Russia

Latest Changes to Russian Corporate Legislation

Russia has adopted legislation which will substantially change the requirements for the acquisition of large percentages of shares in open joint stock companies. The new legislation was enacted in Federal Law No. 7-FZ "On Amendments to the Federal Law 'On Joint Stock Companies' and to Certain Other Legislative Acts of the Russian Federation" dated January 5, 2006 ("Law No. 7-FZ") and will take effect on July 1, 2006.

The new rules have two important implications. First, each acquisition of more than 30, 50 or 75 percent of voting shares in an open joint stock company will trigger an obligation to make a public offer to acquire the remainder of the shares. Second, a person who has acquired more than 95% of open joint stock company's voting shares through a public offer (or who holds more than 95% of open joint stock company's voting shares before July 1, 2006) may force the minority shareholders to sell their shares.

Voluntary and Mandatory offers. Law No. 7-FZ stipulates that a person who together with its affiliated parties ***intends*** to acquire more than 30% of all the voting shares in an open joint stock company, ***may*** make a public offer to the owners of the company's outstanding shares (as well as of securities convertible into shares ("convertible securities")) to purchase their shares and convertible securities, or part thereof (a "Voluntary Offer").

A person who with its affiliated parties ***has already obtained*** more than 30%, 50 % or 75 % of voting shares in an open joint stock company, ***is required*** to make a public offer to buy the rest of the company's shares (and convertible securities) (a "Mandatory Offer") within 35 days after its title to the shares has been recorded in the shareholders' register.

The price offered in a Mandatory Offer for the securities may not be lower than the highest of the following values:

(a) the securities' average weighted stock exchange price for the six months prior to the sending of the Mandatory Offer to the Federal Financial Markets Service ("FSFR");

(b) the securities' market value, as determined by an appraiser, if the securities are not quoted on a stock exchange or have been quoted there for less than six months;

(c) the maximum price at which the offeror agreed to purchase such securities during the six months that preceded the sending of the Mandatory Offer to the joint stock company whose shares are being purchased.

For both Voluntary and Mandatory Offers, payment for the securities must be secured by a bank guarantee.

Before making a Voluntary Offer or Mandatory Offer, the offeror must submit its offer for review to the FSFR. The FSFR will prescribe the offeror to amend the offer if it is inconsistent with the requirements of Law No. 7-FZ. If the FSFR has not reacted within 15 days from the date the offer was submitted to the FSFR, the offeror may commence its Voluntary or Mandatory Offer.

Potential buyers must present both Voluntary and Mandatory Offers through the open joint stock company itself. Upon receiving any such offer, the company's board of directors must adopt recommendations for its shareholders, addressing: the fairness of the offered price; prospects for changes of the securities' value after the sale; and the offeror's plans for the future of the company, including the company's staff. The company's board of directors must send the recommendations to the owners of securities along with the Voluntary Offer or Mandatory Offer. In order to accept an offer, the owner of a security should send a notice of sale to the offeror.

Law 7-FZ forbids a person who has made a Voluntary or Mandatory Offer to buy the voting shares and convertible securities offered for purchase on any other terms until the period reserved for the offer has expired. In addition, until and unless the Mandatory Offer is made as required by the new procedures, the majority shareholder (and its affiliates) may vote no more than 30% of voting shares held. A similar limitation applies to cases

where the offeror seeks to obtain ownership of more than 50% or 75% of open joint stock company's shares (i.e. the acquirer may vote no more than 50 % or 75% of the shares until and unless it duly makes a law compliant Mandatory Offer).

Competing offer. Once an open joint stock company has received a Voluntary Offer or Mandatory Offer, a competing offer may be submitted to the company, provided that the price offered for securities and the number sought by the alternative buyer are at least as high as those stated in the earlier bid.

Buyouts of securities from minority shareholders. A person who with its affiliated parties has acquired more than 95% of the total number of voting shares in an open joint stock company (the "Dominant Shareholder") must notify the other owners of shares and convertible securities of their right to sell their shares and convertible securities to the Dominant Shareholder. The price offered for the securities may not be lower than the highest of the following values:

(a) the securities' average weighted stock exchange price for the six months prior to the sending of the Mandatory Offer to the FSFR (this paragraph does not apply if more than 95 % of the shares were acquired by means other than a Mandatory Offer);

(b) the securities' market value, as determined by an appraiser, if the securities are not quoted on a stock exchange or have been quoted there for less than six months;

(c) the maximum price at which the Dominant Shareholder agreed to purchase such securities during the six months that preceded the sending of the Mandatory Offer to the joint stock company (this paragraph does not apply if more than 95 % of the shares were acquired by means other than a Mandatory Offer);

(d) the price paid by the Dominant Shareholder for any shareholding over 95% of the company's shares in Dominant Shareholder's ownership, whether through a Voluntary Offer or Mandatory Offer; and

(e) the maximum price at which the Dominant Shareholder agreed to purchase such securities after the expiry of the period reserved for acceptance of an offer when subsequently buying more than 95% of the company's shares.

The Dominant Shareholder may also demand that the owners of the rest of the shares and convertible securities sell their shares and convertible securities to the Dominant Shareholder in a compulsory manner. The compulsory buyout rules aim to protect the interests of minority shareholders and of the owners of convertible securities (by envisaging a procedure for maintaining a certain minimum price, and certain other guarantees).

A written notification on the right of minority shareholders and of owners of convertible securities to sell their shares and convertible securities to the Dominant Shareholder and a Dominant Shareholder's written demand for the buyout of the remaining shares and convertible securities are subject to preliminary review by the FSFR.

Those already owning more than 95% of voting shares in open joint stock companies by July 1, 2006 are subject to transitional regulations. Within 35 days of the date on which Article 7 of Law No. 7-FZ comes into force (see below regarding the time when Article 7 will enter into force), they must notify the minority shareholders and the owners of convertible securities of their right to require that the Dominant Shareholder buy out their shares and convertible securities. The obligation to send the notification is waived if the shareholders owning more than 95 % of an open joint stock company's shares require no later than one year after the effective date of Article 7 of Law No. 7-FZ that the minority shareholders and the owners of convertible securities sell to them the remaining shares and convertible securities.

The price offered for the securities may not be lower than the highest of the following values:

(a) the average weighted stock exchange price for the securities over the six months before sending the buyout demand;

(b) the value determination made by an appraiser; and

(c) the maximum price at which the Dominant Shareholder agreed to purchase such securities during the six months that preceded sending in the buyout demand.

Liability for breaches of procedure when purchasing more than 30% of shares in an open joint stock company. Additionally to the loss in voting rights mentioned above, Law 7-FZ provides for the civil liability of the offeror, of a Dominant Shareholder and of the target company's governing bodies for breaches of the new procedures for the acquisition of open joint stock company's shares. A company's governing bodies are liable

for any losses caused to the company or its shareholders through their culpable failure to enforce the new major shareholding purchase procedures. A shareholder may require that the company's bodies reimburse the shareholder for the losses it suffered through any such failure, regardless of the size of its shareholding. The person submitting a Voluntary Offer or Mandatory Offer improperly is liable to the sellers of securities for their resulting losses. A Dominant Shareholder who failed to comply with the procedures for determining a price for the securities is also liable for losses incurred by the owners of the securities. Law No. 7-FZ does not state that a violation by the offeror or the Dominant Shareholder of the procedures for obtaining large blocks of shares in an open joint stock company invalidates a share purchase transaction.

In addition to civil liability, Law No. 7-FZ provides for administrative fines to be paid by legal entities, officials, and individuals in breach of procedures prescribed for the purchase of more than 30% of open joint stock company's shares.

Entry into force. Law No. 7-FZ takes effect on July 1, 2006, with the exception of Article 7, which details transitional provisions for those having bought more than 95% of shares in joint stock companies prior to July 1, 2006. Article 7 will come into force upon the effective date of a law regulating the obligatory civil liability insurance coverage for appraisers, which is yet to be adopted. To the best of our knowledge, an appraiser's obligatory civil liability insurance bill has not been introduced to the State Duma of the Russian Federation. Therefore, currently it is not clear when Article 7 of Law No. 7-FZ will come into effect.

Baker & McKenzie – CIS, Limited

Russian Energy Minister Sees Problems with Caspian Pipeline Venture

BAKU (AFP) – Russia's top energy official suggested that a US-backed pipeline project that would bypass Russia by linking Central Asia's gas fields directly with the West was premature.

Russian Industry and Energy Minister Viktor Khristenko said the undetermined borders of the Caspian Sea area would be a stumbling bloc for the project, which would cut Russia out of deals to transport Central Asian gas across its territory.

"Resolving the issue of a trans-Caspian system, including the construction of a pipeline, will be possible only after agreeing to a clear understanding of the status of the Caspian," Khristenko told reporters.

The proposed pipeline would link the vast gas reserves of Turkmenistan and Kazakhstan to a yet-unfinished pipeline that will soon connect Azerbaijan's own gas deposits with Europe through Georgia and Turkey.

Top US officials dealing with the region have taken a different view of the project.

The Deputy Assistant Secretary of State for European and Eurasian affairs, Matt Bryza, told AFP that it was up to the countries involved to decide whether the project should go ahead

"Several feasibility studies have demonstrated the technical, environmental and economic feasibility of a trans-Caspian pipeline and it is up to the countries through which the pipeline would travel and the investors concerned to decide whether to proceed," Bryza said during a telephone interview.

Bryza added that Saparmurat Niyazov, the president of Turkmenistan, "showed interest in exploring the possibilities of the trans-Caspian pipeline, as well as other options," during a January meeting in Ashgabat.

Azerbaijan currently exports much of its oil through Russia's territory, but an alternative route through a new pipeline linking Baku with the Turkish port of Ceyhan is to open later this year.

"We understand these processes, we are trying to localize the risks," Khristenko said, adding that Russia transported 4.1 million tonnes of Azerbaijani crude through its Novorossiysk pipeline last year.

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Kyoto Protocol: Lack of Legislation Affects CO_2 Emissions Trading Program in Russia

One year after the Kyoto Treaty came into force, the Russian Federation ("RF") has yet to enact relevant legislation to facilitate business' compliance with the treaty's terms. This lack of legislation has consequently hindered business development of carbon trading in the country.

The Kyoto Treaty,[1] which came into force on February 16 2005, requires its signatories to either reduce their emissions of carbon dioxide (CO_2) and other greenhouse gasses or engage in a CO_2 emissions trading program (the "Program"). Under the Program, countries that exceed their treaty-imposed limits of CO_2 emissions may comply with the Protocol by buying credits from other countries who have produced less than their CO_2 thresholds. The buyer must then invest in projects that reduce greenhouse gas emissions in the credit-selling country. The European Union has already launched the Program, while in the RF, a precise mechanism does not yet exist. Without the Program in place, practically speaking, Russian companies have little opportunity to attract such foreign investment.

The RF government bears the responsibility for regulating such activities – among other things, each contract that involves CO_2 emissions trading must receive state approval. In the absence of any legislation on the matter, no credit trading can be carried out.

Consequently, one of the first potential business deals in Russia involving the trade of CO_2 credits, between Unified Energy Systems (UES), Russia's largest producer of greenhouse gases, and Denmark's Environmental Protection Agency, fell through because UES was not legally allowed to execute the contract without government consent. Under the contract, the Danish government would have received 1.2 million CO_2 credits, and in return would have made efficiency improving investments in the Amurskaya Power Plant in the Khabarovsk Region and a natural gas plant in the Orenburg Region. UES losses from the deal falling through are purported to amount to EUR 20 million. By far, UES is not the only Russian company negatively impacted by the inability to trade credits.

Draft Legislation

The Ministry of Economic Development and Trade (the "Economic Ministry") is responsible for drafting legislation on trading CO_2 credits with foreign countries. The Economic Ministry drafted legislation (the "Draft Legislation") during the period of July through November 2005, then sent it to other ministries (the Ministry of Natural Resources, the Federal Agency of Hydrometeorology, the Ministry of External Affairs and the Ministry of Industry and Energy) for approval. Thus far, only the Ministry of Natural Resources and the Federal Agency of Hydrometeorology have approved the Draft. Once all of the foregoing ministries have concurred, it can then be considered by the Prime Minister, Mikhail Fradkov, for final approval.

The Draft Legislation would establish rules for registration, evaluation and realization of investment projects concerning the prevention of climate change in the RF. The Draft Legislation requires that any company wishing to enter into a contract for the purpose of CO_2 credit trading receive prior approval of its business plan by the Ministry of Economy.

Both Gazprom and UES have issued statements urging the Russian government to approve the Draft Legislation as quickly as possible.

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Rights of Legal Entities to the Land Beneath Them – Extension of Deadline... Again

On December 27, 2005, Federal Law No. 192-FZ "On Amendments to Article 3 of the Federal Law "On Implementing the Land Code of the RF" extended the deadline for conversion of land rights by legal entities until January 1, 2008.

During the privatizations of 1991, legal entities gained the right to own their own buildings, while the land underneath such buildings remained government property. The entities were granted "perpetual use rights" allowing them to use and develop the land, provided that they paid a land use tax. They could not, however, divide or sell the land without selling the buildings situated on it or by selling the legal entity itself.

Future land reform was planned, and a date for capitalization finalized; the land was to be either purchased or acquired through a long-term lease from the government by 2004. Absent a valuation system for determining the purchase or lease price, however, this deadline was again extended to January 1, 2006. By December 2005, a means for determining purchase or lease price had yet to be set. Thus, on December 27,2005, the deadline was again extended for two years, by Federal Law No. 192-FZ "On Amendments to Article 3 of the Federal Law "On Implementing the Land Code of the RF". The extension of the deadline benefits those businesses that are situated on what is essentially land they did not have to pay for. However, the lack of valuation system and uncertainty about the future valuation system has unnerved businesses.

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[1] For background, please see Environmental Update on the Kyoto Protocol on Climate Change (Chadbourne & Parke LLP Project Finance Newswire, February, 2005).

New IPO Rules Aimed At Limiting Russian Equity Outflow

In recent years, Russian companies have increased their presence on foreign stock markets. The most significant players in the Russian market, such as AFK Sistema, Vimpelcom and Pyatorochka, have already undergone initial public offerings on the New York Stock Exchange and London Stock Exchange. It seems likely that the number of Russia-based companies listing on both foreign and Russian exchanges will continue to increase in the near future. Even the state oil company Rosneft recently announced the possibility of a global IPO this fall.

The Federal Financial Markets Service (FFMS), however, has long been struggling against the Russian stock outflow abroad. Russian companies succeeded in raising over USD 4 billion in IPOs on foreign markets in the last couple of years, as opposed to only USD 500 million domestically during that same period. Apparently, and despite the fact that all of those companies are also listed on Russian stock exchanges (a requirement of law), almost no equity was purchased locally.[2]

In response to the continuous equity outflow, on January 17,2006, FFMS announced newly promulgated amendments to several Russian statutes dealing with securities and stock markets. The new rules, recently signed into effect by the head of FFMS, Mr. Oleg Vyugin, are aimed, for the most part, at limiting the outflow of Russian equity. At the same time, the legislation simplified some procedural requirements for Russian companies wishing to list on a foreign stock exchange.

The most significant change facing dual stock market players is the further capping of securities allowed on a foreign market from the current 40 to 35 percent of the overall issued shares in the company. This provision, however, will not affect the existing American Depository Receipt (ADR) and Global Depository Receipt (GDR) programs, and will not apply to companies that had submitted all the relevant documents to FFMS before the amendments came into effect, as was the case with Gazprom, which filed its application at the end of 2005. Under the new rules, however, only 70 percent of the shares in each particular issue can now be offered publicly on a foreign stock exchange. The remaining 30 percent must be traded on the Russian stock market. According to some sources, the FFMS regulations will boost the capacity and the liquidity of the Russian stock market and will serve the interests of both domestic and foreign investors, who henceforth can choose where to purchase Russian securities.

The amendments also introduce new procedural requirements aimed at bringing the aforementioned rules in line with international standards. In particular, a company is no longer required to register a report of its IPO. Instead, it may file a simple notification of the IPO with the FFMS. Such notification must be filed in a form prescribed by FFMS. The procedural changes are not only limited to the notification, but also cover other, rather technical requirements (e.g. the shortening of the term for the registration of the report of issuance with FFMS from 30 to 14 days).

At the same time, there are drawbacks. The FFMS disclosure requirements are greater – in particular, companies wishing to list on a foreign market are now required to make public the same information that would be necessary under the foreign law (i.e., the law of the country in which the IPO takes place), in addition to that which is required by Russian law. The disclosure of this information must now be made by publishing all relevant documents on the Internet on the same day that the information must be made public under the respective foreign law. Additionally, the new disclosure rules modify prospectus requirements. Specifically, the prospectus must now disclose not only who advised and assisted in the offer, but also their fees for doing so.

The market has responded favorably thus far, and even the right of an issuer to independently solicit an investor has not been viewed as discriminatory. The new requirements were registered with the Ministry of Justice and published on February 17,2006 and came into force 10 days later.

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Six New Special Economic Zones Created

On January 18, 2006, RF Minister of Economic Development and Trade, German Gref, signed agreements with the heads of six RF regions to create new Special Economic Zones (SEZs) with extensive tax benefits.[3]

[2] Sebasian Kontsyn and EdaterinaDerbilova, "Stocksfor Russia", Vedomosti, 18 January 2006, No. 6.

[3] All previously established SEZs lost their status as special economic zones, except for the Kaliningrad and Magadan SEZs, which were established and governed respectively by the federal law on the Special Economic Zonein the Kaliningrad Region (1996), and the federal law on the Special EconomicZoneintheMagadan Region (1999). The new law does not apply to the Kalinigrad and Magadan SEZs.

The agreements were signed pursuant to the federal law on Special Economic Zones in the Russian Federation, which came into force on January 1, 2006. This new law outlines the SEZ regime and the process for the establishment of the zones. A SEZ may be established for a maximum 20-year period based on the results of a tender, held by the Russian Government. RF Regions and municipalities interested in establishing a SEZ must submit an application with a business plan for the SEZ. Based on results of the tender, the Federal Government issues a decree establishing the SEZ and signs an agreement with the executive authorities of the relevant Region. The agreement, among other things, will specify the amount and terms of financing of the SEZ from Federal and Regional budgets, the plans for the development of the area, the amount of shares and interest owned by the State in SEZ assets, how the assets may be used both during and after the SEZ's 20-year term, the tax benefits, and the formation of the SEZ Supervisory Board.

Based on the tender held at the end of last year, the following SEZs will be established: two technical-manufacturing SEZs-Lipetsk and Elabuga, and four technical-implementation SEZs – in St. Petersburg, Tomsk and the two Moscow Region towns of Zelenograd and Dubna.

Lipetsk plans to host plants producing consumer electronics and furniture, and Elabugaisset to become an auto-parts production center, with reported participation from Hyundai and General Motors, among others. The technical-implementation zone in St. Petersburg will be specified for IT and analytical instrument research and development. Microelectronics will be developed in Zelenograd, and new material development is to take place in Tomsk. Dubna has been picked to become a Russian "Silicon Valley", where high-end technologies are to be developed and a special town will be built for programmers and scientists from different parts of the world.

The main tax benefit for SEZ residents is exemption from all local assessments including land tax, property tax, transport tax and regional income tax for the term of five years. The relevant local acts must be adopted by the authorities within two months. However, Yury Zhdanov, head of the new Federal Agency on SEZ Administration (established in July 2005) announced that he will press for the cancellation of all taxes for SEZ residents, including federal, and for the extension of tax holidays.

Financing of the newly created SEZs will come from both the federal and regional budgets. According to Mr. Gref, about RUR8 billion has been allocated in the 2006 federal budget for developing SEZ infrastructure and transportation, with approximately the same amount coming from the relevant regional budgets. At least 80,000 jobs are expected to be created over the 20-year SEZ term.

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Ukraine

Ukraine's Constitutional Amendments Take Effect on January 1,2006

On December 8, 2004, the Verkhovna Rada (Parliament) of Ukraine passed the controversial "Law on Amendments to the Constitution of Ukraine" (the "Constitutional Amendments"). The Constitutional Amendments were adopted as part of an all-vote compromise in the midst of Ukraine's controversial 2004 presidential election and "Orange Revolution". While the Constitutional Amendments became effective as of January 1, 2006, as a practical matter, the new law will become fully enforceable only after the March 26, 2006 parliamentary election. The Constitutional Amendments significantly redistribute authority among the President, the Parliament and the Cabinet of Ministers (the Government). As a result of such redistribution, Ukraine's form of government will change from a presidential-parliamentary model to a parliamentary-presidential model.

General Provisions

According to the Constitutional Amendments, the Parliament will now be elected for five years, rather than four and will operate under a so-called "imperative mandate". The members of the Parliament must now remain with the same political faction or party to which they belonged at the time of their election to the Parliament. If a parliamentary member leaves his faction or bloc or becomes a member of a different political bloc, he or she may be stripped of his or her deputy mandate.

In addition, the parliamentary members may not occupy other state posts, paid positions, or engage in any entrepreneurial activity (except for academic, scientific, or artistic activity) or be a member of the management or supervisory body of a company or organization, except for a non-profit organization.

The Parliament's Extended Authority

The Constitutional Amendments provide that the Cabinet of Ministers will now be accountable not only to the President, as it was prior to 2006, but also to the Parliament, and must thus be guided in its activity not only by the Constitution, federal law and presidential decrees, but also by the resolutions of Parliament. Furthermore, the Cabinet of Ministers must now seek dismissal from the Parliament rather than the President.

Going forward, the Parliament, instead of the President, will decide on the appointment of Ukraine's Prime Minister, and based on the Prime Minister's proposal, other members of the Cabinet. The new procedure to appoint the Prime Minister will occur as follows. First, a coalition of the parliamentary factions, i.e., the so-called majority, must be formed within one month from the opening date of the first session after the parliamentary election. Second, the coalition of the factions must propose the candidates for the post of Prime Minister. Then, the President must choose from among the candidates and within fifteen days, submit a proposal on the selected candidate for Parliament's consideration. Finally, the Parliament must vote on the appointment of the Prime Minister. Under the previous wording of the Constitution, the President had sole power and discretion to appoint the Prime Minister, provided that a majority of members (226) of Parliament consented.

Additionally, the Parliament acquired the authority to appoint, based on the President's recommendation, the Minister of Defense, the Minister of Foreign Affairs, the Head of the Security Council of Ukraine and the Prosecutor General, as well as independently appoint the heads of the Antimonopoly Committee, the State Television and Radio Committee and the State Property Fund. In addition, the Parliament is now empowered to request the resignation of such appointed persons. Other Ministers (with the exception of the Defense and Foreign Affairs Ministers, whose candidacies are put forth by the President) are appointed by the Parliament based on the recommendation of the Prime Minister. Before the Constitutional Amendments took effect, the President appointed all of the Ministers at the Prime Minister's request.

In the event that the President's authority is terminated before his elected term of office expires, his or her obligations are delegated to the Head of the Parliament, rather than to the Prime Minister, as was the case under the previous Constitution.

The Parliament may also raise the issue of accountability of the Cabinet of Ministers, either at the request of the President or by a motion made by not less than 1/3(150 members) of the Parliament. By a majority vote (226 votes), the Parliament may pass a motion of no-confidence with respect to the Government's activities. However, the issue of the Government's accountability may only be considered once during the same parliamentary session and may not be considered during the last session of Parliament before an election.

The Cabinet of Ministers' New Authority

As a result of the Constitutional Amendments, the Cabinet of Ministers will now interact more closely and directly with the Parliament to whom it is now immediately accountable. The Prime Minister's position will become stronger than ever before since, as a representative of the parliamentary majority, he or she will have a guaranteed opportunity to cooperate constructively with the Parliament without the intermediacy of the President and therefore, will have the chance to become a significant political figure who may influence a majority of economic and political matters in Ukraine.

In addition, the Cabinet of Ministers was delegated new powers previously held by the President, such as: the creation, reorganization and liquidation of the ministries and other central bodies of the executive branch and the appointment

and discharge, at the behest of the Prime Minister, of the chiefs of the central executive bodies, other than the Cabinet. The Prime Minister will be able to directly propose the candidacies of all of the Ministers, with the exception of the Defense and Foreign Affairs Ministers, for approval by the Parliament.

Presidential Authority Weakened

The Constitutional Amendments also reduced the President's influence on the legislative process. In particular, if the President does not sign a law approved by two-thirds of the members of Parliament after the second reading, that law is deemed to be immediately enacted, is signed by the Head of the Parliament and then published in the official newspaper.

In addition, whereas the President was previously entitled to cancel the acts of the Cabinet of Ministers, now the President may only suspend their enforcement on the grounds of unconstitutionality. To accomplish this, the President must concurrently request a Constitutional Court ruling with respect to the constitutionality of such acts.

Simultaneously, the President has acquired certain additional authorities. The President is currently provided additional grounds pursuant to which he or she may terminate Parliamentary power. Previously, the President could dissolve the Parliament only if plenary meetings did not occur within 30 days of each session. Under the Constitutional Law, in addition to this basis, the President now has the power to terminate the authority of the Parliament, if: (1) within one month after the beginning of a session, a coalition of the parliamentary factions has not been formed; or (2) if within 60 days after the Cabinet of Ministers' resignation, a new Cabinet has not been formed. Therefore, while the Constitutional Amendments weaken the influence of the President within the executive branch, at the same time, they noticeably increase the President's control over the Ukrainian Parliament by providing additional grounds for disbanding the Parliament.

Nevertheless, the decision to dissolve Parliament must be made by the President after consultation with the Head and Deputy Heads of the Parliament and the heads of the parliamentary factions. In addition, the President is not allowed to terminate the powers of the Parliament during the last six months of either the President's or the Parliament's term.

The President also retains full authority over foreign affairs, national security and the appointment of heads of the oblast and regional state administrations.

Prosecutor's Additional Authority

Under the Constitutional Amendments, the supervisory functions of the prosecutor's office have been extended. In particular, the monitoring of compliance with human rights and freedom has been added to the prosecutor's existing responsibilities. The prosecutor's office will now have the authority to determine whether an individual's rights and freedom have been violated, whether human rights' laws have been complied with, and whether state officials have acted in accordance with such laws. These additional prosecutorial powers are controversial. According to the Conclusions on the Changes to the Ukrainian Constitution of the European Commission for Democracy through Law, better known as the Venice Commission, dated December 8, 2003, this supervisory function does not comply with the European Council's rule of law standards and should be brought to a vote in a national referendum.

Reform Controversy

The Constitutional Amendments have generated controversy in Ukraine. Many believe that the Parliament considered and adopted the constitutional changes too hastily. Opponents of this constitutional reform say that the new confrontation between the President and Parliament and between the President and Prime Minister (now a creature of Parliament) will send the country into a political crisis. Ukraine President Victor Yushchenko, who opposes these constitutional changes, has already announced that after the March parliamentary elections, he plans to call for a national referendum on constitutional reform. It is difficult to predict, however, whether a referendum will actually take place, since to our knowledge no practical steps have been made in furtherance thereof. If a referendum does take place, significant procedural and substantive issues will be raised since the Constitutional Amendments have already become effective and will be fully implemented after the March 26, 2006 parliamentary election.

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The First Private Center for the Certification of Electronic Digital Signatures Accredited

The first private center for the certification of electronic signatures (through "Open Key"[5] certification) was recently accredited in Ukraine to further implement the Law of Ukraine "On Electronic Digital Signatures", which became effective as of January 1, 2004 (the "EDS Law") (Seethe CIS and Central Europe Newswire, February 12, 2004, for more information). The EDS Law and the Law "On Electronic Documents and Electronic Document Circulation" were adopted on the basis of Article 207of the Ukraine Civil Code, which allows parties to sign contracts by electronic and other technical means.

The EDS Law contemplates the establishment of government entities, such as the Central Certification Agency, and a network of private Key Certification Centers to provide services related to the creation of electronic signatures and Open Key Certificates. To implement the EDS Law, the Cabinet of Ministers in 2004 adopted several resolutions designed to appoint a state body to act as the Central Certification Agency and to establish the procedure for accrediting private Key Certification Centers. In January 2006, the first private Key Certification Center was accredited by the Central Certification Agency, the functions of which are performed by the Ministry of Transport and Communications of Ukraine.

Although electronic documents and electronic signatures have been in use in Ukraine for sometime, their use has been mainly limited to the banking system, particularly for money transfers. Now, any business or individual with an Open Key in the form of an electronic file will be able to certify documents and instantly send them via the Internet without being required to obtain a notary signature. Purchasing the necessary Open Key will cost UAH 500.00 (the equivalent of US$100.00) annually.

Full utilization of the Open Key will only be possible within a few years when both counteragents have access to the Internet. Currently, some state agencies do not have any Internet connection, and thus lack the technical capability to receive electronically signed documents. It is expected that within six months, businesses and entrepreneurs will be able to file tax returns electronically. However, government agencies, such as the tax authorities, may only use the services of an Accredited Key Certification Center, while other legal entities and individuals may confirm the validity of the Open Key through a non-accredited Key Certification Center.

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Ukraine Authorizes Ratification of UNIDROIT's Financial Leasing and Factoring Conventions

On January 11,2006, Ukraine's Verkhovna Rada (Parliament) authorized the ratification of the International Institute for the Unification of Private Law ("UNIDROIT") Conventions on International Financial Leasing and International Factoring, which were adopted in Ottawa, Canada on May 28,1988.[6]

The Leasing Convention is aimed at creating a uniform legal regime applicable to the Contracting States.[7] The Leasing Convention describes the principles of international leasing, the rules applicable to leasing contracts and the rights and obligations of the parties to a leasing contract, along with the guarantees of property right protection and the reimbursement of losses.

The Leasing Convention governs a financial leasing transaction in which one party (the lessor), (a) on the specifications of another party (the lessee), enters into an agreement (the supply agreement) with a third party (the supplier) under which the lessor acquires a plant, capital goods or other equipment (the equipment) on terms approved by the lessee, and (b) enters into an agreement (the leasing agreement) with the lessee, granting to the lessee the right to use the equipment in return for the payment of rent. The Leasing Convention applies to financial leasing transactions in relation to all equipment except for equipment to be used primarily for the lessee's personal, family or household purposes.

At the time when Ukraine ratified the Leasing Convention, there were nineteen Contracting States, including the U.S., France, Italy and the Russian Federation.

[5] Open Key is a cryptographic algorithm developed by special software used for generation, marking and verification of electronic digital signatures. In order to use the Open Key, the signatory must obtain an Open Key Certificate, a document issued by a Key Certification Center to verify that the Open Key is valid and belongs to that particular signatory.

[6] Please note that it is only after the President signs the respective accession laws that the Conventions would be incorporated into Ukraine's national law, which legal experts expect to occur in the near future.

[7] i.e., the entities from those countries which have signed or acceded to the Conventions.

UNIDROIT Convention on International Factoring (the "Factoring Convention")

The Factoring Convention provides a comprehensive and uniform legal framework governing international factoring contracts and assignments of receivables.

Importantly, to the extent that the Factoring Convention would become part of Ukrainian national law once the President signs the accession law, the determination of the minimum functions to be carried out by an entity that falls under the definition of "factor" effectively expands such definition as now set forth under Article 1077(1) of the Civil Code of Ukraine, which currently contemplates that the only function carried out by a factor is "…the transfer of funds to…the client for value." The application of the Factoring Convention extends to services, as references to "goods" and the "sale of goods" includes services and the supply of services.

Both the Leasing Convention and the Factoring Convention apply when the contracting parties' places of business are located in different States and (a) those States and the State in which the factor (in the case of a factoring contract) or the supplier (in the case of a financial leasing contract) has its place of business are Contracting States; or (b) both the contract for the sale of goods and the factoring contract (in the case of a factoring contract) or the supply agreement and lease agreement (in the case of a financial leasing agreement) are governed by the law of a Contracting State.

Application of the Leasing Convention may be rejected by any party to the supply and leasing contracts. The application of the Factoring Convention maybe rejected (a) by the parties to the factoring contract or (b) by the parties to the contract of the sale of goods with respect to receivables arising at or after the time when the factor has been given notice in writing of such rejection.

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Changes to Fiscal Regime of Subsurface Use in Kazakhstan in 2006

As of January 1,2006, additional amendments to the taxation regime of subsurface users came into effect. The amendments, although not very significant in nature, represent a step forward for potential investors in the subsurface use sector. Set forth herein is a brief summary of the latest amendments and a general outline of the 2006 fiscal regime of subsurface use in Kazakhstan. The summary is not meant to be exhaustive, but rather highlights some major developments impacting on investors.

The taxation regime of subsurface use activities in Kazakhstan, including petroleum operations, construction works and operation of underground facilities unrelated to production, is regulated by the Tax Code, dated June 12, 2001, No. 209-II ("the Tax Code"). Our summary is, therefore, based on the Tax Code provisions in effect on January 1, 2006.[8]

There are two taxation models related to subsurface use activities.[9] The first model ("Model 1") envisages payment of taxes and other obligatory paymentsto the budget in accordance with the tax legislation in effect on the date the relevant payment liabilities arise.

The taxation regime under the second model ("Model 2") can only be stipulated in a production sharing agreement ("PSA") and should be in conformity with the tax legislation in effect on the date the PSA is signed/ concluded.

In the event tax legislation changes during the period from the date of the tax review and

[8] Customs duties and fees that may be applicable to subsurface use activities in connection with import and export of goods are set forth in other legislative acts.

[9] Subsurface users engaged in production of mineral resources prior to conclusion of a subsurface use contract should pay royalties in the amount established by the Kazakhstan Government and in accordance with the procedure specified in the Tax Code.

the date a PSA is signed, the taxation regime should be amended to conform to the legislative changes and another tax review should be conducted.

Ring-fencing Requirement

A subsurface user is obliged to maintain separate tax accounting for activities conducted under the contract. Tax liabilities related to activities outside the framework of the contract should be accounted for separately. This requirement does not apply to contracts for production of common mineral resources and/or underground water.

Where several taxpayers are engaged in subsurface use under one PSA, the taxation regime set forth in the PSA should be the same for all taxpayers. Additionally, the taxpayers are obliged to keep consolidated accounts and pay all taxes and payments envisaged by the PSA for activities conducted within itsframework.

Stability of Taxation Regime

Stability of subsurface use contract rights has always been a key issue for foreign investors, particularly in the oil and gas sector. The Tax Code providesthat thetaxation regime set forth in subsurface use contracts that have undergone an obligatory tax review and were concluded before January 1, 2004, should remain in force for the entire contract validity period and may be adjusted in connection with the change of tax legislation upon agreement of the parties.

With respect to PSAs, the Tax Code providesthat thetaxation terms set forth in PSAs may be adjusted in connection with the change of tax legislation upon agreement of the parties. In the event such legislative changes benefited a subsurface user, thetaxation terms of the PSA should be amended to restore the original economic interests of Kazakhstan. In case certain types of taxes and obligatory paymentsto the budget, envisaged in the PSA, are cancelled, the subsurface user should continue such payments in the order and amounts stipulated in the PSA, until the relevant amendments are introduced into the PSA.

Model 1 Contracts

As stated above, these contracts envisage payment by a subsurface user of taxes and other obligatory payments stipulated by the Tax Code, with the exception of the share of the Republic of Kazakhstan.

Model 2 Contracts (PSAs)

Model 2 type contracts provide for payment by a subsurface user of the Republicof Kazakhstan's share and payment of all taxes and obligatory payments to the budget, stipulated by the Tax Code, except for the following:

- Rent tax on exported crude oil, gas condensate
- Royalty
- Excisetaxon crude oil, gas condensate
- Excess profits tax
- Land tax
- Property tax

Latest Amendments to the Tax Code

The amendments related to subsurface use taxation, which were introduced into the Tax Code as of January 1, 2006, concern Model 2 contracts only. Moreover, the changes relate to the subsurface user's share in profit production and a top-up tax.

The share of the Republic of Kazakhstan under a PSA is determined as the total value of profit production to be shared between the Republic of Kazakhstan and a subsurface user, minus the subsurface user's share in profit production.

The share of a subsurface user in profit production is determined as the lesser of the percentage values corresponding to the following three triggers:

1) the R-f actor (profitability indicator) – ratio of the accumulated income of a subsurface user to accumulated project expenses;
2) the internal rate of return (IRR) of a contractor – discounting rate at which real net discounted income reaches zero; and
3) the P-factor (price coefficient) – ratio of the subsurface user's income to the volume of extraction for the reporting period.

The above triggers are determined in accordance with a special methodology. The result obtained from each of the triggers should be compared to the threshold amounts specified in a PSA to determine the percentage value of a share in profit production which is to be transferred to the subsurface user.

According to the Tax Code amendments enacted as of January 1, 2006, the specific percentage values of a subsurface user's share in profit pro-

Taxes/ Payments Under Model 1 And Model 2 Contracts

Taxes/ Paym ents	Tax on M odel 1 Contracts	Tax on M odel 2 Contracts
Corporate income tax	Payable	Payable
Branch profitstax (applicable to branches of foreign legal entities)	Payable	Payable
Value added tax	Payable	Payable
Excise tax	Payable	Excise tax on crude oil, gas condensate is not payable
Rent tax on exported crude oil, gas condensate	Payable	Not payable
Signature bonus	Payable	Payable
Commercial discovery bonus	Payable	Payable
Royalty	Payable	Not payable
Excess profits tax	Payable	Not payable
Share of the Republic under a PSA	Not payable	Payable
Top-up tax	Not payable	Payable
Social tax	Payable	Payable
Land tax	Payable	Not payable
Vehicle tax	Payable	Payable
Property tax	Payable	Not payable
Payment for use of a land plot	Payable	Payable
Payment for use of water resources from surface	Payable	Payable
Payment for environmental pollution	Payable	Payable
Payment for use of specially protected natural areas	Payable	Payable
Payment for radio frequency spectrum use	Payable	Payable
Payment for use of navigable waterways	Payable	Payable

duction, stipulated in the PSA within the limits provided by the Tax Code, are stabilized for the entire PSA term.

The Tax Code amendments also provide that the actual ceiling to apply on the profit oil triggers would be negotiated and fixed in the PSA in the range of 70% to 90%. Previously, such ceiling was capped at 70%.

In addition, based on the Tax Code amendments, during the course of implementation of a PSA, the Republic of Kazakhstan's share of revenue in each tax period, starting from the moment of commencement of production until the moment of return on investment, should not be less than the value set forth in the PSA in the range of 5% to 10% and should not be less than 40% of the volume of production received by the subsurface user in a tax period, in subsequent tax periods. Prior to the latest amendments, the Republic of Kazakhstan's share of revenue[10] was supposed to be not less than 10%during the period preceding the return on investment.

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[10] The Republic of Kazakhstan's share of revenue means the tax liabilities fulfilled by a subsurface user in are porting period, including the Republic's share in product ion sharing, taxes and other obligatory payments to the budget, but excluding VAT and other taxes where the subsurface user acts as a tax agent.