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Bruce W. Bean

Evgeniva Shpak

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The Russian Federation

BRUCE W. BEAN AND EVGENIYA SHPAK*

I. Overview

The year 2001 was the best yet for legal reform in Russia. Legislation introduced by President Putin's administration in 2001 was designed to make Russia more attractive to both domestic and foreign investors. The State Duma enacted more than 160 bills in the 2001 spring and autumn sessions, which reduced taxes, introduced private ownership of land, redefined labor relations, encouraged private pension funds, addressed money laundering, reorganized the judiciary, and streamlined registration of new businesses. This article briefly summarizes the most important of these developments.

II. Land Reform

Russia's decade-long struggle over the sale of land was in large part resolved on October 30, 2001 when the new Land Code¹ became effective. While the Land Code does not regulate the sale of agricultural land or forests, it does authorize sales of land totaling twenty-five times the size of Connecticut. This includes virtually all of Russia's urban industrial, office, and residential buildings. Since the market reforms of the 1990s, ownership of buildings and in a few areas land has been permitted by domestic and foreign parties without any important restriction. Even though there have been no real problems with owning a building on leased land, the Land Code now expressly permits ownership of the land.

Generally, under the Land Code individuals and legal entities may acquire title to land owned by the state or municipalities. The payment for this land is based on the land tax rate and calculated according to a formula established by law. Individuals and legal entities

*Bruce W. Bean is Of Counsel to the law firm of Clifford Chance. Mr. Bean has lived and worked in Moscow for the past eight years handling Foreign Direct Investment into Russia and, more recently, advising major Russian companies on their activities outside Russia. He is the former Chairman of the American Chamber of Commerce in Russia and a Director of Russia's Institute for Corporate Law and Governance. Evgeniya Shpak is a lawyer at Clifford Chance in Moscow. A member of Clifford Chance's corporate team, she works on joint ventures, share acquisitions and other corporate projects. Evgeniya graduated from Moscow State University in 2001, majoring in Civil Law, and is currently continuing her Ph.D. studies.

1. The Land Code of the Russian Federation No. 136-FZ, Oct. 25, 2001, GARANT 12024624.

owning buildings or industrial facilities on land owned by others have a right of first refusal to buy or lease such plots of land. If such buildings or industrial facilities are located on land owned by the state or a municipality, the owners of such buildings or industrial facilities have the exclusive right to purchase or lease it. With the exception of land located near border regions, foreign individuals and legal entities may sell, mortgage, lease, or otherwise dispose of land on an equal footing with Russian citizens and legal entities.

With the entry into force of the Land Code, Chapter 17 of the Civil Code, which regulates the rights to land, use of land, and transactions with land, came into force, except as regards agricultural land.

III. Company Law

A. REGISTRATION OF LEGAL ENTITIES

The Law On State Registration of Legal Entities (the "Registration Law")² became effective on July 1, 2002. The Registration Law regulates the registration of new and reorganized legal entities, as well as the registration of legal entities undergoing liquidation. Previously both federal and local authorities performed company registration. Now the power to register legal entities vests solely in the Federal Ministry of Tax and Duties.³ Under the Registration Law, registration must be completed within five days after all documents are filed. This is designed to streamline a process that formerly took four weeks or more.

B. AMENDMENTS TO THE JOINT STOCK COMPANY LAW (the "JSC Law")

On August 7, 2001, President Putin signed into law substantial amendments to the JSC Law,⁴ which came into full force on January 1, 2002. Seventy-six of the ninety-four articles of the JSC Law were changed. The most significant portion of these amendments is specifically designed to prevent shareholder abuse. Important amendments concern the majority vote requirements at a general shareholders' meeting. The JSC Law now strictly limits the cases requiring 75 percent of the votes by the cases specified in the JSC Law. In all other cases a simple majority (50 percent plus one vote) is sufficient. Further, a company's charter may no longer establish a greater percentage for all these cases.

The amendments introduce the concept of fractional shares. Such shares may be created as a result of (i) exercising of a right of first refusal in a closed stock company, (ii) exercising of a preemptive right to purchase new shares, or (iii) consolidating of shares. Prior to the amendments, a company purchase of fractional shares following such actions was mandatory.

The amended JSC Law now more effectively protects shareholders against dilution of their percentage of ownership through company issuance of new shares. The law grants preemptive rights to existing company shareholders to protect their proportion of ownership. Further protection is provided by prohibiting any waiver of this preemptive right, whether by shareholder vote or otherwise. A closed subscription (an offering of shares to a specified class of offerees) must be approved by at least 75 percent of shareholders attending

2. Federal Law On State Registration of Legal Entities No. 129-FZ, Aug. 8, 2001, GARANT 12023875.

3. By Regulation No. 139 of the Government of the Russian Federation, May 17, 2002, amended Aug. 17, 2002, The Federal Ministry of Tax and Duties was appointed the authority responsible for registration of legal entities.

4. Federal Law On Amendments And Additions to the Federal Law On Joint Stock Companies No. 120-FZ, Aug. 7, 2001, GARANT 12023866.

a general meeting. Those shareholders voting against such a transaction have the right to purchase new shares pro rata to their shareholdings even though they are not part of the designated class of offerees. Also, preemptive rights now are available in open subscriptions.

Another amendment provides that when a company wishes to issue new shares constituting or convertible into more than 25 percent of its common shares, this must be authorized by a vote of 75 percent of the shareholders participating in a shareholders meeting, unless the company charter imposes a higher voting threshold. As noted, shareholders will have the right to protect their existing proportion of ownership whenever such an offering is authorized.

Attacking one further area of abuse, the new amendments provide that in a reorganization involving a spin-off of a new company or the dividing of the company into two or more new companies, a shareholder voting against such a proposal or who does not participate in the voting must receive a pro rata portion of the shares of the newly formed entity(ies).

In the many amended articles of the JSC Law are other improvements that benefit non-controlling shareholders and generally enhance the corporate governance environment. These include: enhanced access to shareholder lists and accounting records, the right to nominate candidates for board and management positions, and an easing of the requirements for removing a company's general director/CEO.

C. DEPOSITORY RECEIPTS

On March 13, 2001, the Federal Commission for the Securities Market of the Russian Federation (FCSM) issued Resolution No. 3⁵ relating to American and global depository receipts. This Resolution specifies the procedure according to which securities of Russian issuers may circulate outside of the country in the form of depository receipts. The Resolution states that such circulation may take place only with the permission of the FCSM. The Resolution contains an exhaustive list of the grounds on which the FCSM may decline such permission. The most interesting ground is that permission may be denied if a depository agreement provides for the possibility of exercising voting rights conferred by shares, represented by depository receipts, other than in accordance with the specific instructions of the owners of such receipts.

D. LICENSING OF ACTIVITIES

A new Law on Licensing of Certain Types of Activity (the "Licensing Law")⁶ came into force on February 10, 2002. The Licensing Law restates a similar 1998 law but significantly reduces the number of activities that are subject to government licensing. Licensing is not required now for many formerly regulated activities. The Licensing Law also extends the minimum term of validity for which a license is issued from three to five years.

IV. Tax Law

A. AMENDMENTS TO THE TAX CODE OF THE RUSSIAN FEDERATION

One of the most important developments in 2001 was a significant cut in Russia's corporate income tax rate. Russia's flat personal income tax rate of 13 percent, which became effective January 1, 2001, is now joined by a corporate profit tax of only 24 percent, down

5. Decision of the Federal Commission for Securities Market No. 3, Mar. 13, 2001, amended Apr. 17, 2002, GARANT 12022685.

6. Federal Law On Licensing of Certain Types of Activity, No. 128-FZ, Aug. 8, 2001, amended Mar. 13 and 21, 2002, GARANT 12023874.

from 35 percent. While the rate obviously improves the overall Russian investment climate, it has a significant negative impact on tax incentives previously offered by Russia's regions. Under the new regime, regional governments will no longer be able to reduce their portion of the profit tax to nearly zero, a policy that was successfully followed in the past by certain governors to make their regions more attractive to investors. Under the new legislation, regional governments may only reduce their portion of this tax by four percentage points, from 14.5 percent to 10.5 percent.

V. Currency Regulation

A. AMENDMENTS TO THE LAW ON CURRENCY REGULATION AND CURRENCY CONTROL

Certain amendments to the Law On Currency Regulation and Currency Control⁷ became effective on July 6, 2001. The amendments liberalized a number of currency operations for Russian residents. One of the most important of these amendments allows resident individuals to transfer foreign currency to and from the Russian Federation in an amount of up to \$75,000 per calendar year to acquire foreign securities. Russian residents also now have the right, without seeking permissions from the Central Bank of Russia, to pay for the export of certain goods, so long as such goods are paid for within three years. Furthermore, Russian residents have the right to pay premiums and necessary compensation under insurance and reinsurance contracts, if the terms of these contracts do not exceed five years.

In another important change, on August 10, 2001, the percentage of foreign currency received in an export transaction, which must now be converted to rubles, was reduced from 75 percent to 50 percent.

B. REGULATIONS OF THE CENTRAL BANK OF RUSSIA

During 2001, the Central Bank of Russia issued a substantial number of liberalizing regulations dealing with foreign currency operations.

Central Bank Regulation No. 157-P⁸ added to the list of settlements in foreign currency between Russian residents and non-residents that can be made without a license. These include payments by non-residents to Russian residents for services, if they constitute prepayment or are made within ninety days of the provision of such services. It also includes payments by Russian residents to non-residents for services, if prepayment is made no more than ninety days before the provision of the services or payments are made at any time after such services are provided.

Central Bank Regulation No. 152-P⁹ eliminated the need for a license for foreign currency transfers from non-residents to Russian resident legal entities when purchasing or renting real estate located in Russia. It also eliminated foreign currency transfers by Russian residents to purchase Eurobonds issued by Russian issuers, and payments in foreign currency by Russian residents under suretyship contracts, which secure certain obligations.

7. Federal Law On Amendment and Additions to the Law of the Russian Federation On Currency Regulation and Currency Control No. 72-FZ, May 31, 2001, GARANT 12023175.

8. Regulation of the Central Bank of Russia No. 157-P On Order of Settlements Between Residents and Non-Residents Under Works Contracts, Services Contracts or Contracts on Transfer of Intellectual Property Rights, Oct. 24, 2001.

9. Regulation of the Central Bank of Russia No. 152-P, Sept. 17, 2001, GARANT 12024546.

VI. Money Laundering

In May 2001, Russia ratified the Convention on Money Laundering of 1990. This brings Russian law into line with international standards and procedures to combat money laundering.¹⁰ On February 1, 2002, the Law On Countermeasures to Legalization (Laundering) of Illegally Received Incomes¹¹ took effect. This law establishes the basis for regulating money laundering. It provides that certain operations with monetary funds or other assets are subject to control of the Committee on Financial Monitoring (CFM),¹² if the amount of the transferred funds exceeds 600,000 rubles (approximately \$19,500). The CFM requests information for transactions involving a jurisdiction that either is known as a territory where narcotics are illegally produced, or does not disclose or provide information at the time financial operations are performed. This law also imposes reporting obligations on banks and certain of their employees who are suspected of money laundering activities.

VII. Part III of the Civil Code of the Russian Federation

Part III of the Civil Code of the Russian Federation,¹³ effective March 1, 2002, replaced certain chapters of the 1964 Civil Code. Part III of the Civil Code introduces new regulation of inheritance and international private law issues. The general rule regarding the execution of wills is that they must be notarized or otherwise certified in accordance with the law. Part III of the Civil Code authorized holographic wills executed in an emergency situation, if such wills were witnessed by two persons and subsequently confirmed by a court. Part III of the Civil Code also changes prior law by extending general inheritance rules to cover inheritance of all bank accounts.

VIII. New Labor Legislation

The new Labor Code of the Russian Federation¹⁴ came into force on February 1, 2002. Thoroughly modernizing Russia's 1971 Labor Code, the new Labor Code is a welcome and significant improvement of the investment climate in Russia. This new code strikes a better balance between the interests of all types of employers and employees.

The Labor Code provides an extended list of new grounds for unilateral termination of labor contracts by the employer (e.g., disclosure by the employee of a commercial secret, presentation by employee of falsified documents, or information when concluding the labor contract). The Labor Code provides grounds for terminating labor contracts with the chief executive officer (CEO) or his deputies. In the event of a change of the "owner of the company's properties," the new owner shall be entitled to terminate labor contracts with the company's CEO, his deputies, and the chief accountant. In practice, "change of the owner of the company's properties" implies the change of title to the company's shares or interests in a limited liability company.

10. Federal Law No. 62-FZ On Ratification of the Convention On Laundering, Search, Seizure and Confiscation of the Proceeds From Crime, May 28, 2001.

11. Federal Law On Countermeasures to Legalization (Laundering) of Illegally Received Incomes No. 115-FZ, Aug. 7, 2001, amended July 25, 2002, GARANT 12023862.

12. The Committee on Financial Monitoring was established by Order of the President of the Russian Federation No. 1263, Nov. 1, 2001, GARANT 83888.

13. Civil Code of the Russian Federation, Part III, No. 146-FZ, Nov. 26, 2001, GARANT 10064072.

14. Labor Code of the Russian Federation No. 197-FZ, Dec. 30, 2001, GARANT 12025268.

Under existing practice, a labor contract is effective for an indefinite period. In another important innovation, the Labor Code sets out an extended list of instances when a fixed-term labor contract may be concluded, such as with the CEO, his deputies and the chief accountant and with employees of small enterprises (with fewer than forty employees). If a contract is concluded for a fixed term without good cause, as determined by federal labor inspectors or a court, or so as to avoid granting the rights and guarantees accruing to employees under indefinite-term contracts, such contract will be deemed concluded for an indefinite term.

IX. Pension Reform

Three key pension laws were adopted at the end of 2001: the Law On Mandatory Pension Insurance,¹⁵ the Law On State Pensions,¹⁶ and the Law On Labor Pensions.¹⁷ The government plans a three-tier pension system. The first tier will be a universal flat pension that is independent of past earnings, to which every Russian citizen and foreign national permanently residing in Russia will be entitled upon reaching a certain age (fifty-five years for women and sixty years for men). The second, called a labor pension, will supplement the universal pension with a pay-as-you-go pension linked to past earnings. Individual contributions will be registered to personal accounts and consist of both employee-funded and state-funded components, each linked to the records on the individual accounts. The proposed third tier, a voluntary pay-as-you-go approach, has not yet been implemented.

X. Judicial Reform

The much-needed judicial reform package includes three new procedure codes: the Criminal Procedure Code, the Civil Procedure Code, and the Arbitration Procedure Code. The Criminal Procedure Code came into force on July 1, 2002, with certain provisions effective as of January 1, 2003 and 2004. The new Arbitration Procedure Code came into force on September 1, 2002, except for certain provisions. The new Civil Procedure Code is now being discussed in the State Duma.

The Criminal Procedure Code grants additional rights to accused persons, reduces the power of public prosecutors during proceedings, and vests more power in the judiciary. For example, now only judges may issue search and arrest warrants. Trial by jury is now guaranteed for serious criminal cases in all eighty-nine regions of Russia. Nine of eighty-nine regions began a jury trial experiment in 1993, and it is clear that accused persons have fared much better under this pilot jury program. Overall the jury system, combined with proposals aimed at increasing the independence of the judicial board, is expected to have a significant impact on enhancing both the perception and the performance of the Russian criminal justice system.

15. Federal Law On Mandatory Pension Insurance in the Russian Federation No. 167-FZ, dated Dec. 15, 2001, amended May 26, 2002, GARANT 82804.

16. Federal Law On State Pensions in the Russian Federation No. 166-FZ, Dec. 15, 2001, amended July 25, 2002, GARANT 12025128.

17. Federal Law On Labor Pensions in the Russian Federation No. 173-FZ, Dec. 17, 2001, amended July 25, 2002.