Oil & Gas of Sakhalin. Legal Aspects

This book represents a collection of articles presented at the Sakhalin Oil and Gas Conference in London in November 2003 by six attorneys from the Russin & Vecchi Russian Practice Group.

Oil & Gas of Sakhalin covers different legal issues necessary to consider for those starting or investing in a business in the oil & gas industry on Sakhalin, Russia. Among those issues are antimonopoly considerations, water use licensing, Russian content requirements, dos and don'ts of labor contracts, visa and taxation requirements, etc.

In this issue of the RusEnergy Law Journal you'll find several articles from this book. The full collection will be published in June by Nestor Academic Publishers LLC.

II. Management and Control of a Russian Enterprise

Presented by ***Jonathan Russin****, Managing Partner of the firm's Russian Practice Group*

Bidders for contracts awarded by the Sakhalin I and II operators must consider the benefits of meeting Russian Content requirements, that is to bid through a company the equity of which is at least 50% held by Russian natural or juridical persons. Meeting Russian Content requirements is discussed in further detail below, but often entails the creation of a 50:50 joint venture. The usual corporate form to comply with the 50% Russian ownership requirement is the formation of a Russian[1] limited liability company or LLC (sometimes known by its Russian initials as an "OOO"). One of the principal issues confronted by the non-Russian shareholders in this situation is how to deal with control and direction of the 50:50 joint venture company. In our experience there are three main approaches to this question.

Mutual Sharing of Control

Russian law governing the formation and operation of LLCs is relatively extensively detailed and sets out a number of requirements that cannot be varied by the parties. One of the fundamental rules is that obligatory requirements of Russian law cannot be avoided by an agreement between the shareholders that attempts to override them. The type of Shareholders Agreement often used in the United States and England, in which the shareholders agree in advance on the division of seats on the Board of Directors, on the selection of the Managing Director, and on the budgeting and financing of future operations of the LLC has frequently been found by Russian courts to be unenforceable. Russian law requires that these issues remain open for review and decision by the shareholders at the yearly meeting or at the times established in the company bylaws.

The standard Russian LLC, with relations between shareholders subject to review and decision at regular shareholder meetings, and with control shared in proportion to equity ownership, is probably best suited for a situation where the Russian and foreign parties are making equal contributions to the management and operations of the joint venture company.

[1] The use of an offshore company with 50% Russian ownership is also permitted; however, Russian companies and individuals are restricted in investing in companies outside Russia, making the use of an offshore joint venture more theoretical than realistic.

Both parties will look to Russian company law to regulate the mutual control features of their joint venture.

It should be noted, however, that Russian custom and tradition gives substantial authority to the Managing Director of a Russian LLC. Although the authorities of the Managing Director can be limited by the bylaws and by narrow delegations of authority from the shareholders or the Board of Directors, much operational discretion will still rest with the Managing Director. The choice of this officer will be a major decision for the joint venture partners.

Disproportionate Control Via Management Agreement

One of the classic solutions used in situations where a foreign shareholder is in fact providing a disproportionate part of the financing and expertise of the LLC is to have the shareholders unanimously agree in the charter of the LLC that the management functions of the company will be contracted to a third party. A Management Contract between the LLC, usually approved by unanimous vote of the shareholders, and the foreign shareholder, conveys operating responsibility on the foreign party. The Management Contract can be for an extended period and can be drafted to allow for termination only by decision of the shareholders (where a 50:50 structure could block any decision in which the shareholders are divided) or for breach by the management company confirmed by a court decision.

Delegation of control under a Management Contract does not remove all aspects of participation of the Russian partner. Russian company law requires that changes in the structure of the LLC, such as decisions to amend the bylaws, to increase or decrease authorized capital, to reorganize or liquidate, and to pay dividends, are in the exclusive competence of the shareholders and cannot be delegated through a Management Contract.

One additional technique used to address a situation where there is an imbalance between the contributions of the two partners in a 50:50 joint venture is to create different attributes to the shares held by each partner, for example, by establishing that the shares held by the partner making the disproportionate contribution are entitled to a greater percentage of dividends.

In general, the solution to problems associated with disproportionate contributions by the partners is to address the issues presented through structures permitted by and consistent with Russian company law, rather than to attempt solutions through the use of standard U.S. or English style Shareholders Agreements, which run the risk of being ruled unenforceable by Russian courts.

Undivided Control Through Two-Tiered Structures

The third approach to the issue of control, which may be useful in the context of meeting the Sakhalin PSA Russian Content requirements discussed below, is to create a Russian structure that avoids the participation of a local partner. For this purpose it is necessary to incorporate two Russian companies. For example, Company A is established as a Russian LLC and is 100% owned by foreign shareholders. Company A then incorporates a Russian subsidiary, Company B, that is100% owned by Company A[2]. Company B is eligible to bid on Sakhalin I and II projects because it is a Russian company, the shares of which are at least 50% owned by a Russian shareholder. Although this structure meets the legal requirement for Russian Content, it also results in the creation of two companies, both subject to the payment of Russian taxes on their operations.

There are obviously advantages and disadvantages to each of these three approaches. The choice will depend on an assessment of all the circumstances involved in each tender offered by SEIC and ENL. Relevant issues will include: Will the services required be performed in Russia or offshore? How much of the required work will be subcontracted? To which partner? What will be the resultant cash flow and tax structure? The control issue will be an important, but not the sole factor determining the structure of the Russian LLC.

[2] In this situation Russian company law requires that one of the two Russian companies have more than one shareholder. In this case, the assumption is more than one foreign shareholder of Company A. In the alternative, Company A could have one foreign shareholder and Company B would then need two shareholders.

III. Meeting Russian Content Requirements

*Presented by **Jonathan Russin,** Managing Partner of the firm's Russian Practice Group*

Sources of the Rules

There are at least three legal sources that have a bearing on this question: the Production Sharing Agreement for Sakhalin II signed by Sakhalin Energy in 1994, the PSA for Sakhalin I signed by Exxon Neftegas and its partners in 1995, and the Law on Production Sharing Agreements and its amendments, originally signed into law by President Yeltsin on December 30, 1995. Although the two PSAs antedate the passing of the PSA law, and are therefore "grandfathered," it is clear that Russian authorities also look to the definitions in the PSA law as setting the standards they wish to achieve. In addition to the Sakhalin II PSA, SEIC's Russian Content rules stem from its Supervisory Board Resolutions and Agreed Procedures.

Defining a Russian Enterprise

There are two distinct and often confused aspects of Russian Content. The PSAs for both Sakhalin I and II and the PSA law itself provide that the operators (ENL and SEIC) will grant "Russian Enterprises" a "priority right" or "preference" over non-Russian enterprises in awarding contracts.

What then is a "Russian Enterprise?" The PSA Law defines it as a "Russian legal entity," which appears to mean that any company incorporated in Russia, even if all of its shares are owned by non-Russians, will be recognized as a Russian Enterprise. As stated above, however, for the purposes of the Sakhalin I and II projects, the PSA law does not apply as they have grandfathered PSAs, which control. Although ENL has interpreted Russian Content in the same manner as the PSA Law, its PSA defines a Russian Enterprise in the following manner: "If Russian natural persons, legal entities or government organizations own at least fifty percent of the stock of such organization"[3].

Similarly, the SEIC PSA provides that a Russian Enterprise is defined as a company in which "at least fifty percent of its equity is held directly or indirectly by Russian natural or juridical persons or by any [Russian] governmental authority." SEIC does not require that the bidding entity be formed at the time of its bid, but the founders must commit to form a compliant entity thereafter. The entity, once formed, must provide proof of compliance in the form of a certificate of incorporation and a list of its major shareholders evidencing at least 50% Russian ownership. If Russian Content is lost post-award, the company must notify SEIC and may be at risk for loss of its contract.

Measuring Russian Labor and Russian Materials

Although the Sakhalin I PSA does not contain specific percentage requirements, ENL requires its contractors to meet specific requirements similar to the 70% targets employed by SEIC.

SEIC's requirements are specific and state that the company is to make its best efforts to maximize Russian Content each year with a target of reaching 70% Russian labor, materials, equipment, and services over the project life. SEIC considers materials and equipment to be Russian if they are procured by a Russian entity or individual, or by an entity otherwise compliant with Russian Content ownership requirements. Contractors must report on both Russian and Non-Russian material volume and man-hours. SEIC must track the number and US Dollar value of contracts awarded to Russian Enterprises.

Although it is relatively clear that Russian Labor means the employment of Russian citizens, which can be tracked by man-hours, the definition of Russian Materials is not as self-evident. For SEIC, the determining factor is the legal status of the source of procurement, without specific express regard to the country of manufacture. The PSA Law requires operators on an annual basis, to procure at least 70 percent of the total value of specified types of materials in the form of goods of "Russian origin"[4]. Pursuant to the PSA Law, the Russian origin requirement is satisfied where materials are produced by Russian legal entities and/or Russian citizens on the territory of the Russian Fede-

[3] Although the ENL PSA is a confidential document, the Russian Content provisions have been discussed publicly in order to assist contractors in meeting these requirements.

[4] Federal Law No. 225-FZ "On Production Sharing," December 30, 1995, as amended by Federal law No 19-FZ , as amended June 6, 2003 ("Law on Production Sharing"), Article 7(2).

ration, from parts that are at least 50% (based on total value) produced in Russia by Russian legal entities and/or Russian citizens[5]. The 70% also only applies to materials, the expenses for the procurement and use of which are recoverable to the operator through its production share[6]. Thus, the PSA Law's definition for Russian materials actually requires that a percentage of procured goods be manufactured in Russia, using Russian-manufactured parts. As stated above, however, this is not a requirement for the Sakhalin I and II projects as these PSAs enjoy grandfathered status.

V. Antimonopoly Considerations of Investments in Sakhalin Projects

Presented by ***Sergei L. Lazarev,*** *Partner of the firm's Russian Practice Group and Executive Director of the firm's Moscow office*

Types of Antimonopoly Control

The predominant Russian legislation governing transactions that may influence competition is a law passed during Soviet times entitled, "On Competition and the Limitation of Monopolistic Activities on Commodity Markets" ("Antimonopoly Law")[7]. Particularly noteworthy is the fact that in addition to defining certain events as potentially influencing competition on Russian markets, the Antimonopoly Law provides for the extraterritorial effect of its rules, expressly covering instances where the actions of foreign entities outside of the Russian Federation may potentially limit competition within Russian markets[8].

The Russian government, through the Ministry of Antimonopoly Policy ("Ministry"), exercises two major forms of antimonopoly control over typical corporate transactions. Depending on the type of activity and the amount of assets involved, a company seeking to perform an activity may need to either seek prior governmental approval of the transaction, or notify the government about the transaction after it is completed.

Of the two forms of control, prior approval, is from a timing and planning perspective, the more burdensome, as it requires filing a motion with antimonopoly bodies before a transaction is commenced. The Ministry considers the motion in view of the transaction's potential effect on competition. If there is no negative effect, the motion should be granted. If there is a potential limitation on competition, the motion may be denied. If an applicant can demonstrate that the transaction's positive social effect outweighs its negative consequences, or that the applicant is able to take measures to preserve competition, a motion may be granted even in the presence of a finding that competition will be limited as a result of the proposed transaction[9].

Subsequent notification of a transaction to the Ministry must furnish information that enables the Ministry to assess the effect of the transaction on competition. A finding that the transaction has negatively impacted competition may result in its rescission by the Ministry.

Typical Transactions Subject to Antimonopoly Control

Subject to the triggering of economic thresholds, which vary for each type of transaction and are set forth in the table below, the Antimonopoly Law governs the following types of transactions:

- The formation of a commercial organization such as a limited liability company, joint stock company, full partnership or limited partnership[10].
- Mergers and acquisitions involving Russian commercial organizations[11].
- A transfer of fixed assets exceeding 10% of the total book value of the fixed and intangible assets of the transferring entity, through sale, do-

[5] Law on Production Sharing, Article 7(2).

[6] Law on Production Sharing, Article 7(2).

[7] Law of the RSFSR No. 948-1, dated March 22, 1991 (as amended).

[8] Antimonopoly Law, Article 2(1).

[9] Antimonopoly Law, Article 17(4).

[10] Antimonopoly Law, Article 17(5).

[11] Antimonopoly Law, Article 17(1).

nation, lease, temporary uncompensated use, or other instances of temporary transfer[12].

- The acquisition of 20% or more of the shares or participatory interests in a Russian company[13]. This rule is not applied to the founders of a company at the time of its formation.
- The acquisition of the right to control business activity of a Russian legal entity or to perform the functions of its executive body[14]. For example, the execution of a management contract by which one legal entity performs the functions of the executive body of another legal entity[15].
- The election of an individual to the Board of Directors (Supervisory Board) or to another executive body of a Russian legal entity.

Threshold Amounts Invoking Antimonopoly Control

Type of transaction	Value of assets of person/entity involved:	
	exceeding 100,000 TMW[16] (approximately $345,000)	exceeding 200,000 TMW (approximately $690,000)
Formation of a Russian legal entity	No control	Notification
Mergers and acquisitions	Notification	Approval

Timing and Venue of Filing

The antimonopoly bodies generally must consider motions for approval within 30 days from the date of filing[17], however, under certain circumstances, they may extend this period for an additional 20 days. In practice, the antimonopoly bodies may also request additional documents and thus renew the period of consideration.

Subsequent notifications must be filed within 45 days after the reported event took place[18]. The Antimonopoly Law does not specify the time period within which the Ministry must issue a decision regarding notifications. In practice, a reply is usually received within two months after filing.

Motions for approval and notifications of mergers and acquisitions, and notifications of the formation of legal entities are filed with the federal Ministry of Antimonopoly Policy, if the assets in question exceed 10 million TMW[19]. In other cases, these motions and notifications are filed on the regional level with the relevant subdivisions of the Ministry.

The acquisition of rights to control business activity, transfers of fixed assets, purchases of shares and elections to the boards, as set forth above, are controlled on the federal level when the assets of the entities involved exceed 20 million TMW[20]. Otherwise, these events are subject to antimonopoly control on the regional level.

Basic Information and Documents Required for Filing

Document requirements are extensive and vary for each type of controlled transaction. However, all filings include the registration documents of parties to the transaction (charter, certificate of incorporation), a statement of the purpose of the transaction, the value of total assets involved, and a list of the members of the executive body and the board of directors. All foreign documents filed must bear an apostille or consular legalization and be supplemented by a certified Russian translation. If information provided at filing constitutes a commercial secret, applicants must alert the antimonopoly bodies to this fact.

After the initial filing, the Ministry may require additional information and documents before making a decision on the application and may set a deadline for the provision of such information and documents at its own discretion[21]. Therefore, preparatory work to collect the anticipated information and documents should be undertaken in advance. Additional information may be requested relating not only to the parties to the transaction, but also related to other interested persons. The list of additional information is extensive[22]. The most noteworthy requests include the following:

a) Information contained in quarterly accounting and statistical reports or in their supporting documents, as well as other documents

[12] Antimonopoly Law, Article 18(1).

[13] Antimonopoly Law, Article 18(1).

[14] Antimonopoly Law, Article 18(1).

[15] Antimonopoly Law, Article 18(6).

[16] TMW is an abbreviation for "times the minimum (monthly) wage," established by the Government of the Russian Federation. As of today the minimum wage for the purposes of administrative law is 100 rubles. Given the current exchange rate of approximately US$1to RuR 29, the minimum wage is approximately US$3.45.

[17] Antimonopoly Law, Article 17(2).

[18] Antimonopoly Law, Article 17(5).

[19] Regulations on the procedure of filing of motions and notifications with the antimonopoly bodies under Articles 17 and 18 of the Law of the RSFSR "On Competition and Limitation of Monopolistic Activities on Commodity Markets," approved by Ministry of Antimonopoly Policy Order #276, August 13, 1999 (MAP Order), Item 6.1.2.

[20] MAP Order, Item 6.2.1.

[21] MAP Order, Item 5.3.

[22] MAP Order, Appendix 1, Item 2.

related to the calculation and payment of taxes and other obligatory payments for three preceding years.

b) Description of major types of goods (work, services) supplied to the market and their major substitutes in production and consumption.

c) Information on the volume and share of supply for government and military orders.

d) Description of the market environment before and after the transaction.

e) Information on production facilities and the level of their utilization for the production of the specific type of goods (work, services), including an assessment of the total production facilities of the type in the Russian Federation or region.

Liability for Violation of Antimonopoly Control Rules

Failure to file a motion for approval or a subsequent notification with the antimonopoly bodies when required by law is subject to administrative fines. The amount of such fines ranges from 20 to 50 TMW (approximately $70-170) for executives[23], and from 500 to 5,000 TMW (approximately $1,700-17,000) for legal entities[24].

In addition to administrative fines, antimonopoly bodies may seek court ordered liquidation of a legal entity formed in contravention of the Antimonopoly Law[25]. Furthermore, any transaction conducted in violation of the Antimonopoly Law may be challenged and invalidated in court proceedings on the basis of its illegality[26].

IV. Drafting a Company Charter: What to include and what to avoid

Presented by ***Sergei L. Lazarev****, Partner of the firm's Russian Practice Group and Executive Director of the firm's Moscow office*

A specialist in Russian civil and corporate law, tax and labor law, as well as in litigation and dispute resolution, Mr. Lazarev has over 10 years experience in advising foreign and Russian companies on structuring and operating investments in Russia. Together with other Russin & Vecchi attorneys, Mr. Lazarev has worked on numerous issues related to Sakhalin oil and gas exploration and extraction projects, including: obtaining government approval of a PSA for a Sakhalin offshore development project, and assisting with complex permit and licensing requirements for large-scale equipment delivery and beaching operations. Mr. Lazarev has assisted clients in reconciling the latest state of the art drilling waste disposal technologies with Russian environmental law and PSA-related requirements, and advised on Russian and international oil spill containment requirements. He is a 1983 graduate of the Law Faculty at Moscow State University and in 1990 defended his dissertation "Arbitral Settlement of Interstate Disputes" and earned a Ph.D. from Moscow State University. In 1993, he completed his study at The George Washington University National Law Center (USA) under the Edmund S. Muskie Graduate Fellowship Program.

Foreign investors should be aware of several fundamental requirements regarding the structure and function of Russian limited liability companies. These include obligatory forms for management structures, the role of the General Director, procedures for transfer of shares, participant withdrawal, distribution of profits, and investments in the property of an LLC. As LLCs are the most widely used type of commercial legal entity in Russia, this article will cover issues related to LLCs, rather than Joint-Stock Companies, although in many instances, they are similar.

Russian law provides little freedom in drafting LLC charters[27]. Most LLC activities are set forth by law and can be varied only in cases specifically pro-

[23] The Code of the Russian Federation on Administrative offences #195-FZ, dated December 30, 2001, Article 19(8).

[24] The Code of the Russian Federation on Administrative offences #195-FZ, dated December 30, 2001, Article 19(8).

[25] Antimonopoly Law, Article 17(9).

[26] Russian Civil Code, Article 168.

[27] There is little freedom in drafting Joint-Stock Company charters as well.

vided for by the law. In this regard, many schemes that are successfully employed in foreign practice, may be unenforceable in Russia.

The main law regulating activities of LLCs in Russia is the Federal Law On Limited Liability Companies No. 14-FZ dated February 8, 1998 (the "Law on LLCs"). Although the Law on LLCs is not new, court practice in interpreting its provisions is still quite limited. The main court act which clarifies provisions of the Law on LLCs is the joint Enactment of Plenums of the Highest Arbitrazh Court and Supreme Court of Russia No.90/14 dated December 9, 1999 "On Some Issues of Applying Provisions of the Federal Law On Limited Liability Companies."

Management

For the majority of foreign investors operating in Russia, the most critical question usually pertains to control, or who is playing the management role. Russian law provides a detailed scheme of LLC management structure, which include the following bodies:

1. General Meeting of Participants (GMP) – the supreme body
2. Sole executive body – General Director or President – executive body
3. Collective executive body – Executive Committee (EC) – optional second executive body
4. Board of Directors (BD) – optional observing body
5. Audit commission (Auditor) – optional controlling body[28].

Most LLCs may successfully operate without forming optional bodies. If a company has many participants or anticipates conflict, then it may be advisable to consider forming optional bodies.

Russian legislation stipulates that a participant of an LLC is not its body and can take part in its management only through a GMP. In this regard, granting to some participants the right to appoint general directors, members of the BOD or the EC, is unenforceable. However, Russian law provides the possibility to grant additional rights or obligations to some LLC participants, subject to unanimous consent of the other participants. Whether a grant of additional rights or an imposition of additional obligations is appropriate should be verified in every specific case, in light of other imperative norms of Russian law, which may not be deviated from, even with consent of the participants.

General Meeting of Participants (GMP)

The GMP's decision-making procedures are defined in detail in the Law on LLCs. Every participant has equal authority to propose issues for the GMP agenda and to vote on all issues[29]. In this regard, charter provisions that empower one participant to nominate a general director are void and unenforceable as limiting the rights of other participants. The GMP generally forms all other bodies of the company.

Although the GMP adopts most decisions by a simple majority of votes of all participants of the LLC rather than by a majority of those participants who attend the GMP, the charter may provide for a qualified amount of votes for some or every GMP decision[30]. According to the Law on LLCs, decisions to amend a foundation agreement or to liquidate or reorganize an LLC must be adopted unanimously, and decisions to amend a charter must be adopted by a 2/3 majority of votes. The charter may not reduce these qualified amounts of votes, which are established by law. Despite these limitations with regard to voting, upon unanimous decision of the participants, a charter may provide for a division of votes disproportional to shareholding[31].

Russian law sets forth extremely strict requirements regarding the procedure for calling a GMP. A GMP may be called by other bodies of the LLC or by participant(s) who have invested at least 10 of the charter capital of the LLC[32]. A body or person calling a GMP is obligated to notify all participants at least 30 days prior to holding the GMP, unless the charter provides for a shorter term[33]. All participants have the right to propose additional issues to the GMP's agenda at least 15 days prior to the GMP, unless the charter provides for a shorter term[34]. Such proposals must be included in the agenda unless they contradict Russian legislation or do not fall within the GMP's competence. Other participants must be notified regarding such additional issues at least 10 days prior to holding the GMP. Shortening the notice period for calling the GMP (and all related deadlines) rather than applying the legal defaults affords participants greater control over the timing of decision-making.

[28] An audit commission is obligatory in an LLC with more than 15 participants.

[29] Law on LLCs, Articles 8(1) and 36(2).

[30] Law on LLCs, Article 37(8).

[31] Law on LLCs, Article 32(1).

[32] Law on LLCs, Article 35(2).

[33] Law on LLCs, Article 36(1).

[34] Law on LLCs, Article 36(2).

Sole Executive Body

The sole executive body, which is the general director or president (GD), conducts the day-to-day operations of the company. Only the GD may sign agreements, hire employees and operate the monetary assets of the company without a power of attorney. The GD's powers are limited by the Law on LLCs with respect to the conclusion of large-scale transactions (valued at least 25% of the company's assets) and transactions in which he is an interested party (with affiliated persons)[35]. The charter may also limit the GD's power, for example, by prohibiting the GD from concluding transactions exceeding a certain sum without the GMP's consent. However, transactions concluded in breach of such charter provisions can only be declared void within one year of their conclusion, and only if the company or its participants can prove that another party to the transaction knew or should have known about such limitations[36].

A GD's rights may also be assigned to a Managing Company by a decision of the GMP, as long as the possibility to do so is clearly established in the Charter[37].

Collective Executive Body

The Collective Executive Body, or the Executive Committee (EC), is used very rarely in an LLC. Russian law regulating the EC is not well defined, other than to state that it should conduct its activities in accordance with the charter. Thus, participants have much freedom in respect to this body. The EC Chairman is the GD, who retains his main authorities and signatory powers. As a result, the EC, which is considered an optional body, is in most instances not necessary.

Board of Directors (BOD)

The Board of Directors is also an optional body. If a BOD is established in the charter, however, the following issues may be granted to its consideration: electing and terminating executive bodies of the company (GD, EC or Managing Company), the conclusion of large-scale or interested transactions, and issues related to preparing, calling and holding the GMP[38]. Members of the BOD have no signatory powers and are elected by the GMP. Granting participants the right to nominate specific numbers of BOD members is unenforceable.

Establishing a BOD is not necessary and makes sense only in specific cases, such as, for example when participants seek to have greater control over the GD.

Audit commission (Auditor)

The audit commission conducts inspections of the LLC's financial activities. This body is optional unless an LLC has more than 15 participants, in which case, an audit commission is obligatory. We generally do not recommend using this body unless there are certain fears with respect to other participants or the executive bodies of the LLC.

Role of the General Director of an LLC

As mentioned above, the GD is responsible for the day-to-day management of the LLC. In particular, the GD concludes transactions, issues powers of attorney on behalf of the LLC and conducts other activities, which are not transferred to the competence of the BOD or EC. The GD's powers may be limited only by the charter and not by a decision of the LLC's participants.

The GD must have signatory power with regard to the LLC bank account and must sign the bank cards enabling an account to be opened. Russian banks have different, and sometimes contradicting, policies with respect to signatures on the bank cards, specifically regarding whether the bank will accept documents certifying the GD's signatory powers abroad. In this regard, if at all logistically possible, it is advisable to have the general director present to open the LLC bank account.

The LLC charter should provide a term of validity for the GD's authorities[39]. There are no limitations for such term and in practice this term generally varies from 1 to 5 years. During this time, the GD may transfer his powers based on a power of attorney and at any time revoke such power of attorney.

The GMP (or BOD, if it is provided for in the charter) may at any time terminate the GD's powers. However, due to the somewhat complicated procedures for calling a GMP, such termination usually cannot be accomplished immediately.

[35] Law on LLCs, Articles 45, 46.

[36] Russian Federation Civil Code dated November 30, 1994 No. 51-FZ, Article 174 ("Russian Civil Code").

[37] Law on LLCs, Article 42.

[38] Law on LLCs, Article 32(2).

[39] Law on LLCs, Article 40(1).

Alienation of shares

By default, any participant of an LLC may alienate its shares to another participant or to third parties. According to Russian law, the sale of a participant's share to third parties is not subject to the consent of the LLC or other participants. However, other participants, and the LLC itself, if provided for by the charter, have the right of first refusal to purchase the share being sold, in proportion to the shares held by remaining participants[40]. Russian law provides the following options in this regard, provisions for which must be expressly included in the charter:

1. Alienation of shares to other participants may be made subject to approval of the LLC or other participants[41].
2. Alienation of shares to third parties may be prohibited[42].
3. Alienation of shares to third parties in a manner other than through a sale may be made subject to approval of the LLC or other participants[43].

Unless otherwise provided in the charter, the transfer of shares to heirs and legal successors of a former LLC participant is not subject to the consent of other participants[44].

A participant may mortgage its shares to other participants without limitation, however, a mortgage of shares to third parties requires approval of the GMP and may be prohibited by the charter[45].

The methods set forth above for limiting the manner in which shares may be alienated may be recommended in instances where the founders would like to maintain control over the entry of other participants to the LLC.

Withdrawal

The founding participants of an LLC should be aware that participants have the right to withdraw from the company at any time. Within six months from the time of the withdrawal, the LLC is obligated to pay the withdrawing participant the actual value of its share[46]. The right to withdrawal can be a double-edged sword. On one hand, the foreign investor enjoys the freedom to withdraw from the company at any time. On the other hand, if the foreign investor established an LLC with a Russian partner, one day this foreign investor could find himself alone in the joint venture if his Russian partner decides to suddenly withdraw. If the Russian partner was needed for Russian Content purposes in the context of the Sakhalin PSAs, the Russian partner's withdrawal could result in the loss of a contract. The right to withdraw from the LLC cannot be prohibited by the charter.

Distribution of profits

By default, LLC profits are distributed in proportion to the participants' share ownership. Upon unanimous decision of the participants, this procedure may be amended. Russian law affords opportunities to establish shares with varying attributes, including profit distribution that differs from shareholding. Amending or deleting such provisions from a charter must also be accomplished by unanimous decision[47].

Investments to LLC property

The LLC's charter may include a provision obligating the participants to make additional investments to the LLC's property. Respective provisions of the charter should be adopted by unanimous decision of the GMP. Decisions on each additional investment must be adopted by a qualified 2/3 majority of votes, if the charter does not provide a greater amount of votes[48].

Unless the charter provides otherwise, investments must be made proportionally to share ownership. The charter may also specify a maximum amount of investment applicable to all, or to specific individual, LLC participants. If participants plan to invest assets in the company, in addition to those contributed to the charter capital of the company, it is reasonable to include such provisions in the charter.

List of Company Activities

According to Russian legislation, an LLC may perform any activity not prohibited by law. Although a charter need not provide a list of planned activities, it is general practice to include them.

Conclusion

Although impossible to analyze all aspects of Russian LLC law in the confines of a short article, this article is intended to provide a general overview of some of the main aspects of legal practice related to LLCs, which should be considered by foreign investors who plan to enter a JV with a Russian partner. Where foreign investors set up Russian subsidiaries with 100% foreign ownership of one participant, some of the issues described above are less significant. □

[40] Law on LLCs, Article 21(4).

[41] Law on LLCs, Article 21(1).

[42] Law on LLCs, Article 21(2).

[43] Law on LLCs, Article 21(5).

[44] Law on LLCs, Article 21(7).

[45] Law on LLCs, Article 22.

[46] Law on LLCs, Article 26.

[47] Law on LLCs, Article 28(2).

[48] Law on LLCs, Article 27(1).