 30, 1994, *ROSS. GAZETA*, Dec. 8, 1994 (last amended Apr. 16, 2001).

79. See GK RF, pt. 1, div. 2. The major exception to the practice described above (note 51) regarding the use of proprietary translations is the civil code, Parts 1 and 2. A widely used, commercially available translation was published by the Private Law Research Center of the Office of the President of the Russian Federation, Moscow 1997. It is the translation referred to in this article.

80. See GK RF, pt. 1, div. 1, sub-div. 2, ch. 4, §§ 1-4. These provisions came into effect on Nov. 30, 1994.

81. See GK RF, pt. 1, divs. 1, 3, sub-div. 2.

82. See GK RF, ch. 23.

83. See *Federal'nyi Zakon* No. 15-FZ, Jan. 26, 1996, *ROSS. GAZETA*, Feb. 6, 1996.

quickly learn that these differences relate more to the nature of a civil law system than to any sinister aspects of an attempt by an evil empire to become a functioning market economy. The remainder of this article presents the principal aspects of the legal regime in modern Russia as it impacts businesses operating there.

Contract law provisions are concentrated in the civil code.⁸⁴ There are, however, other federal laws that address contracts as well.⁸⁵ For example, a transfer of shares in a company organized in Russia, while falling within the scope of contract law, must also comply with the Securities Market Law,⁸⁶ regulations of the Federal Commission on the Securities Market (FCSM) as well as antitrust⁸⁷ and exchange control⁸⁸ laws and regulations.

In Russia—as in all other jurisdictions with a participatory, democratic law-making regime—legislation enacted at different times by different bodies is sometimes inconsistent, or at least arguably so. Additionally and not surprisingly, the division of powers among various government authorities remains a matter of debate. Inconsistencies and ambiguities may also be found within the civil code itself.

The primary principles underlying contract law in Russia are freedom of contract⁸⁹ and good faith.⁹⁰ A contract is defined as “an agreement of two or several persons on establishing, changing, or terminating civil law rights and duties.”⁹¹ A contract is regarded as entered into if “an agreement has been reached on all the essential terms of the contract among the parties in the form required in appropriate cases.”⁹² As an example, the civil code establishes that “the terms of a contract of purchase and sale of goods shall be considered agreed if the contract allows the determination of the name and quantity of the goods.”⁹³ For leasing, the civil code provides,

In a contract of lease there must be data allowing the definite identification of the property subject to transfer to the lessee as the object of the lease. In the absence of these data in the contract, the term on the object subject to transfer by lease shall be considered not agreed upon by the parties and the respective contract shall not be considered to have been made.⁹⁴

Any contract concluded between an individual and a legal entity must be in writing as must (1) contracts between legal entities and (2) contracts between individuals involving at least ten times the minimum monthly wage (approximately 1,000 rubles or \$30).⁹⁵ Specific types of contracts such as suretyship⁹⁶ and international commercial transactions⁹⁷ must also

84. See Copyright and Trademark amendments, *infra* note 85.

85. See, e.g., Zakon RF No. 5351-I, July 9, 1993, ROSS. GAZETA, Aug. 3, 1992 (amended on July 19, 1995; on copyright); Zakon RF No. 3520-I, Sept. 23, 1992, ROSS. GAZETA, Oct. 17, 1992 (amended Dec. 27, 2000; on trademarks).

86. See Federal'nyi Zakon No. 39-FZ, Apr. 22, 1996, ROSS. GAZETA, Apr. 25, 1996 (last amended July 8, 1999) [hereinafter Securities Market Law].

87. See Zakon RF No. 948-I, Mar. 22, 1991, ROSS. GAZETA, Aug. 14, 1993 (last amended Jan. 2, 2000; on competition and restriction of anti-monopoly activity) [hereinafter Monopoly Law].

88. See Zakon RF No. 3615-1, Oct. 9, 1992, ROSS. GAZETA, Nov. 4, 1992 (last amended July 5, 1999).

89. See GK RF, arts. 1(2), 421(1), (2), (4).

90. See *id.* arts. 10(1), (3).

91. See *id.* pt. 1, art. 420(1).

92. See *id.* pt. 1, art. 432(1).

93. See *id.* art. 455(3).

94. See *id.* art. 607(3).

95. See *id.* art. 161.

96. See *id.* art. 362.

97. See *id.* art. 162(3); see also *infra* notes 114–115 and accompanying text.

be in writing. If a written contract is required or if the parties have agreed to conclude it in writing, noncompliance with a written form of this contract deprives the parties in a dispute of the right to prove the existence of the contract through the use of testimony.⁹⁸ Notarization of a contract is required if (1) the parties so agree, or (2) expressly provided by law, such as for mortgages.⁹⁹ Failure to comply with this requirement may render the contract void.¹⁰⁰

Under the civil code a faulty agreement may be either void or voidable.¹⁰¹ A void transaction is void *ab initio*¹⁰² and does not create any rights or obligations in the parties to the agreement whereas a voidable transaction is valid unless and until it is voided by a court decision.¹⁰³ For a void agreement, a court would not have to—nor would it be able to—establish its invalidity. Instead, the court would apply the consequences of invalidity. For a voidable agreement, the court first invalidates the agreement and only then applies the consequences of invalidity. Unless otherwise provided by law, a general consequence of invalidity of an agreement is restitution.¹⁰⁴ An important distinction between void and voidable agreements is that a voidable agreement may be disputed in court only by a limited range of parties specified by law, while any interested party may seek to apply the consequences of a void agreement.¹⁰⁵

One example that may occur in Russia is when a company enters into a transaction *ultra vires*. The law establishes the procedures for invalidating such a transaction.¹⁰⁶ This brings the transaction under the umbrella of voidable transactions. The transaction is valid unless and until invalidated by court. On the other hand, a transaction that contradicts the requirements of law is void unless other consequences are contemplated by law.¹⁰⁷ For a void transaction, the statute of limitations for challenging the transaction is ten years from the date on which the performance of the transaction commenced.¹⁰⁸ For a voidable transaction, the limitation period is one year from the date on which the claimant has, or should have, become aware of grounds for invalidation of the transaction.¹⁰⁹ Notwithstanding these uncertainties or perhaps because of the extra care they inspire, allegations of void transactions are rarely encountered.

IV. Choice of Foreign Law

A basic aspect of doing business in Russia is knowing when and whether one should select foreign law to govern a contractual arrangement with a Russian counter-party. The prin-

98. See *id.* art. 162(1).

99. See *id.* art. 339(2).

100. See *id.* art. 165(1).

101. See *id.* art. 166.

102. See *id.* art. 167(1) (“[a]n invalid transaction . . . is invalid from the time of its making”).

103. See *id.* arts. 166(1), 167(3).

104. See *id.* art. 167(2).

105. See *id.* art. 166(2).

106. See *id.* art. 173.

107. See *id.* art. 168 (“[a] transaction not corresponding to the requirements of a state or of other legal acts is void, unless the statute establishes that such a transaction is avoidable or provides other consequences for the violation”).

108. See *id.* art. 181(1).

109. See *id.* art. 181(2).

cial sources of Russian law that regulate choice of law are the fundamentals, which, although adopted in the Soviet era, remain the basic Russian statute governing conflicts of laws; International Commercial Arbitration Law;¹¹⁰ and practice reviews and ordinances of the presidium of the Supreme Arbitrazh Court of the Russian Federation.

The fundamentals establish that for a contract to be governed by foreign law, such contract must be an international commercial transaction. There is no definition of an international commercial transaction. By summarizing the approaches to this notion developed in practice since 1992, it is possible to suggest the elements of a basic definition. Thus, an *international commercial transaction* is a contract in which (1) the parties are located in Russia and abroad¹¹¹ and (2) the agreement involves a cross-border transfer of money, goods, or services.¹¹²

Russian law also contains restrictions on the choice of foreign law as the governing law of a contract. Foreign law may not be applied or enforced if its application or enforcement would contradict the fundamental principles of Russian law.¹¹³

What actually contradicts the fundamental principles is resolved on a case-to-case basis by the courts or in arbitration. Certain scholars have argued that foreign law should not apply if its application and enforcement contradicts any portion of effective Russian legislation.¹¹⁴ A recent official interpretation of the law of the Supreme Court of the Russian Federation on this point has held that Russian courts should not refuse to apply foreign law merely because it contradicts Russian legislation.¹¹⁵

The freedom of Russian parties to choose applicable law is most helpful. Certain provisions of Russian law are still not appropriate to a modern market economy, and these may sometimes be avoided by selecting foreign law as the governing law.

V. Doing Business/Forms of Organization

A. REPRESENTATIVE OFFICE

Russian law does not directly prohibit business activities of a foreign company with no representative office or legal entity in Russia. However, Russian tax authorities will rightly claim that a company carrying on business activities in Russia has a permanent establishment there for tax purposes and is therefore liable for Russian taxes. Opening a representative

110. See Zakon RF No. 5338-I, July 7, 1993, ROSS. GAZETA, Aug. 14, 1993 [hereinafter International Arbitration Law].

111. See Information Letter of the Supreme Arbitrazh Court of the Russian Federation No. 29, Feb. 16, 1998, Section II (7).

112. M.M. BOGUSLAVSKI, PRIVATE INTERNATIONAL LAW: THE SOVIET APPROACH (David Winter et al. trans., 1988), §§ 2-4, at 200-01.

113. See Fundamentals, *supra* note 76, art. 158. ("Foreign law shall not apply if its application would violate the basics of Russian law. In such cases, Russian law shall apply.") See also International Arbitration Law, *supra* note 110, arts. 34(2) and 36(2).

114. See A. Muranov, *The Issue of the Order of Signing of International Commercial Transactions and Russian Public Order*, MOSCOW J. INT'L L., No. 3 (1998); but see B. Seglin, *Doubtful Ornaments of Russian Justice*, BUSINESS-ADVOKAT, No. 11, 2000; see also V. Kabatov, *Applicable Law in Dispute Resolution with the Moscow Court of International Commercial Arbitration of the Russian Chamber of Industry and Commerce*, KHOZIAISTVO I PRAVO, No. 5, 6, 1998.

115. See The Ruling of the Judicial College of the Supreme Court of the Russian Federation of Sept. 25, 1998.

office permits a company to separate its Russian revenues and limit its Russian tax exposure. Establishing an accredited representative office is often a workable solution for a company rendering services and trading (as opposed to those involved in manufacturing) and provides the following additional benefits:

- the ability to obtain visas and work permits for expatriate employees;
- facilitating activities and dealings with Russian government agencies and local businesses by virtue of the legitimacy afforded to an accredited office;
- under certain circumstances, exemption from the value added tax¹¹⁶ for leasing residential and nonresidential premises; and
- facilitating automobile registration.

A company seeking to commence business in Russia will often consider the somewhat simpler procedure of opening a representative office rather than establishing a Russian legal entity. The procedure for establishment of a representative office of a company in Russia is called accreditation.¹¹⁷ Representative offices must also register with the tax inspectorate, social funds, and other state bodies.

Under Russian legislation, a representative office may be opened to represent the interests of a company and, in particular, to assist the company in gathering economic, commercial, scientific and technical information, and in facilitating commercial and other transactions. The civil code provides, "A representative office is a self-contained division of a legal entity, located elsewhere than at its business address, which represents and protects the interests of such legal entity."¹¹⁸

B. JOINT STOCK COMPANY AND LIMITED LIABILITY COMPANY

For American companies with significant operations in Russia, it is routine to establish a Russian legal entity that is either wholly owned or jointly owned with Russian or other partners. Company law provisions are found in the civil code¹¹⁹ and in other specialized legislation.¹²⁰ The more common forms of commercial organizations described generally in the civil code include partnership,¹²¹ limited partnership,¹²² limited liability company (LLC),¹²³ and joint stock company (JSC).¹²⁴ Of these, JSCs and LLCs are the most useful,

116. The current maximum VAT rate is 20% and varies depending on the type of the products or services to which VAT applies. See *infra* note 220, Nalogovyi Kodeks [Tax Code], art. 164.

117. The procedures for the opening of representative offices are governed by the Regulations Governing the Procedure for the Opening and Operation in the USSR of Representative Offices of Foreign Firms, Banks and Organizations (as approved by the Decree of the Council of Ministers of the USSR dated Nov. 30, 1989, No. 1074, as last amended July 11, 1991).

118. See GK RF, pt. 1, art. 55(1).

119. See *id.* ch. 4.

120. See Federal'nyi Zakon No. 208-FZ, Dec. 26, 1995 [On Joint Stock Companies], Ross. GAZETA, Dec. 29, 1995 (last amended Aug. 7, 2001) [hereinafter JSC Law]; Federal'nyi Zakon No. 14-FZ, Feb. 8, 1998 [On Limited Liability Companies], Ross. GAZETA, Feb. 17, 1998 (last amended Dec. 31, 1998) [hereinafter LLC Law].

121. See GK RF, art. 69.

122. See *id.* art. 82.

123. See *id.* art. 87.

124. See *id.* art. 96.

and the forms overwhelmingly used in business operations in Russia. The popularity of these forms is significantly due to the fairly detailed provisions of two additional federal laws: the Joint Stock Company Law (JSC Law)¹²⁵ and the Limited Liability Company Law (LLC Law).¹²⁶ The JSC Law was substantially amended in August 2001, and the great majority of these amendments are effective January 1, 2002.¹²⁷

A JSC may be of two types: open¹²⁸ or closed.¹²⁹ Ownership is represented by shares in both, but in an open JSC, shares may be distributed to the public while in a closed JSC, the total number of shareholders is limited to fifty,¹³⁰ and the sale of shares is restricted.¹³¹ From an American practitioner's point of view, one of the very few distinct weaknesses of the JSC Law and of the Securities Market Law is the general failure of these laws to distinguish in a helpful, pragmatic way between a widely held public company and a privately held JSC.

Ownership in an LLC is represented by interests that are distributed among the company's participants and are not made available to the public.¹³² This feature of an LLC makes it comparable to a closed JSC. As with a closed JSC, the number of participants in an LLC may not exceed fifty.¹³³ A single founder, whether Russian or non-Russian, may create a JSC or an LLC but only if such founder is not itself a company owned by a single person or entity.¹³⁴

1. *Charter Capital*

In a JSC, charter capital is comprised of the nominal or par value of company shares issued to its shareholders.¹³⁵ Shares of a JSC, whether open or closed, are securities that must be registered with the FCSM.¹³⁶ Charter capital of an LLC consists of the value of interests owned by its participants.¹³⁷ Unlike shares in a JSC, an interest in an LLC is normally described as a percentage of the total capital contributed. Interests in an LLC are not securities and need not be registered with the FCSM. This creates a real, practical advantage for the LLC, which has become the vehicle of choice for foreign investors. As with JSC shares, interests held in an LLC may be transferred among interest holders as well as to third parties and to the company itself.¹³⁸

Russian legislation requires that 50 percent of the charter capital of a JSC be contributed within three months following its registration with the state. Until 50 percent of the

125. See JSC Law, *supra* note 120.

126. See LLC Law, *supra* note 120.

127. The amendments were introduced by Federal'nyi Zakon No. 120-FZ of Aug. 7, 2001, ROSS. GAZETA, Aug. 9, 2001, and effective Jan. 1, 2002. However, the provisions, which amended the competence of the general shareholders' meeting (art. 48) and the majority vote requirements at a general shareholders' meeting (art. 49), became effective on Aug. 9, 2001.

128. See JSC Law, *supra* note 120, art. 7(2).

129. See *id.* art. 7(3).

130. See *id.*

131. See *id.*

132. See LLC Law, *supra* note 120, art. 2(1).

133. See *id.* art. 7(3).

134. See *id.* art. 7(2); see also JSC Law, *supra* note 120, art. 10(2).

135. See JSC Law, *supra* note 120, art. 25(1).

136. See Securities Market Law, *supra* note 86, art. 16.

137. See LLC Law, *supra* note 120, art. 14(1).

138. See *id.* arts. 21(1), (2), 23.

charter capital has been contributed, a JSC may not conduct any business except that related to its establishment.¹³⁹ For an LLC, 50 percent of the charter capital must be contributed prior to such registration.¹⁴⁰ The full amount of the charter capital specified in the initial charter of a company must be fully paid within one year of its registration.¹⁴¹ These requirements are the same for both a JSC and an LLC.

Under Russian law, a contribution to the charter capital of an LLC or a JSC may be made in kind or in cash.¹⁴² Cash contributions may be made in rubles or in foreign currency. Cash contributions in foreign currency no longer require prior permission from the Central Bank of Russia (CBR) and are now the preferred method of making cash contributions.¹⁴³ In-kind contributions have customs clearance and import duty implications.

2. Increasing Capital

An increase in the capital of a JSC is possible by either increasing the par value of shares acquired by the shareholders or issuing additional shares.¹⁴⁴ In the event of an issue of additional shares, a securities tax in the amount of 0.8 percent of the par value of the issue must be paid.¹⁴⁵ The issue of additional shares must be also registered with the FCSM.¹⁴⁶ Existing shareholders of a JSC have preemptive rights with respect to the issuance of new shares.¹⁴⁷

The JSC Law provides for the issuance of preferred stock with its rights and limitations set forth in the law. Voting for preferred shares is generally limited to reorganization and liquidation, except for series of cumulative preferred. These shares have a vote on all matters at shareholders meetings following any annual meeting where shareholders fail to vote to pay such dividends in full.¹⁴⁸ Preferred shares may be converted into ordinary shares upon demand of the shareholders if so provided by the company's charter.¹⁴⁹ Under the JSC Law, preferred stock is limited to 25 percent of total charter capital.¹⁵⁰

An increase in the capital of an LLC is made through additional contributions to its charter capital or out of the assets of the company.¹⁵¹ No securities tax payment or registration of such increase with the FCSM is required. For both JSCs and LLCs, capital may be increased only after the initial charter capital has been paid in full¹⁵² and the capital

139. See generally JSC Law, *supra* note 120, arts. 34(1), 2 (3).

140. LLC Law, *supra* note 120, art. 16(2).

141. See generally JSC Law, *supra* note 120, art. 34(1); LLC Law, *supra* note 120, art. 16(1).

142. See generally JSC Law, *supra* note 120, art. 34(2); LLC Law, *supra* note 120, art. 15(1).

143. Cash contributions in foreign currency are regarded as "transactions relating to the movement of capital." INSTRUCTION OF THE CENTRAL BANK NO. 660-U, ON THE PROCEDURE FOR PERFORMANCE OF CURRENCY OPERATIONS CONNECTED WITH THE ATTRACTION AND RETURN OF FOREIGN INVESTMENTS (Oct. 8, 1999) (section 1(1) authorizes such contributions to be made without a special permission from the CBR).

144. See JSC Law, *supra* note 120, art. 28(1).

145. See Federal'nyi Zakon No. 158-FZ, Oct. 18, 1995, art. 3, ROSS. GAZETA, Oct. 24, 1995 (last amended May 30, 2001) (this tax is not imposed upon the initial issuance of shares by a JSC).

146. See Securities Market Law, *supra* note 86, art. 16.

147. See JSC Law, *supra* note 120, art. 40.

148. See *id.* art. 32(5).

149. See *id.* art. 32(3).

150. See *id.* art. 25(2).

151. See LLC Law, *supra* note 120, art. 17(2).

152. See generally ORDINANCES OF THE FEDERAL COMMITTEE FOR THE SECURITIES MARKET, STANDARDS OF ISSUE OF SECURITIES ON ESTABLISHMENT OF JOINT STOCK COMPANIES, ADDITIONAL SHARES, BONDS AND PROSPECTUSES OF THEIR ISSUE, 10(2), ORDINANCE OF THE FEDERAL COMMITTEE FOR THE SECURITIES MARKET (1996) No. 19, 47 (1998); LLC Law, *supra* note 120, art. 17(1).

increase reflected in an amendment to the company charter, which must be registered with Russian authorities in charge of company registration. The need to register each capital increase of a JSC with the FCSM adds weeks of delay to a capital increase and is the principal reason foreign investors choose to use an LLC for their wholly owned Russian legal entities.

3. *Sale of Shares/Withdrawal of an Interest*

The fundamental drawback of an LLC is that any interest holder in an LLC may withdraw from the LLC at any time without consent of the other participants or of the company.¹⁵³ In such cases, the interest of a withdrawing party is transferred to the LLC from the moment of application for withdrawal.¹⁵⁴ The company is obliged to pay the withdrawing participant the actual value¹⁵⁵ of its interest, either in cash or in kind, within six months from the expiration of the fiscal year in which the application for withdrawal was filed unless a shorter period is provided by the charter.¹⁵⁶ In practice, this means an LLC is not used for entities involving partners but works well as a wholly owned subsidiary.

For a JSC, the rules are less surprising. In an open JSC, a shareholder may sell his shares any time he can find a willing buyer. For a closed JSC, the sale procedure is different because the other existing shareholders have a right of first refusal to purchase shares a shareholder wishes to sell.¹⁵⁷ The JSC Law also provides that the charter of a closed JSC may give the company itself a right of first refusal to purchase shares held by a shareholder who wishes to sell where existing shareholders do not exercise their right to do so.¹⁵⁸

4. *Management Structure*

The JSC Law prescribes a three-tier management structure consisting of (1) the general meeting of shareholders, (2) the board of directors, and (3) the executive body.¹⁵⁹ The LLC Law has comparable provisions.¹⁶⁰ For JSCs with fewer than fifty shareholders and for LLCs, there is the option to eliminate the board of directors and to vest its powers in the shareholders¹⁶¹ or participants.¹⁶² The so-called executive body of an LLC or a JSC regularly takes the form of an individual executive, often called the general director, although a collective executive body may also be vested with responsibility for day-to-day operations of the company in addition to a general director.¹⁶³ The general director enjoys substantial discretion and, generally, has full power to act on behalf of the company.¹⁶⁴

An annual meeting of shareholders of a JSC or participants in an LLC must be held each year.¹⁶⁵ In a JSC, the annual general meeting must be held not earlier than two nor later

153. See LLC Law, *supra* note 120, art. 26(1) ("[a] participant in a company shall have the right to withdraw from the company at any time, regardless of the consent of the other participants therein or the company itself").

154. See *id.* art. 26(2).

155. See *id.*

156. See *id.* art. 26(3).

157. See JSC Law, *supra* note 120, art. 7(3).

158. See *id.* art. 7(3).

159. See *id.* arts. 47(1), 64(1), 69(1).

160. See generally LLC Law, *supra* note 120, arts. 32(1), (2), (4).

161. See JSC Law, *supra* note 120, art. 64(1).

162. See LLC Law, *supra* note 120, art. 32(2).

163. See JSC Law, *supra* note 120, art. 69(1).

164. See *id.* art. 69(2); LLC Law, *supra* note 120, art. 40(3).

165. See JSC Law, *supra* note 120, art. 47(1); LLC Law, *supra* note 120, art. 34.

than six months after the end of fiscal year;¹⁶⁶ for an LLC, such meeting must be held not earlier than two nor later than four months after the end of the fiscal year.¹⁶⁷ Interestingly, the power of a general meeting of both a JSC¹⁶⁸ and an LLC¹⁶⁹ is limited to that explicitly set forth in the law. While the JSC Law prohibits a general meeting from taking decisions on issues that are not included on the agenda, the LLC Law permits other decisions to be passed at a meeting attended by all participants.¹⁷⁰

5. *Interested and Major Transactions*

Both the LLC Law and the JSC Law address the questions of interested¹⁷¹ and major¹⁷² transactions. A transaction is *major* if it involves property of the company representing more than 25 percent of its book value as shown on the balance sheet of the company as of its latest reporting date. The LLC Law allows its participants to provide in the company

166. See JSC Law, *supra* note 120, art. 47(1).

167. See LLC Law, *supra* note 120, art. 34.

168. See JSC Law, *supra* note 120, art. 48.

169. See LLC Law, *supra* note 120, art. 33.

170. See *id.* art. 37(7).

171. See *id.* art. 45(1). Article 45(1) defines *interested transactions* as

transactions in which there is an interest of a member of the board of directors of a company or of the supervisory board of the company, of a person performing the functions of the one-person executive body of the company, or of a company's participant who, jointly with his affiliated persons, owns 20% or more of votes from the total number of votes of participants in the company. . . . The said persons shall be deemed to be interested in the company concluding a transaction, in case they themselves, their spouses, parents, children, brothers, sisters and/or their affiliated persons (i) are a party to the relevant transaction or act in the interests of third parties in relationships between such third parties and the company; or (ii) own individually or in aggregate 20% or more of the stock, participating interests, or shares of a legal entity which is a party to the relevant transaction or act in the interests of third parties in relationships between such third parties and the company; or (iii) hold positions in the management bodies of a legal entity which is a party to the relevant transaction or act in the interests of third parties in relationships between such third parties and the company; and (iv) in any other cases specified in the charter of the company.

A slightly different definition of *interested transactions* is contained at the JSC Law, *supra* note 120, art. 81: transactions (including loan, credit, pledge or mortgage and surety) in the performance of which there is an interest of a member of the board of directors of the company, a person exercising the functions of the single person executive body of the company including an external managing organization or external manager, a member of the collegiate executive body of the company or a shareholder that owns jointly with its affiliated parties 20% or more of the voting shares in the company as well as a person who has authority to issue instructions mandatory for the company, in the event such person, his or her spouse, parents, children, full and partial siblings, adopted parents and adopted children and/or their affiliated parties: (i) are a party, beneficiary, intermediary or representative in the transaction; (ii) own (each separately or together) 20% or more of the shares (ownership interests) in a legal entity which is a party, beneficiary, intermediary or representative in the transaction; (iii) occupy posts on a managing body of a legal entity that is a party, beneficiary, intermediary or representative in the transaction or posts on a managing body of the external managing organization of such legal entity; or (iv) in other instances specified in the company charter.

172. See LLC Law, *supra* note 120, art. 46(1). Article 46(1) defines a major transaction as

a single transaction or several mutually-linked transactions related to the acquisition, or alienation, or the possibility of alienation by a company directly or indirectly of the assets valued at more than 25% of the company asset value determined on the basis of the bookkeeping records for the latest reporting time period proceeding the date of the decision concerning such transaction, unless a higher amount for a large-scale transaction is provided for by the charter of the company.

JSC Law, *supra* note 120, art. 78(1) contains a similar definition of a major transaction:

charter for a higher value of a transaction, which is to be considered major.¹⁷³ Interested transactions for both a JSC and an LLC are generally those involving a company and a board member, senior executive officer, or shareholder holding 20 percent or more of the shares of or interests in the company.

The approval of interested and major transactions is generally within the power of the general meeting; however, the board of directors may approve such transactions in certain cases.¹⁷⁴ The LLC Law establishes that the charter of a company may provide that no approval of major transactions is required by the participants or the board of directors.¹⁷⁵ This relief, however, does not extend to interested transactions, which require approval. No such relief is available in the case of a JSC. The approval process for interested transactions entered into by either a JSC or an LLC is generally comparable to those for a major transaction, although in a JSC with more than 1,000 shareholders, more elaborate procedures come into play where an interested transaction is contemplated.¹⁷⁶ It is in the area of

a transaction (including loan, credit, pledge or mortgage and surety) or a series of interrelated transactions involving the purchase, alienation or the possibility of alienation by a company, directly or indirectly, of property, the value of which constitutes 25% or more of the balance-sheet value of the company's assets determined on the basis of the company's accounting reports as of the latest reporting date, with the exception of transactions conducted in the ordinary course of business of the company, transactions related to the placement through subscription (to the sale) of common shares of the company and transactions related to the placement of issuable securities convertible into common shares of the company.

173. See *id.* art. 46(1).

174. See JSC Law, *supra* note 120, art. 79. Article 79 states,

(1) The decision to approve a major transaction involving property, the value of which comprises from 25% to 50% of the balance-sheet value of a company's assets shall be adopted by all members of the board of directors (supervisory board) of the company by a unanimous vote, without taking into consideration the votes of members who no longer serve on the board of directors (supervisory board) of the company. In the event that the board of directors (supervisory board) of a company fails to reach a unanimous decision regarding the approval of a major transaction, the board of directors (supervisory board) of the company may adopt a resolution delegating the issue of whether to approve of such major transaction to the general shareholders' meeting. In such case the decision regarding the approval of the major transaction shall be adopted by the general shareholders' meeting by a majority vote of the shareholders that own voting shares and participate in the general shareholders' meeting. (2) The decision to approve a major transaction involving property, the value of which exceeds 50% of the balance-sheet value of a company's assets, shall be adopted by the general shareholders' meeting by a three-fourths majority vote of the shareholders that own voting shares and participate in the general shareholders' meeting.

LLC Law, *supra* note 120, art. 46 provides,

(3) The decision concerning entering into a major transaction shall be made by the general meeting of participants in the company. (4) If either a board of directors or a supervisory board is established by a company, the charter of the company may refer the decision concerning the entering into major transactions related to the acquisition, or alienation, or the possibility of alienation by the company directly or indirectly of assets valued at more than 25% but less than 50% of the value of the assets of the company, to the jurisdiction of the board of directors or the supervisory board of the company.

175. See LLC Law, *supra* note 120, art. 46(6).

176. See JSC Law, *supra* note 120, art. 83(3) states,

In a company with more than 1,000 shareholders that own voting shares a decision on approving a transaction where an interest exists in its performance shall be made by the board of directors (supervisory board) of the company by a majority vote of the independent directors who do not have an interest in its performance. Where all members of the board of directors (supervisory board) of the

major and interested transactions that a few Russian companies have featured prominently in the Western press in articles describing abuse of minority shareholders.

6. *Thirty-Percent Threshold for Takeovers*

The JSC Law regulates acquisition of major positions in a JSC by requiring a party acquiring 30 percent or more of the voting shares in a JSC to offer to purchase company shares from all other shareholders at a statutorily determined price.¹⁷⁷ Failure to comply with this requirement results in limiting the voting rights of the acquirer to the number of shares purchased by such shareholder in compliance with the law.¹⁷⁸ It is possible to exclude the application of this requirement by including an express waiver in the company charter or in a shareholder resolution.¹⁷⁹

7. *A Porous Corporate Veil?*

For a foreign direct investor contemplating establishing a corporate entity in Russia, a critical area to consider is the apparent limitation in Russian law relating to the sanctity of the corporate veil. The liability of a shareholder of a JSC¹⁸⁰ or a participant in an LLC¹⁸¹ is generally limited to the amount of such shareholder's contribution to the charter capital of the company. However, under the civil code¹⁸² and under specific provisions of the JSC Law¹⁸³ and the LLC Law,¹⁸⁴ a shareholder or a participant may be exposed to subsidiary liability for a company's obligations if (1) the shareholder or participant is entitled to give binding instructions to that company or able to determine the course of action of the company by other means and (2) the shareholder's or participant's act or failure to act caused the company's insolvency. Similarly, a shareholder or participant may be jointly and severally liable for losses that arise out of transactions entered into by the company and/or any other actions taken by the company as a result of the person's binding instructions.¹⁸⁵ There is no clarity as to the meaning of the "right to give binding instructions" and "ability

company are regarded as interested persons and/or are not independent directors, the transaction may be approved by a decision of the general shareholders' meeting adopted in accordance with the procedure set forth at clause 4 of article 83. An independent director shall mean a member of the board of directors (supervisory board) of a company who is not and, during one year preceding the adoption of the decision, was not: (i) a person exercising the function of the single-person executive body of the company including the company's external manager, a member of the collegial executive body of the company, a person holding positions in the managing bodies of the external managing organization; (ii) a person whose spouse, parents, children, full and partial siblings, adopted parents and adopted children occupy posts in the above mentioned managing bodies of the company, of the company's external managing organization or are an external manager of the company; or (iii) an affiliate of the company except for a member of the board of directors (supervisory board) of the company.

177. See JSC Law, *supra* note 120, art. 80.

178. See *id.* art. 80(6).

179. See *id.* art. 80(2).

180. See *id.* art. 2(1) ("[s]hareholders shall not be liable for the obligations of the company and shall bear the risk of loss connected with its activity to the extent of the value of the shares they own").

181. See LLC Law, *supra* note 120, art. 2(1) ("[p]articipants in the company shall not be liable for its obligations and shall bear the risk of loss related to company business to the extent of the value of the respective contributions made by them").

182. See GK RF, arts. 56(3), 105.

183. See JSC Law, *supra* note 120, arts. 3(3), 6(3).

184. See LLC Law, *supra* note 120, art. 6(3).

185. See GK RF, art. 105(2); JSC Law, *supra* note 120, art. 6(3); LLC Law, *supra* note 120, art. 6(3).

to determine the course of action of the company."¹⁸⁶ However, a general principle applies that liability arises only where fault is established¹⁸⁷ in court.

These comments regarding JSC shareholder or LLC participant liability apply equally to members of the board and executive body. While these provisions generated major adverse comments from Western practitioners in Russia when they were first introduced with part 1 of the civil code in 1995, they have not proven to be a major factor for investors. Drafters of the JSC and LLC Laws, each of which appeared after introduction of part 1 of the civil code, apparently sought to mitigate the problems presented by these provisions of the civil code.¹⁸⁸ Careful drafting of charters, the widespread practice of holding shares and interests in Russian JSCs and LLCs through asset-free firebreak entities offshore, and the absence of actual resort to these provisions in the courts have drastically reduced the originally perceived significance of these provisions.

C. LABOR LAW

Russian labor law¹⁸⁹ contains elaborate proscriptions on employers and protections for employees.¹⁹⁰ An employee may be hired and put on a trial basis generally for a period of up to three months¹⁹¹ or, under certain circumstances, may be hired for a fixed term only.¹⁹² A permanent employee, however, has a number of statutorily established rights not normally found in American jurisprudence except perhaps in rules applicable to state and federal civil service employment. For example, the labor law provides for twenty-four days of annual vacation, based on a six-day business week,¹⁹³ education leave,¹⁹⁴ maternity leave,¹⁹⁵ extensive sick leave,¹⁹⁶ and substantial protection in the case of termination.¹⁹⁷ Russian law does not restrict employment of Russian nationals by foreign companies, and employment contracts governed by foreign law have been successfully used. The application of foreign law may be limited to the minimum benefit levels provided for in Russian labor law.

186. Such ability is to be determined in court on a case-by-case basis.

187. See GK RF, art. 401; Federal'nyi Zakon No. 6-FZ, Jan. 8, 1998, art. 10, Ross. GAZETA, Jan. 20–21, 1998 [hereinafter Insolvency Law]; JSC Law, *supra* note 120, art. 6(3); LLC Law, *supra* note 120, art. 6(3).

188. JSC Law, *supra* note 120, arts. 3(3), 6(3).

189. The Russian labor law regulatory framework is based upon the Kodeks Zakonov o Trade RF (Labor Code) [KZoT RF], Dec. 9, 1971 (last amended July 10, 2001) and numerous instructions issued by the Ministry of Labor and its predecessors, some of which date back to the early days of the twentieth century. A new draft Russian Labor Code has been on the agenda of the legislature for years, which regularly triggers public debate. Attempts are underway to reconcile the regulation of employment with market reforms and regulatory developments in the European Union (e.g., in the area of personal data protection).

190. See *id.* art. 5 (The underlying principle of the labor regulation in Russia is that the terms of an employment contract may not be less favorable than those established by the Labor Code.). The Labor Code purports to protect employees from unreasonable dismissal, discrimination on the basis of gender, ethnic origin, religious and political affiliation and place of residency thus reinforcing the constitutional provisions relating to human rights.

191. See *id.* arts. 21, 23.

192. See *id.* art. 17.

193. See *id.* art. 67.

194. See *id.* ch. 13.

195. See *id.* art. 165.

196. See *id.* art. 33(1.5).

197. For example, in the case of a lay off an employee is entitled to at least two-month advance notice and a severance payment of one month's wages. See KZoT RF (Labor Code), arts. 40.2, 40.3.

In practice, Russian labor law has not been an obstacle to foreign investment. Currently, Russian workers at all levels are pleased to hold a job with a viable, progressive entity, and the ranks of qualified Russian managers has led to a substantial reduction in the number of expatriate management personnel seconded to Russia since 1998.

D. JOINT VENTURES

Joint ventures first became popular in the USSR in the late 1980s when the doors for foreign investors were tentatively opened.¹⁹⁸ Today joint ventures are often used for business operations where foreign investors find it useful to work with Russian businesses. A distinctive feature of joint ventures today is the substantial degree of sophistication that has evolved in determining the rights and obligations of the parties.

A joint venture may take the form of a contract of simple partnership, which is not a legal entity.¹⁹⁹ This form of joint activity²⁰⁰ was common prior to enactment of the JSC and LLC Laws and is rarely used today. As noted above,²⁰¹ the serious shortcoming of an LLC is the absolute right of a participant to withdraw at any time. Joint ventures are thus normally structured as JSCs. While a joint venture through a JSC could be created by acquiring shares in an existing JSC, many foreign investors embarking on a joint enterprise in Russia prefer, where possible, to start with a newly organized entity with no contingent liabilities for taxes, wages, or otherwise.

VI. Competition and Anti-Monopoly Legislation

Russian anti-monopoly legislation²⁰² regulates competition in the Russian market and applies to Russia-based companies and foreign companies doing business in the Russian market. This legislation is administered by the Ministry for Anti-monopoly Policy and Support of Entrepreneurship (MAP) and prohibits monopolistic activities, including abuse²⁰³ of a dominant position,²⁰⁴ limitation of competition,²⁰⁵ and unfair competition.²⁰⁶ Russian anti-monopoly authorities²⁰⁷ focus on monitoring compliance with anti-monopoly legislation to prevent monopolization of the Russian market. Anti-monopoly legislation also identifies specific corporate activities such as acquisitions, mergers, and others²⁰⁸ that

198. See Decree 49, art. 1. On the Order of Establishment and Activities of Joint Ventures with Participation by Soviet Enterprises and Firms from Capitalist and Developing Countries, Jan. 13, 1987 (last amended Sept. 3, 1990).

199. See GK RF, art. 48.

200. See *id.* art. 1041.

201. See JSC Law, *supra* note 120.

202. Monopoly Law, *supra* note 87; Federal'nyi Zakon No. 117-FZ, Jun. 23, 1999, Ross. GAZETA, June 29, 1999 (on protection of competition in the market of financial services) [hereinafter Financial Monopoly Law], Federal'nyi Zakon No. 147-FZ, Aug. 17, 1995, Ross. GAZETA, Aug. 24, 1995 (on natural monopolies) (other provisions exist that are scattered throughout various laws as well as numerous subordinate acts of the president, government and anti-monopoly authorities).

203. See Monopoly Law, *supra* note 87, art. 5.

204. See *id.* art. 4.

205. See *id.* art. 6.

206. See *id.* art. 10.

207. Anti-monopoly authorities include the MAP and its territorial agencies; the CBR monitors the compliance of banks and other financial institutions with anti-monopoly legislation.

208. See Monopoly Law, *supra* note 87, arts. 17, 18 ("(i) approval of the merger of companies; (ii) acquisition of stakes or assets in other companies which provides control over such companies (at least 20% of shares,

either require prior consent²⁰⁹ from the MAP or must be reported subsequently.²¹⁰ Violations of anti-monopoly legislation may trigger administrative,²¹¹ civil,²¹² and criminal liability.²¹³

Russian law prescribes that the founders of a Russian LLC or JSC are required to notify the MAP of the establishment of the Russian company within fifteen days of the date of the company's registration if the aggregate amount of the balance sheet assets of its founders exceeds 100,000 times the so-called minimum monthly wage²¹⁴ (approximately \$350,000).

When acquiring an interest in an LLC or shares in a JSC results in the ownership by an acquirer of more than 20 percent of voting shares of a JSC or interests in an LLC, the acquirer will be required either to file a subsequent notice²¹⁵ with the MAP or obtain its prior consent.²¹⁶ While practitioners differ on this point, arguably, offshore transactions resulting in a change of control over indirectly held Russian companies also require such clearance. Similar clearance requirements apply to acquisitions of assets,²¹⁷ mergers,²¹⁸ and other forms of corporate restructuring. To American lawyers and businessmen the threshold for prior consent seems low. Nevertheless, to date the practice of the MAP is to collect numerous documents and then grant consent. Delays may occur if documents are not readily available or have not previously been translated into Russian, but MAP approvals are generally available on a timely basis.²¹⁹

VII. Russia's New Tax Regime

A. GENERAL

Fundamental tax reform has been taking place in Russia for the past ten years. Acts adopted in the early 1990s are now being superseded by new legislation. In 1999, part 1 of

10% of net assets, management control); (iii) creation of a company; (iv) a general director or a member of the board of directors occupies multiple positions in the management or supervisory bodies of two or more companies); Financial Monopoly Law, *supra* note 202, art. 16 (financial institutions must additionally clear any change in their charter capital).

209. *See supra* note 87, art. 18.

210. *See id.* arts. 17, 18 subsequent notification is required where combined balance-sheet value of the companies in question (i) is between 50,000 and 100,000 MMW for the purposes of merger and stakes or assets acquisition; (ii) exceeds 50,000 MMW for the purposes of occupation of management positions; and (iii) that of the founders exceeds 100,000 for the purposes of creation of a company (for "minimum monthly wage" see note 214). Financial Monopoly Law, *supra* note 202, art. 19, states that for a financial institution subsequent notification is required for any of the specified actions if its charter is below the established threshold.

211. *See id.* arts. 22, 23.

212. *See id.* art. 22-1; GK RF, art. 15.

213. Ugolovnyi Kodeks RF (Criminal Code) [hereinafter UK RF], art. 178.

214. The administratively convenient "minimum monthly wage" (MMW) is an arbitrary value, revised on a regular basis by the government that is used as a standard measure of value in many areas, such as salary, pension, social benefit payments, and establishing fines for minor driving infractions. For example, the MMW was 83.49 rubles from Jan. 1, 1997 to Jan. 1, 2000. During this period the fluctuating value of the ruble moved the value of the MMW from U.S.\$14.99 to U.S.\$2.96. The value of the MMW was increased to 100 rubles with effect from Jan. 1, 2001 (approximately \$3.50).

215. *See supra* note 208.

216. *See* Monopoly Law, *supra* note 87, art. 18.

217. *See id.* art. 18.

218. *See id.* art. 17.

219. *See id.* art. 17.

a new Russian tax code came into force.²²⁰ Effective January 1, 2001, the first four chapters of part 2 of the tax code came into effect. These chapters regulate the following taxes: value-added tax (VAT), excise tax, personal income tax, and unified social tax.²²¹ The rules established by these chapters clarify many issues connected with assessment of VAT and reduce the tax burden on individuals. Chapter 25 of the tax code, which regulates profits tax, was effective January 1, 2002. The balance of more than fifty other taxes remains uncoded. Among these are the road user's tax and taxes on the property of enterprises.

B. PROFITS TAX

As of January 1, 2002, the overall profit tax rate is 24 percent, consisting of 7.5 percent for the federal budget, 10.5 percent to 14.5 percent for the regional budget, and 2 percent for the local budget.²²²

Russian legislation still does not allow the deduction of all reasonable business expenses. It previously provided for a limited list of deductible business expenses.²²³ Moreover, for some expenses (for example, advertising expenses²²⁴ and interest on loans²²⁵) there was a cap on the deduction. However, most deductibility limitations were moderated or eliminated as of January 1, 2002.²²⁶

C. VALUE-ADDED TAX

Current changes in VAT are designed to eliminate inconsistencies and make VAT legislation consistent with worldwide practice. The rates are²²⁷

- zero percent for goods exported from Russia (except for oil, gas condensate, and natural gas exported to the member states of Commonwealth of Independent States) and precious metals sold to banks by taxpayers who extract them;²²⁸
- 10 percent for meat and meat products, grain, vegetables, seafood, and so on; and
- 20 percent for all other goods and services.

Sales of certain goods and the rendering of certain specified services are exempt from VAT (for example, certain medical goods, banking services, and operations with securities).²²⁹

220. See Nalogovyi Kodeks RF, July 31, 1998, No. 146-FZ, pt. 1 (Russ.) [hereinafter Tax Code], available at www.ey.com/global/gcr.nsf/Russia_E/Russia_Home_E.

221. See Nalogovyi Kodeks RF, Aug. 5, 2000, No. 117-FZ pt. 2 (Russ.), available at www.ey.com/global/gcr.nsf/Russia_E/Russia_Home_E.

222. See *supra* note 220, Chapter 25 of the Second Part of the Tax Code, art. 284(1). Chapter 25 of the Second Part of the Tax Code will be effective as of January 1, 2002; see Federal'nyi Zakon No. 110-FZ, Aug. 6, 2001, Ross. GAZETA, Aug. 8, 2001.

223. See On the Adoption of the Regulation On the Expenses Incurred in the Production or Sale of Products (Works, Services), Included in the Cost of Products (Works, Services), and on the Procedure of Forming Financial Results Counted for the Purposes of Profits Taxation, Sobr. Zakonod. RF, Aug. 5, 1992.

224. See *id.* § 2(s).

225. See *id.* § 2(q).

226. See Tax Code, *supra* note 220, pt. 2; see generally ch. 25 of the Second Part of the Tax Code.

227. See Tax Code, *supra* note 220, pt. 2, ch. 21, art. 164.

228. See *id.* § 1.

229. See *id.* art. 149.

D. ROAD USER'S TAX

Road user's tax is a turnover tax that is levied on the revenues of a company. It is charged at a rate of 1 percent.²³⁰ This tax is scheduled to be abolished on January 1, 2003.²³¹

E. TAX ON THE PROPERTY OF ENTERPRISES

Tax on the property of enterprises is levied on the balance sheet value of tangible and intangible assets and inventory. The maximum tax rate is 2 percent. Subjects of the Russian Federation may establish lower rates.²³²

F. PERSONAL INCOME TAX

The tax code provides for three different tax rates depending on the type of taxpayer and kind of income. A general flat tax rate of 13 percent applies to the incomes of Russian tax residents.²³³ An individual is a tax resident of Russia if present in Russia for not less than 183 days in a calendar year.²³⁴ There are exceptions to this 13-percent rate for lottery prizes, certain insurance payouts, discounted interest, and others, which are taxed at the rate of 35 percent.²³⁵ A flat rate of 30 percent applies to dividends and incomes of nonresidents.²³⁶

G. UNIFIED SOCIAL TAX

The unified social tax is a payroll tax imposed on an employer. It is charged at rates ranging from 35.6 percent to 2 percent. This lower rate is effective as of January 1, 2002. The actual rate depends on total employee compensation received annually and is as follows:

- 35.6 percent of the first 100,000 rubles;
- 20 percent of the next 200,000 rubles;
- 10 percent of the next 300,000 rubles; and
- 2 percent of all amounts in excess of 600,000 rubles.²³⁷

The unified social tax, payable by employers, became effective on January 1, 2001, and is a great improvement over the 38.5 percent flat rate previously due from an employer with respect to the entire amount of an employee's salary.

230. See *Sobr. Zakonod. RF*, 1991, No. 1759-1, Oct. 18, 1991, art. 5, § 2.

231. See The Federal Law of the Russian Federation on the Entry into Force of the Second Part of the Tax Code of the Russian Federation and the Alteration of Some Acts of the Russian Federation Concerning Taxes, No. 118-FZ, Aug. 5, 2000, art. 5.

232. See *Sobr. Zakonod. RF*, 1991, No. 2030-1, Dec. 13, 1991, art. 6.

233. See Tax Code, *supra* note 220, pt. 2, ch. 23, art. 224, § 1.

234. See *id.* pt. 1, art. 11, § 2.

235. See *id.* pt. 2, ch. 23, art. 224, § 2.

236. See *id.* pt. 2, ch. 23, art. 224, § 3.

237. See *id.* pt. 2, ch. 24, art. 241.

VIII. Tax Incentives

A. FEDERAL LAW

Before January 1, 2002, Russian tax legislation provided incentives to certain taxpayers that offered limited relief from certain taxes.²³⁸ Profits tax incentives include a deduction of up to 50 percent of taxable income for productive capital investments.²³⁹ There was also an exemption from taxation of profits derived from newly acquired manufacturing facilities that cost at least 20,000,000 rubles. This exemption was for three years or until the entire investment had been recovered,²⁴⁰ whichever occurred first. These incentives, however, are abolished as of January 1, 2002.²⁴¹

Certain small businesses and individual entrepreneurs may be exempt from VAT if they do not deal in excisable goods.²⁴² A widely used exemption from VAT applies to the import of technological equipment contributed to the charter capital of a Russian company.²⁴³

Property of certain entities, such as agricultural processing and storage facilities, *inter alia*, may not be subject to property tax.²⁴⁴ Regional and local authorities also have the right to establish other tax benefits for certain types of taxpayers.²⁴⁵

B. OTHER INCENTIVES

The right of regional and local authorities to grant tax concessions on federal taxes to the extent of payments to their budgets was previously provided in articles 1 and 10 of the Federal Law on the Fundamentals of the Tax System of the Russian Federation. These provisions were superseded on January 1, 1999, when part 1 of the tax code came into force. A new law enacted in August 2000, but effective from April 1, 1999, establishes the right of regional and local legislative bodies to grant tax concessions on the profits tax (which is a federal tax) to the extent of payments to their own regional or local budget.²⁴⁶ Regional and local authorities may also grant concessions on regional and local taxes if the law establishing such tax provides them with such power. However, tax incentives may not be of an individual character but may be established only for a particular category of taxpayers.²⁴⁷

IX. Tax Incentives Available Only to Foreign Investors

Russian legislation provides that applicable taxes on investments by foreigners and the profits received therefrom shall not be greater than the taxes imposed on Russian taxpay-

238. See *id.* pt. 1, art. 56, § 1.

239. See *Sobr. Zakonod. RF*, 1991, art. 6, § 1.

240. See *id.* art. 6, § 6.

241. See *supra* note 222; see art. 2, Federal'nyi Zakon No. 110-FZ, Aug. 6, 2001, *ROSS. GAZETA*, Aug. 8, 2001.

242. See Tax Code, *supra* note 220, pt. 2, art. 145, § 1.

243. See *id.* ch. 21, art. 150, § 1.

244. Federal'nyi Zakon No. 2030-1, Dec. 13, 1991, art. 4, *ROSS. GAZETA*, Mar. 10, 1991.

245. See *id.* art. 5.

246. See Federal Law No. 118-FZ, art. 8, § 2.

247. See *supra* note 233.

ers.²⁴⁸ While this general rule provides for national treatment of foreign investors, the Law on Foreign Investments in the Russian Federation²⁴⁹ provides for certain exclusions from this rule.²⁵⁰

The foreign investment law also contains a so-called grandfather clause, which covers federal taxes and customs duties.²⁵¹ It provides protection from subsequent adverse changes in tax legislation that would increase the overall tax burden on the activities of (1) companies with at least 25-percent foreign ownership and (2) commercial organizations with foreign investments carrying out a priority investment project.²⁵² A *priority investment project* is a project with an overall foreign investment of not less than one billion rubles (currently approximately \$34.8 million) or a project carried out by a company with foreign investment if the overall amount of foreign investment in its charter capital is at least one hundred million rubles (currently approximately \$3.4 million). In both cases, a priority investment project must be included on a list approved by the government.²⁵³ The grandfather clause protects qualifying commercial organizations for an investment recoupment period, which may not exceed seven years.²⁵⁴

On January 1, 2001, Federal Law No. 118-FZ entered into force. This law grants local authorities the right to establish an additional five-percent profits tax.²⁵⁵ Whether the grandfather clause protects against this tax is still unsettled.

X. The Double Tax Convention

The Russia-U.S. Double Tax Convention²⁵⁶ entered into force on December 16, 1993, and replaced an outdated treaty between the United States and the USSR, which had been signed on June 20, 1973. The double tax convention established certain benefits related to taxation of income and capital,²⁵⁷ which are not otherwise available under Russian law. For example, there is a 5-percent or 10-percent²⁵⁸ tax rate on dividends. This contrasts with the normal Russian rate of 15 percent for corporations²⁵⁹ and 30 percent for individuals.²⁶⁰ In addition, interest and royalties, which are earned from sources in Russia by a U.S. resident subject to Russian personal income tax, are taxed only by the United States.²⁶¹ There

248. Federal'nyi Zakon No. 160-FZ, July 9, 1999, Ross. GAZETA, July 14, 1999, art. 4, § 1.

249. See *id.* art. 2(5).

250. See *id.* art. 4, § 2.

251. See *id.* art. 9, § 1.

252. See *id.* art. 9, § 3.

253. See *id.* art. 2, § 5.

254. See *id.* art. 9, § 2.

255. See Federal Law No. 118, art. 8.

256. See Convention between the United States of America and the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, 1992 [hereinafter Double Tax Convention].

257. That is, incomes derived in Russia by American companies and individuals that do not have a permanent establishment in Russia.

258. The rate of 5% applies if the beneficial owner of dividends holds at least 10% of interest in the Russian company paying dividends. See Double Tax Convention, *supra* note 256, art. 10, § 2.

259. See Federal'nyi Zakon No. 2116-I, Dec. 27, 1991 (last amended Aug. 6, 2001), Ross. GAZETA, Mar. 5, 1992, art. 9, § 3.

260. See Tax Code, *supra* note 220, pt. 2, ch. 23, art. 224, § 3.

261. See Double Tax Convention, *supra* note 256, art. 11, § 1; art. 12, § 1.

is also an income tax credit in respect of income tax paid by residents of the United States in Russia.²⁶²

XI. Accounting

Pursuant to Russian legislation, all bookkeeping records are to be kept in the Russian language, expressed in Russian rubles,²⁶³ and maintained in accordance with Russian bookkeeping standards.²⁶⁴ At present, Russian accounting standards are undergoing massive changes to make them more consistent with international accounting standards and the needs and experience of market economy investors.²⁶⁵ Many aspects of Russian accounting have already been revised, including the following: accounting policies;²⁶⁶ accounting for intangible assets, fixed assets, income, and expenses;²⁶⁷ valuation of assets and liabilities in foreign currency;²⁶⁸ contingencies;²⁶⁹ and segment information.²⁷⁰

Effective January 1, 2002, accounting records of a Russian company must be maintained on the basis of a new chart of accounts approved by the Ministry of Finance on October 31, 2000.²⁷¹ Financial statements (the balance sheet and profit and loss accounts) must be submitted to tax authorities and the State Statistics Committee quarterly and annually.²⁷² Some entities must publish their annual financial statements in a form accessible to all interested persons.²⁷³

Every transaction entered into by a company must be evidenced by primary accounting documents.²⁷⁴ The required documents are generally specified by the State Statistics Committee. Primary accounting documents, accounting ledgers, and bookkeeping reports must be maintained for not less than five years.²⁷⁵

Most foreign investors find it convenient to have accounting and bookkeeping functions performed by a full-time Russian accountant²⁷⁶ (the chief accountant) even if they have an expatriate chief financial officer.

XII. Real Estate

The constitution establishes that land may be owned privately.²⁷⁷ This constitutional right remained unfulfilled in most of Russia because there was no land code and the relevant

262. See *id.* art. 22.

263. See Federal'nyi Zakon No. 129-FZ, Nov. 21, 1996 (last amended July 23, 1998), *ROSS. GAZETA*, Nov. 28, 1996 [hereinafter *Accounting Law*], art. 8, § 1.

264. See *id.* art. 2.

265. See *Sobr. Zakonod. RF*, 1998, No. 283.

266. See *Biull. Norm. Akt. RF*, 1998, No. 60n, Dec. 9, 1998, On the Adoption of Accounting Regulations.

267. See *id.* No. 91n, Oct. 16, 2000, On the Adoption of Accounting Regulations; No. 65n, Sept. 3, 1997 (revised Mar. 24, 2000), On the Adoption of Accounting Regulations; No. 32n, May 6, 1999, On the Adoption of Accounting Regulations; No. 33n, May 6, 1999, On the Adoption of Accounting Regulations.

268. See *id.* No. 2n, Jan. 10, 2000, On the Adoption of Accounting Regulations.

269. See *id.* No. 57n, Nov. 25, 1998, On the Adoption of Accounting Regulations.

270. See *id.* No. 11n, Jan. 27, 2000, On the Adoption of Accounting Regulations.

271. See *id.* No. 94n, Oct. 31, 2000, Concerning Approval of the Chart of Accounts for Bookkeeping for the Financial and Economic Activities of Organizations and the Instruction on the Application Thereof.

272. See *Accounting Law*, *supra* note 263, art. 15, § 2.

273. See *id.* art. 16.

274. See *id.* arts. 1(1), 9(2).

275. See *id.* art. 17(1).

276. See *id.* art. 6, § 2.

277. See *KONST. RF*, art. 36(1).

provisions of the civil code²⁷⁸ had been suspended²⁷⁹ pending adoption of such a code. On September 20, 2001, after a seven-year struggle, the State Duma passed a new land code.²⁸⁰ The Federation Council (the upper house) approved the land code on October 10, 2001.²⁸¹

Prior to the enactment of the land code, a plot of land and a building were not irrevocably linked. Buildings were owned even though situated upon land under long-term lease. The new land code establishes the principle that in the event of transfer of land, objects connected with the land follow.

Rights of ownership in real estate, their transfer, and their termination are subject to registration in a state register,²⁸² which was established only in 1998.²⁸³ Rights to real estate crystallize only upon such registration. State registration of rights to real estate and transactions involving such rights are regulated by the Real Estate Registration Law.²⁸⁴ Registration of rights established prior to the effective date of this law is not mandatory. Thus, encumbrances may exist which are not reflected in the state register. Information regarding real property rights registered with the state is publicly accessible, although not yet in electronic form.

XIII. Currency Transactions

A. GENERAL

The CBR serves a dual role.²⁸⁵ It regulates the activity of commercial banks with the power to enact normative acts (regulations) binding on legal entities, individuals and other state bodies; it is also a legal entity with the power to engage in commercial activity.²⁸⁶ Along with the federal government, the CBR is the state body responsible for exchange control.

Under Russian law there are two types of regulated currency transactions: current transactions²⁸⁷ and transactions "connected with the movement of capital."²⁸⁸ Russian legislation specifies the list of current transactions:

- (i) transfers to and from Russia of foreign currency as payment for the import and export of goods (works, services and the results of intellectual activity) and as payment connected with the providing of credit for export and import transactions for terms which do not exceed ninety days;²⁸⁹

278. See GK RF, ch. 17.

279. Article 13 of the federal statute on enacting part 1 of the civil code provides that "Chapter 17 of the Civil Code shall be put into effect from the day on which the land code of the Russian Federation adopted by the State Duma of the Federal Assembly of the Russian Federation is put into effect."

280. See ROSS. GAZETA, Sept. 21, 2001, No. 184.

281. See ROSS. GAZETA, Oct. 11, 2001, No. 198.

282. See GK RF, pt. 1, art. 131.

283. Decree of the Government of the RF, No. 288, Mar. 6, 1998, On Approval of the Model Regulations on a Justice Institution on State Registration of Rights to Real Estate and Transactions Therewith.

284. Federal'nyi Zakon, No. 122-FZ, July 21, 1997, ROSS. GAZETA, July 30, 1997 (enacted Jan. 31, 1998).

285. See LEGAL REGULATION OF BANKING ACTIVITY 20 (E.A. Sukhanov, ed. 1997).

286. Federal'nyi Zakon, No. 394-1, Dec. 2, 1990, Vedomosti S'yezda Narodnykh Deputatov RSFSR, Dec. 6, 1990, No. 27, Item 356, arts. 45, 47 (last amended Aug. 6, 2001).

287. Federal'nyi Zakon, No. 3615-1, Oct. 9 1992, ROSS. GAZETA, Nov. 4, 1992, arts. 1(9), 6(1) (last amended Aug. 8, 2001) [hereinafter Currency Control Law].

288. See *id.* arts. 1(10), 6(2).

289. See *id.* art. 1(9)(a).

- (ii) the receipt and extension of financial credit for terms not exceeding 180 days;²⁹⁰
- (iii) transfers to and from Russia of interest payments, dividends and other income on deposits, investments, credits and other transactions connected with the movement of capital;²⁹¹ and
- (iv) transfers of a non-commercial nature to and from Russia, including the transfer of wages and salaries, pensions, alimony, legacies, and similar transactions.²⁹²

Currency operations "connected with the movement of capital" include

- (i) direct investments, for example, contributions to the charter capital of enterprises to earn income and to obtain the right to participate in the management of such enterprises;²⁹³
- (ii) portfolio investments (i.e., the acquisition of securities);²⁹⁴
- (iii) cash transfers to pay for the right of ownership to buildings, facilities and other property, including land and the mineral resources thereof, which constitute real estate according to the legislation of the country in which they are located, and also for other rights to real estate;²⁹⁵
- (iv) extension of credit for payments deferred for more than ninety days and the receipt of payment therefore for exports and imports of goods (works, services, the results of intellectual activity);²⁹⁶
- (v) the extension and receipt of financial credits for a term exceeding 180 days;²⁹⁷ and
- (vi) any other currency transaction that is not a current currency transaction.²⁹⁸

Movement-of-capital transactions and current transactions are subject to very different rules. Russian law provides that current currency operations of residents do not need a license from the CBR. Currency operations connected with the movement of capital, which include all transactions not otherwise defined as current, must be performed in accordance with procedures established by the CBR.²⁹⁹ As a general rule, movement-of-capital transactions by Russian residents, including legal entities owned by non-Russian residents, may be performed only when a resident has a license issued by the CBR. Nevertheless, there are some operations connected with the movement of capital that are exempt from the licensing regime (for instance, charter capital contributions by nonresidents in foreign currency and transfers by residents in payment for insurance premiums to nonresident insurers).³⁰⁰

290. *See id.* art. 1(9)(b).

291. *See id.* art. 1(9)(c).

292. *See id.* art. 1(9)(d).

293. *See id.* art. 1(10)(a).

294. *See id.* art. 1(10)(b).

295. *See id.* art. 1(10)(c).

296. *See id.* art. 1(10)(d).

297. *See id.* art. 1(10)(e).

298. *See id.* art. 1(9)–(10).

299. *See id.* art. 6(2).

300. *See* Buill. Norm. Akt. RF, No. 02–94, Apr. 24, 1996, On Approving the Regulations on the Change of the Procedure for Performing Certain Types of Currency Operations in the Russian Federation; Instruction of the Central Bank No. 660-U, Oct. 8, 1999, On the Procedure for Performance of Currency Operations Connected with the Attraction and Return of Foreign Investments; Instruction of the Central Bank No. 611-U, July 21, 1999, On the Procedure for Currency Operations Connected with Donation and the Waiver of Debt.

New rules on the opening of nonresident ruble accounts were announced in the fall of 2000 and came into effect in March 2001.³⁰¹ Under these rules, authorized Russian banks³⁰² may open three types of ruble accounts for nonresidents. These are (1) type K accounts (a convertible account); (2) type N accounts (a nonconvertible account), which are for both legal entities and individuals; and (3) type F accounts for individuals.³⁰³ The kinds of operations that may be effected through the above-mentioned accounts are described in schedule 1 to Instruction No. 93-I.³⁰⁴

B. REPATRIATION OF PROCEEDS

There exists a general repatriation rule providing that all foreign currency proceeds of Russian residents must be credited to their accounts with authorized banks in the Russian Federation unless the CBR specifically authorizes otherwise.³⁰⁵

C. MANDATORY CURRENCY CONVERSION

There is also a mandatory currency conversion requirement providing that 50 percent of a Russian resident's foreign currency proceeds from the export of goods is subject to compulsory sale through authorized banks on the domestic Russian market. The conversion must be performed within seven days following receipt by a resident of such foreign currency proceeds.³⁰⁶

There are no prohibitions on Russian residents, including legal entities that are owned by foreign investors and are incurring foreign currency obligations. Most importantly, there is no relationship between the amount of foreign currency a Russian resident may purchase with rubles and the amount of foreign currency his business operations generate.

XIV. Dispute Resolution

There are two parallel Russian court systems of interest to foreign investors: the regular civil courts and the arbitrazh courts. Arbitrazh courts have been especially established to hear commercial disputes. Despite the name *arbitrazh*, these are courts, not venues for commercial arbitration.³⁰⁷ An alternative forum in Russia where a foreign party is involved

301. Instruction of the Central Bank of the Russian Federation, No. 93-I, On the Procedure for Opening Russian Currency Accounts for Nonresidents by the Authorized Banks and the Procedure for Operations on such Accounts, Oct. 12, 2000, § 7.1.

302. *Id.* § 1.1 (1.1.2).

303. *See id.* § 1.2

304. *See id.* Schedule 1.

305. *See* Currency Control Law, *supra* note 287, art. 5(1).

306. *See* Currency Control Law, *supra* note 287, art. 6. The procedure for mandatory sale is established by Instruction of the Central Bank, No. 80-I, On the Procedure for Mandatory Sale of Currency Proceeds from the Export of Goods by Legal Persons-Residents, Making Recovery of Loans and the Record of Operations by Authorized Banks, Connected with the Performance of Legal Persons-Residents' Obligations under Loan Agreements, Apr. 6, 1999.

307. According to Section 3 of Article 4 of the Federal Constitutional Law of the Russian Federation, No. 1-FKZ, On the Court System of the Russian Federation, Dec. 31, 1996, "the Supreme Arbitrazh Court, circuit arbitrazh courts and arbitrazh courts of the subjects of the Russian Federation which form the system of arbitrazh courts" have the legal status of federal courts.

is arbitration under the auspices of the International Commercial Arbitration Court of the Chamber of Commerce and Industry.

The USSR was party to the 1958 New York Convention.³⁰⁸ Russia has succeeded to these arrangements,³⁰⁹ and there has been some success in enforcing foreign arbitral awards in Russia. Such enforcement is not a simple process and, as described earlier, arbitral awards inconsistent with Russian public policy³¹⁰ are not enforceable. Given the short history of modern Russia, predicting which aspects of public policy may preclude enforcement of foreign arbitral awards under the 1958 New York Convention has not proved straightforward. For that reason and to avoid the significant delays and costs of foreign arbitration, more and more foreign investors are opting for direct access to Russian courts. Lower level judges are not yet sophisticated in dealing with commercial disputes. There is no discovery, as American lawyers know it, involved in Russian litigation. Proceedings are relatively quick, especially when compared to arbitration or crowded American court dockets, and foreign litigating parties find that the right result is normally obtained.

XV. Secured Landing

A. GENERAL

While Russia's domestic banking system has hardly begun to develop into anything like a traditional market economy mechanism for recycling savings into productive loans, foreign banks and a few Russian banks are active in secured lending into Russia principally through secured pre-export financing and other comparable mechanisms.

As noted,³¹¹ it is possible for a Russian entity to enter into a security arrangement under foreign law. With a few caveats,³¹² there is no prohibition in Russian law against a foreign party taking security over an asset situated in Russia or owned by a Russian party in a manner provided by foreign law. However, to avoid problems of enforcement in Russian courts, lenders often find it preferable to establish security arrangements under Russian law since Russian courts and other authorities³¹³ are more familiar with Russian methods of taking security. Another reason for the use of such Russian security is that in bankruptcy, preferred creditor status may not be achieved if a non-Russian pledge is used. Current practice is that parties to cross-border finance transactions will use a Russian law pledge over property or bank accounts³¹⁴ and will often take foreign law security assignments over receivables. Security for performance of obligations is regulated by the civil code,³¹⁵ the Law on Pledge, dated May 29, 1992, the Mortgage Law, and a few other laws.³¹⁶

308. Russia is a party to the 1980 Vienna Convention on the Contracts of International Sale of Goods and the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitration Decisions. The USSR signed the New York Convention on Dec. 29, 1958. The Convention was ratified by the Decree of the Supreme Council of the USSR of August 10, 1960.

309. The Note of the Ministry of Foreign Affairs of the Russian Federation of Jan. 12, 1991, No. 11/Ugp.

310. See Muranov, *supra* note 114.

311. See BOGUSLAVSKY, *supra* note 112.

312. See [Fundamentals, art. 165 of which provides that the "form of the agreement" of pledge of immovable property needs to be under Russian law].

313. E.g., notaries, bailiffs.

314. See *infra* note 342.

315. See GK RF, ch. 23.

316. Federal'nyi Zakon No. 119-FZ, July 21, 1997 (amended by decision of the Constitutional Court, RF No. 13-P of July 30, 2001), ROSS. GAZETA, Aug. 5, 1997.

The civil code provides that performance of obligations may be secured by pledge,³¹⁷ suretyship,³¹⁸ bank guarantee,³¹⁹ deposit,³²⁰ retention of the debtor's property (lien),³²¹ penalty, or by such other means as provided for by law or contract.³²² The most commonly used means of effecting security in Russia are described in the upcoming sections.

B. PLEDGE

A Russian pledge provides the pledgee with a right in the property pledged, which is good against persons other than those who are parties to the pledge contract.³²³ As a result, if the pledged property is sold, the rights of pledge do not end, but follow the property. A Russian law pledge may thus be said to create rights that attach to the asset itself and is not merely a claim against the initial owner of the asset. Under Russian law, this principle is not affected by the fact that a subsequent purchaser of property subject to a pledge is a good faith purchaser who acquires the property for value.³²⁴

1. *Priority of Claims*

Priority for satisfying claims of creditors upon the liquidation of a legal entity is established by the civil code³²⁵ and by the Insolvency Law.³²⁶ Secured creditors holding a valid pledge of property of an insolvent legal entity are third in line (fourth if the entity is a bank because of the priority given to depositors³²⁷) since, in Russia, individuals with claims relating to (1) health and personal injuries and (2) severance and employment related obligations³²⁸ have priority over secured creditors. However, properly secured claims have priority over claims of the state for profits tax or payments owed by an employer to the state in the nature of social security obligations. In practice, once a debtor has been declared insolvent by a court, all property is included in a pool of assets, and following satisfaction in full of prior claims, secured creditors are satisfied out of the entire pool.³²⁹

2. *Property That Can Be Pledged*

The civil code provides that almost anything can be pledged except (1) assets removed from circulation (property withdrawn from circulation is that which is stipulated to be so by law), and (2) claims of a personal nature that cannot be assigned, such as payments in compensation for tort.³³⁰ Generally, if one can sell it, one can pledge it.

3. *Mortgage*

The civil code provides that a mortgage is a specific form of pledge. Thus, a mortgage is a pledge of land, an enterprise, a building, an apartment, or other form of "immovable

317. See GK RF, pt. 1, art. 334.

318. See *id.* art. 361.

319. See *id.* art. 368.

320. See *id.* art. 380.

321. See *id.* art. 359.

322. See *id.* art. 330(1).

323. See *id.* art. 353(1).

324. See *id.* art. 302(1).

325. See GK RF, art. 64(1).

326. Insolvency Law, *supra* note 187.

327. See GK RF, art. 64(1).

328. See *id.* art. 64(1).

329. See Insolvency Law, *supra* note 187, arts. 103(1), 109(3).

330. See GK RF, art. 336(1).

property.³³¹ The definition of *immovable property*³³² also includes aircraft, ships, outer space objects, and what American real property law broadly recognizes as *fixtures*.³³³

4. *Perfection of Pledge*

To be valid, a Russian pledge must be in writing³³⁴ and must specifically identify the item pledged, the value of the item pledged, and details of the obligation secured.³³⁵ Failure to include one or more of the required items renders the pledge invalid.³³⁶

Generally, immovable property and transactions involving immovable property are subject to state registration. Hence, Russian law requires a mortgage contract be registered in the uniform state register of rights to immovable property.³³⁷ However, since Russian law does not provide an exhaustive list of property subject to state registration, one must determine in each case whether the property to be pledged is registered and whether it is necessary to register the pledge.

The general principle is that a contract of pledge is concluded at the time the contract is executed unless the pledge is subject to registration.³³⁸ A pledge subject to state registration, which includes all mortgages, is effective only upon registration.³³⁹ A pledge may exist only if it is not prohibited by a prior pledge agreement. If such a prohibition exists, any subsequent pledge may be declared invalid. A mortgage is a public transaction. Therefore, an interested party can acquire evidence of registration³⁴⁰ and be in a position to know whether the property was previously mortgaged. Priority is established strictly by reference to the time of state registration.³⁴¹

Notarial certification is required for a mortgage contract.³⁴² Failure to certify a mortgage contract results in its invalidity.³⁴³ A pledge of movable property or rights to such property is also subject to notarial certification if the obligation secured thereby requires such certification.³⁴⁴ Currently notarial certification requires payment of a fee of 1.5 percent of the value of the contract.³⁴⁵

5. *Parties to a Pledge*

Under Russian law the pledgor may be either the debtor under the principal obligation that is being secured or a third party.³⁴⁶ If the security is granted by a third party, there may

331. *See id.* art. 334(2).

332. *See id.* art. 130.

333. *See id.* art. 130(1).

334. *See id.* arts. 334(3), 339(2).

335. *See id.* art. 339(1).

336. *See id.* art. 339(4).

337. *See id.* art. 339(3).

338. *See id.* art. 425(1); *see also* Federal'nyi Zakon No. 102-FZ, July 16, 1998, On Mortgage, *ROSS. GAZETA*, July 22, 1998 [hereinafter Mortgage Law], art. 10(2).

339. *See* Federal'nyi Zakon, No. 2872-1, May 29, 1992, art. 11; *see also* Mortgage Law, *supra* note 338, art. 10(2).

340. *See* Mortgage Law, *supra* note 338, art. 26.

341. *See id.* art. 43(1).

342. *See* GK RF, art. 339(2).

343. *See id.* art. 339(4).

344. *See id.* art. 339(2).

345. Federal'nyi Zakon No. 226-FZ, Dec. 31, 1995, *ROSS. GAZETA*, Jan. 12, 1996 (last amended Aug. 7, 2001).

346. *See* GK RF, art. 335(1).

be an interested-party issue under the JSC Law or the LLC Law.³⁴⁷ In one case, the Supreme Arbitrazh Court held that a pledge agreement concluded by a third party securing the obligation of an unconnected company resulted in a gift of property, which is prohibited between commercial entities in Russia.³⁴⁸ This issue remains unsettled.

The pledgor must be the owner of the property or a person who has the property under a "right of economic management."³⁴⁹ Obviously, failure to own the pledged property makes the pledge agreement invalid. However, a pledge may be created over after-acquired property—that is, property that is not owned by the pledgor at the time the pledge is created but becomes owned by the pledgor at a later date.³⁵⁰ In this case the pledge is effective only when the pledgor becomes the owner of the after-acquired property.

6. *Enforcement of a Pledge*

The exclusive remedy available to a secured creditor on enforcement of a pledge of property is sale of the asset at a public auction.³⁵¹ Self-help remedies such as exercising a power of sale or taking possession of a secured asset are not available. The involvement of a court and a bailiff in a sale of secured assets is also required in certain circumstances, and significant delays may be encountered.³⁵² In addition, enforcement is available only if the debtor has materially failed to perform the obligation for which it is responsible, and the amount of the pledgee's claim is not "manifestly disproportionate to the value of the pledged property."³⁵³ This limitation means that some events of default typically included in financing documents may not give rise to a right to levy execution.

When levying execution against immovable property, a court decision is required unless the parties conclude, *after* the debtor's failure to perform, a notarially certified agreement providing that the levying of execution may be performed without a court decision.³⁵⁴ If the pledge is of movable property, execution against such property must occur pursuant to a decision of a court unless the pledgor and pledgee have agreed to another method of levying execution.³⁵⁵ There is no prescribed time for when such an agreement needs to be concluded. Thus, it is possible for the parties to agree in the pledge agreement that the levying of execution against the relevant movable property may occur without court proceedings.

It should be noted that Russian law contains restrictions on a nonresident's ability to receive and convert rubles. This restriction needs to be borne in mind when security is taken by way of a Russian law pledge since the enforcement of such security would normally result in ruble proceeds.

7. *Pledge of Cash Deposits/Bank Accounts*

Many secured finance structures involve taking security over bank accounts of a debtor. However, the Supreme Arbitrazh Court has held in a number of decisions³⁵⁶ that money

347. See *supra* note 171.

348. See Decree of the Russian Supreme Arbitrazh Court, No. 7422/97, Mar. 10, 1998.

349. See GK RF, art. 335(2).

350. See *id.* art. 340(6).

351. See *id.* art. 350(1).

352. See, e.g., GK RF, art. 350(2) ("on request of the pledgor, the court has the right in a decision on levying execution on the pledged property, to postpone its sale at public auction for the period of up to one year").

353. See *id.* art. 348(2).

354. See *id.* art. 349(1).

355. See *id.* art. 349(2).

356. See, e.g., Resolution of the Supreme Arbitrazh Court of the Russian Federation, No. 7965/95, July 2, 1996.

cannot be the subject of a pledge. The rationale for these decisions is that money cannot be sold at public auction and an auction is the only permitted mechanism for enforcement of a pledge. To accommodate these decisions, pledges of accounts are now being structured as a pledge of the pledgor's rights to such accounts. However, it is not yet certain that this distinction will be recognized by Russian courts.

8. *Shared Security*

There is no concept of either a security trustee or a security agent in Russian law. Therefore, security for several beneficiaries or a changing group of beneficiaries is not generally available without either assigning the benefit of such security or using a parallel debt structure, under which another parallel obligation of a debtor is created in favor of an agent acting as a security trustee for all members of a syndicate.

C. SURETYSHIP

Suretyship under Russian law is a form of guarantee provided by non-credit organizations. The essence of suretyship is that a surety is liable in full or in part to the creditor of another person for the performance of an obligation of such other person.³⁵⁷ If a debtor under an obligation secured by suretyship fails to perform, the surety is liable to the creditor to the same extent as the debtor unless otherwise provided by the contract of suretyship.³⁵⁸ If the secured obligation involves payment in hard currency, the requirements of Russian currency control legislation will need to be considered.

The express consent of a surety is required for any change in the scope of a secured obligation.³⁵⁹ Failure to secure such consent permits a challenge to the validity of the suretyship. This is the case even when the underlying obligation grants its parties the unilateral right to change or amend its terms and the surety is aware of such right.³⁶⁰ A surety that has satisfied the obligation of a debtor acquires the creditor's rights under such obligation and can claim from the debtor the amounts paid to the creditor plus compensation for all other losses incurred in connection with performing the debtor's obligations.³⁶¹

XVI. Criminal Law

Russian criminal law is governed by the constitution,³⁶² the criminal code,³⁶³ and the criminal procedural code.³⁶⁴ Criminal liability in Russia does not extend to legal entities but only to individuals of appropriate age and mental capacity.³⁶⁵

The criminal code provides for criminal liability for certain kinds of business activities.³⁶⁶ Under Russian law, crimes in the area of business and economics include, among many others, the following, which could be of concern to foreign investors:

357. See GK RF, art. 361.

358. See *id.* art. 363(2).

359. See *id.* art. 367(1).

360. See *id.*

361. See *id.* art. 365(1).

362. See KONST. RF, arts. 49 (presumption of innocence), 47(2) (right to a jury trial), 48 (right for advocacy). See also *id.* arts. 50, 51.

363. See UK RF, *supra* note 213.

364. Ugolovno-Protsessual'nyi Kodeks RF (Code of Criminal Procedure) [hereinafter UPK RF].

365. See *id.* art. 19.

366. See *id.* ch. 22 (on business-related crimes).

- unlawful entrepreneurial activity, such as operating without a required license;³⁶⁷
- production, purchase, storage, transportation, or sale of unmarked goods;³⁶⁸
- unlicensed banking activity;³⁶⁹
- money-laundering or other fraudulent acquisition of assets;³⁷⁰
- acquisition or sale of property knowingly obtained in a criminal manner;³⁷¹
- fraudulent securing of a loan;³⁷²
- deliberate evasion of repayment of debts;³⁷³
- abuse of a monopolistic economic position or restricting competition;³⁷⁴
- extortion and duress in entering into contracts;³⁷⁵
- illegal use of a trademark³⁷⁶ or of state certification marks;³⁷⁷
- false advertising;³⁷⁸
- illegal procurement of commercial or banking secrets;³⁷⁹
- utilizing a fraudulent prospectus in connection with issuing securities;³⁸⁰
- counterfeiting credit or debit cards and other payment documents;³⁸¹
- illegal import of goods;³⁸²
- illegal export of technology or of scientific and technical information and services, materials, and equipment that may be used for the purposes of creating weapons of mass destruction, armaments, and military hardware, the export of which is restricted;³⁸³
- illegal sale of precious metals, precious stones, or pearls;³⁸⁴
- violation of rules for handing over precious metals and precious stones to the state;³⁸⁵
- failure to comply with rules regarding the repatriation of foreign currency from abroad;³⁸⁶
- evasion of payment of required customs duties;³⁸⁷
- bankruptcy fraud;³⁸⁸
- fictitious bankruptcy;³⁸⁹

367. *See id.* art. 171.

368. *See id.* art. 171(1)

369. *See id.* art. 172.

370. *See id.* art. 174.

371. *See id.* art. 175.

372. *See id.* art. 176.

373. *See id.* art. 177.

374. *See id.* art. 178.

375. *See id.* art. 179.

376. *See id.* art. 180.

377. *See id.* art. 181.

378. *See id.* art. 182.

379. *See id.* art. 183.

380. *See id.* art. 185.

381. *See id.* art. 187.

382. *See id.* art. 188.

383. *See id.* art. 189.

384. *See id.* art. 191.

385. *See id.* art. 192.

386. *See id.* art. 193.

387. *See id.* art. 194.

388. *See id.* art. 195.

389. *See id.* art. 197.

- tax evasion;³⁹⁰ and
- consumer fraud.³⁹¹

XVII. Conclusion

The current Russian legal environment is certainly one in which American companies may and, in fact, do thrive. Notwithstanding crisis headlines and alarming sound bites, the new Russia is working. Experience over the past ten years has confirmed that there is no simple, straightforward way to convert a command economy that is dominated by military-oriented production into a consumer-oriented market economy. It is now evident that it is not just the collapse of a wall, the voluntary, peaceful dissolution of a nuclear superpower, or even the well intentioned efforts of many erudite Western academicians that create a functioning market economy based upon the rule of law. Progress in the new Russia to date has required—and further progress toward a prosperous market economy in the new Russia will continue to require—the incessant efforts of many millions of democratically inclined consumers, voters, business leaders, legislators, lawyers, and government officials.

One should recall that the successful consumer economy in the United States did not develop overnight, and notwithstanding its current effectiveness, U.S. legislation is revised regularly. It should be further noted that despite experienced, sophisticated, well funded enforcement personnel, scandals and abuse emerge regularly in the U.S. economy. The many American-based companies successfully doing business in Russia have found that the legal basis for a favorable business climate already exists in Russia.

390. *See id.* art. 198.

391. *See id.* art. 200, which states criminal liability for false measurement, false weighting, cheating, and deceiving customers regarding properties or the quality of goods (services), or any other deception of customers by organizations selling goods or rendering services to people, or by individuals registered as entrepreneurs in the sphere of trade (services) if these deeds have been committed on a large scale.