

Russia

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Changes in the Russian Government Structure

Decrees of the Russian President, Vladimir Putin No. 314 of 9 March 2004 "On the System and Structure of the Federal Organs of Executive Power" and No. 649 of 20 May 2004, established a revised system of Government of the Russian Federation consisting of Federal Ministries; Federal Services; and Federal Agencies.

The Federal Ministries are authorised to adopt legal acts. The Federal Services carry out controlling and supervision functions. The Federal Agencies provide state services, manage the state-owned property and carry out law enforcement functions.

As a rule, Federal Services and Federal Agencies are administered by the Federal Ministries. However, a number of Services and Agencies administered by the Government directly (for example, Federal Service for the Financial Markets and Federal Antimonopoly Service) are also authorised to adopt legal acts. Several ministries were merged and two were downgraded to the level of Federal Agency or Federal Service.

Some of these reforms impact on the day-to-day activities of investors as they introduce new business regulators and abolish some of the existing regulatory authorities. In particular, as a result of the reform, the Ministry for Anti-Monopoly Politics and Support for Entrepreneurship will cease to exist and will be replaced by the Federal Anti-Monopoly Service ("FAS"). FAS shall be entitled to exercise control and supervision over compliance with the requirements of the competition, natural monopolies and advertisement laws.

Federal Commission for the Securities Market ("FCSM") will be replaced by the Federal Service for the Financial Markets ("FSFM"). The new regulator will be vested with powers to:

- ! carry out registration of securities issues, reports on securities issues and securities prospectus;
- ! ensure the disclosure of information relating to the securities market; and

! exercise control and supervision over the issuers and professional participants of the securities market.

In general, the new structure of the Russian Government promises to be more transparent with a more coherent division of competence.

Corporate

Amendments to the Joint Stock Companies Law

Amendments passed in February 2004 to the Joint Stock Companies Law relating to the appointment of company's directors became effective on 15 March 2004.

First, the amendments provide that a minimum of five directors shall sit on the board of a joint stock company ("JSC") irrespective of the number of the company's shareholders. The requirement to have at least seven directors in a company with more than 1,000 voting shareholders and nine directors in a company with more than 10,000 voting shareholders has not been changed (the previous version of the JSC Law allowed companies with 1,000 or less voting shareholders to determine the number of directors at their own discretion).

Second, all directors of a JSC must now be elected by a cumulative vote whereas, previously, this type of vote was mandatory only for companies with more than 1,000 voting shareholders. Under the cumulative voting mechanism the minimum number of shares required to secure the election of a certain number of directors to the board by way of cumulative voting may be calculated using the following formula:

$$\frac{\text{total number of company's shares} \times \text{number of directors you wish to elect} + 1}{\text{total number of directors to be elected} + 1}$$

Accordingly, the minimum number of shares required to ensure a certain level of board representation by way of cumulative voting depends on

the total number of company's shares and the number of directors which are prescribed by its charter. For example, in order to secure the election of one candidate to the board of directors in a company with 1,000 shares a shareholder must have:

- ! 16.8% of votes to elect one candidate to the five-member board;
- ! 12.6% of votes to elect one candidate to the seven-member board; and
- ! 10.1% of votes to elect one candidate to the nine-member board.

The introduction of mandatory cumulative voting for the election of the board of directors gives the minority shareholders a greater chance to elect their own representative to the board of directors.

The new procedure applies equally to the re-election of directors at the annual shareholders' meeting as well as to the by-election of particular directors if two or more of them leave the board earlier. Under the JSC Law a by-election is not necessary until the next annual shareholders' meeting if the number of remaining directors satisfies the quorum established by the company's charter. If not, the remaining directors must convene an extraordinary shareholders' meeting to elect new directors.

Banking and Finance

New Russian Central Bank Regulations on Mandatory Conversion of Foreign Currency Receivables

The Central Bank of the Russian Federation (the "CBR") issued an Instruction "On Mandatory Conversion of Foreign Currency Receivables on the Internal Currency Market of the Russian Federation" No. 111-I of 30 March 2004 (the "Instruction"). The Instruction was adopted in implementation of the new Russian Currency Law and enters into force on 18 June 2004, simultaneously with this law¹. The Instruction will replace the provisions of the existing CBR Instruction No. 7 dated 29 June 1992, which presently deals with the mandatory conversion of foreign currency receivables.

The Instruction leaves unchanged:

- ! the currently existing 25% level of mandatory conversion of foreign currency receivables; and
- ! the main features of the procedure for mandatory conversion (in particular, transit accounts used for the purposes of such conversion will remain).

The Instruction however introduces a number of changes, in comparison with the current regime. In particular, it:

- ! provides for a more detailed procedure of mandatory conversion;
- ! changes the timing for conversion from seven calendar days to seven business days (as provided in the new Currency Law); and
- ! provides that, if the holder of a transit account has not given the relevant conversion instructions to its passport bank, the funds will remain in the transit account (whereas under the current regime the conversion is to be performed by the passport bank even in the absence of client's instructions).

In addition, it is important to note that the Instruction takes into account the exemptions from mandatory conversion for certain types of foreign currency proceeds granted by the Currency Law, and does not impose an obligation to convert such exempted proceeds. In order for the exemptions to become fully operational, further regulations will need to be adopted/amended by the CBR (i.e., the currently existing regulations on the regime of the passport of the deal).

The Instruction is one of the very first regulations adopted by the CBR in implementation of the Currency Law.

Litigation and Arbitration

Right of audience update

In April 2004 the Constitutional Court of the Russian Federation issued a ruling that is likely to be ground breaking for the Russian legal profession. Galina Sityaeva's son was killed in the army by two sailors but only one was sent to prison (the second was only disqualified). She wanted to appeal against the court verdict which in her view was too soft for the second man. However, Ms Sityaeva could not find an advocate who would take her case. So, she hired professional lawyers from a social assistance organisation. However, the court refused to grant rights of audience to those lawyers arguing that they were not advocates as required by Article 45 of the Criminal Procedural Code.

Following that refusal, a complaint was filed with the Constitutional Court to review the constitutionality of Article 45 which provides that a victim can only be represented in criminal proceedings in court by an advocate. Russian criminal courts traditionally interpreted this provision literally and did not allow other professional lawyers to represent victims in criminal matters. This approach was never

seriously criticised by the legal community in Russia since there was a general appreciation that advocates are greater specialists in criminal law. However, this led to a situation where in many instances the victims could not find an advocate because of high fees or because advocates thought the particular case not sufficiently remunerative. Such interpretation disallowed victims from, for example, using lawyers from human rights organisations etc., since in the majority of cases they are not advocates.

The Constitutional Court considered the application and ruled that Article 45 of the Criminal Procedural Code should not be interpreted in a way depriving persons other than advocates from representing victims in criminal proceedings.

The Russian legal community awaits further developments in this area, since similar difficulties are still an issue in Russian arbitrazh (commercial) courts. According to Article 59 of the Arbitrazh Procedural Code advocates or a company's employees may represent companies before these courts. It was reported that TNK and a local Russian law firm challenged the constitutionality of this provision but the Constitutional Court has still not considered the application. It is expected that the review will take place sometime in summer 2004. It is possible that the Constitutional Court will take a similar position as regards rights of audience before the commercial courts.

Court review of labour law

On 17 March 2004 the Plenum of the Supreme Court of the Russian Federation adopted Decree No. 2 containing guidance in relation to resolution of labour law disputes. The Decree provides for comprehensive overview of the procedures for entering into, amendment and termination of employment agreements, guarantees to employees terminated by the employer and some other related issues. Russia is not a precedent-based legal system, however, guidance from the Plenum of the Supreme Court in relation to law interpretation is binding on lower courts.

Taxation System

Tax Update

In addition to changes that came into effect as of 1 January 2004 (reduction of VAT from 20% to 18%) during 2004 the Government of the Russian Federation has announced a number of possible amendments to the Tax Code, which may affect almost all the major taxes. Some of these initiatives have already been adopted and may, therefore, be relevant to potential investors into Russia.

Rates of mineral extraction tax and customs duties on oil

The new law has been recently signed by the President, which effectively increases the export custom duty on crude oil from 1 August 2004 and provides for the new mineral extraction tax rate (on the extraction of oil), which would be effective from 1 January 2005. The draft has been introduced by the Government earlier this year.

As a result of these amendments, the basic rate of the mineral extraction tax on crude will be increased from RUR347 per tonne to RUR400 per tonne.

The mineral extraction tax on crude, therefore, will be calculated as follows:

RUR400 per tonne \times [(average Urals prices per the tax period in US\$ - 9) \times (average US\$/RUR exchange rate in the tax period)/261].

The new law also amends the existing schedule for calculation of export custom duties on crude. The revised schedule should look as follows:

- ! if the price for crude is below US\$15 per barrel no export duty will be imposed;
- ! if the price for crude is over US\$15 but below US\$20 per barrel a rate of up to 35% will apply to the difference between the actual price per barrel and US\$15;
- ! if the price for crude is over US\$20 but below US\$25 per barrel the maximum rate is US\$12.78 per tonne of crude plus 45% of the difference between the actual price and US\$20 per barrel;
- ! if the price for crude is over US\$25 per barrel the maximum rate is US\$29.2 per tonne of crude plus 65% of the difference between the actual price and US\$25.

The average rate of export duties on oil products should not exceed 90% of the rates applied to crude oil.

Russian tax treaty network

The Russian Ministry of Finance issued a letter listing double tax treaties with the Russian Federation being in force as of 1 January 2004. The list refers to 66 treaties, six of which have been in effect from 1 January 2004 and include Australia, Iceland, New Zealand, Syria, Kuwait and Tajikistan. This increases a variety of choices available for inbound investors coming to Russia. □