Russia

Corporate

Federal Law "On Trade Secrets"

The Federal Law of the Russian Federation "On Trade Secrets" (hereinafter the "Law") was put into effect on 16 August, 2004. The Law governs relationships in connection with the classification of information as trade secrets, the disclosure of such information and the observation of confidentiality in respect of such trade secrets. It also defines information that may not be the subject of a trade secret.

The criteria used to determine whether or not information should be classified as a trade secret has been set out previously by the Civil Code of the Russian Federation (Article 139). However, the new Law provides a definition of a trade secret, offering a rough schedule of information that may be treated as a trade secret. In addition, the schedule sets out the type of information which may not be deemed to be a trade secret. The schedule is analogous with that provided by RSFSR Government Resolution No. 35, dated 5 December, 1991.

The Law keeps in effect existing obligations of business entities to disclose to governmental authorities (whether federal or local) information, which constitutes a trade secret without charge, upon request. Should a party in possession of information, which constitutes a trade secret refuse to disclose such information, the relevant authorities may seek the information through the courts.

For the first time, Russian lawmakers have promulgated a mandatory list of measures, which the holder of the information must adhere to in order to set the status of a commercial secret with regard to specific information and by this to ensure legal protection of such trade secret.

The Law has set forth the duties and responsibilities of employers and employees with respect to nondisclosure of trade secrets. In particular, an employer shall, in order to keep any information confidential, deliver to its employees a list of information which constitutes a trade secret and have it acknowledged by each employee by their signed receipt. Employees shall not disclose such information without the consent of the employer and the employer's contracting parties, and not to use such information for the employees' personal ends. The obligation not to disclose information constituting a trade secret survives the termination of employment contracts, for a period as may be agreed between the employer and the employee, or three years following the termination of the employment contract in the absence of agreement between the parties.

Finally, the Law provides for disciplinary, civil, administrative, and criminal liability for breaches of legislation relating to the protection of trade secrets.

The authors of numerous publications responding to the promulgation of the Law, unanimously suggest that the lawmakers have failed to clearly regulate the relationships arising in connection with the protection of information constituting a trade secret, and that the promulgation of the Law was to a certain extent a political move intended to advance Russia's accession to the WTO. In any event, the promulgation of the Law is a positive step on the way toward improving the body of law relating to the protection intellectual property.

For the purposes of protecting trade secrets, we recommend that employers draw up a schedule of information considered a trade secret, and internal regulations governing the protection of trade secrets. They should incorporate provisions regarding relationships arising in connection with protection of a trade secret into employment agreements and civil law contracts concluded with their counterparties, and carry out such other measures to procure nondisclosure of trade secrets as provided by the Law.

Baker & McKenzie

Proposed Amendments Would Allow "Squeezing Out" of Minority Shareholders

On July 7, 2004, the Russian Federation ("RF") State Duma adopted in the first reading, a set of draft amendments (the "Draft Amendments") to the Law "On Joint Stock Companies," dated December 26,1995, as amended (the "JSC Law"),

which would grant majority shareholders in joint stock companies (a "JSC") the right to force a sale of shares held by minority shareholders. The Draft Amendments would also provide minority shareholders with the right to demand a buy-out of their shares by the majority shareholder under certain circumstances.

Under current Russian practice, minority shareholders in companies majority-owned by one shareholder have often yielded power disproportionate to their equity interest through their ability to block interested party transactions involving the majority shareholder or through other means. The Draft Amendments would allow a shareholder holding 90% plus 1 share of stock (a "Majority Shareholder") to compel the remaining shareholders in the JSC to sell their common shares at "market price" to the Majority Shareholder. The market price must be confirmed by an independent appraiser. In order to exercise this right, the Majority Shareholder would need to send a demand to minority shareholders, containing relevant information on the Majority Shareholder, the number of shares owned by the Majority Shareholder, the price to be paid per share, etc. Upon receipt of such a demand, the minority shareholders would be required to sell their shares to the Majority Shareholder under the conditions set forth in the Majority Shareholder's buy-out demand. A minority shareholder who does not agree with the calculation of the market price of the shares would have the right to challenge this calculation in court. However, the filing of a lawsuit would neither suspend the buy-out of shares, nor constitute legal grounds for invalidating the buy-out.

In a situation where the Majority Shareholder intends to exercise its right to buy out shares owned by minority shareholders, the Draft Amendments would override current provisions of the JSC Law which give existing shareholders in a closed joint stock company a right of first refusal to acquire shares sold by another shareholder.

At the same time, the Draft Amendments would expand Article 75 of the JSC Law under which shareholders are currently entitled to demand a buy-out of their shares in a JSC under certain circumstances. According to the Draft Amendments, on completion of a transaction resulting in a shareholder's acquisition of 90% plus 1 share of the issued shares of a JSC, the board of directors would be required to notify the shareholders within 5 days of the date when the relevant record was made in the company's shareholders' register. Following such notification, minority shareholders would have 45 days to demand the Majority Shareholder to buy out their shares, and the Majority Shareholder would have 30 days from the date of such demand to complete the buy-out. The shares must be bought out at a price determined by the board of directors, which may not be less than their market value as determined by an independent appraiser.

Notably, the Draft Amendments (with regard to both the Majority Shareholder's right to buy out shares from minority shareholders, and the minority shareholders' right to demand a buy-out) would not apply in situations where the State and/or a municipal unit is the owner of 10 percent minus 1 share in the company.

If implemented into law, the Draft Amendments would allow Majority Shareholders greater control over their operations without the threat of being overridden by shareholders holding only minor stakes in a company. This could also attract greater investment into large privatized Russian entities, where investors have often declined to invest given their inability to buy-out minority shareholders. Finally, the law seeks to obtain a balance, by also allowing minority shareholders the right to be bought out if a new shareholder takes over the company.

We will continue to monitor the status of the Draft Amendments and will report on further developments.

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Draft Law Would Set Term for Challenging Board of Directors' Decisions

On April 29, 2004, the RF State Duma approved in the first hearing the draft law "On the Introduction of Additions to the Federal Law 'On Joint Stock Companies'" (the "Draft Law"), which addresses the issue of challenging decisions made by the directors of a joint stock company ("JSC"). Under the Draft Law, shareholders and members of a JSC's board of directors would be entitled to challenge decisions of the board of directors in court if such decisions: (i) were made in violation of the law or the JSC's charter; or (ii) affect the challenging party's rights or legal interests. The Draft Law also specifically sets the term for challenging a decision of the board of directors at six months after the relevant shareholder or board member learned (or should have learned) of such decision.

Under current law, it has been unclear under what circumstances a decision of the JSC's board of di-

rectors may be challenged. Also, experts have disagreed over how long the period for challenging a decision should be. Two possibilities have been suggested: (i) the general three-year statute of limitations term; or (ii) the special six-month statute of limitations term applicable to invalidating the decisions of a general shareholders' meeting.

Due to the lack of regulations on this issue, court practice has been inconsistent. Recently, the RF Supreme Arbitration Court stated in Decree No. 19 "On Certain Issues on the Application of the Federal Law 'On Joint Stock Companies,'" dated November 18, 2003, that any decision of the board of directors may be challenged in court, irrespective of whether this right is expressly provided for by law. However, the Supreme Arbitration Court did not specify the circumstances necessary or the term during which decisions may be challenged. If the Draft Law is passed, it should provide clear guidelines on these questions.

Under Russian law, the Draft Law must still pass through a second and third hearing in the State Duma before becoming law, but it is expected to be adopted after favorable reports from the RF Government and State Duma committees. The RF Government has suggested certain additions to the Draft Law, in particular, to specify that a board member may challenge a decision of the board of directors only if he/she did not participate in the meeting during which the vote was taken, or voted against the decision (this is similar to the rules for invalidating decisions of general shareholders' meetings). The expediency of this additional basis for challenging decisions, along with all other suggestions, will be discussed during the second hearing of the Draft Law in the State Duma, which is currently scheduled for November 2004.

By A. Kelina,
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Taxation

Yukos Tax Litigation May Affect Other Taxpayers

As almost everyone by now knows, pursuant to a Moscow Arbitration Court decision (the "Moscow Arbitration Court" or the "Court") rendered in May of this year, one of the largest Russian companies, OAO Yukos ("Yukos"), has been ordered to pay approximately US $3.4 billion in taxes, penalties and fines owed in connection with the 2000 financial year. In July, the RF Ministry of Taxes and Levies (the "Tax Ministry") sent Yukos a claim for a similar amount in relation to the 2001 financial year, which the company is disputing. An examination of the amount of taxes paid by Yukos in 2002 has also been announced, leading many to speculate that Yukos' final tax bill for 2000-2003 could grow to $10 billion.

The Russian business community has been watching the developments with respect to the tax cases against Yukos very closely. In general, the Moscow Arbitration Court's decision has generated significant concern on the part of many Russian companies who currently employ various tax optimization plans in their Russian operations.

The case against Yukos was brought by the Tax Ministry, which has argued that Yukos "unscrupulously" utilized tax benefits, resulting in an underpayment of taxes. In particular, the tax authorities have alleged that Yukos' proceeds were passed through 21 affiliated companies registered in so-called "internal offshore zones" *(i.e.,* Russian regions which provide certain tax benefits based on a taxpayer's investment in the region) exclusively for tax evasion purposes.

Prior to January 1, 2004, many Russian companies took advantage of the benefits provided by Russian tax legislation, including obtaining tax benefits from "internal offshore zones" such as Kalmykia, Mordovia and Chukotka, in order to decrease their tax burdens. The Russian media reported that active tax optimization resulted in an effective tax profit rate of 12% -15% for certain Russian companies in 2000-2002, far below the normal *(i.e.,* without application of any tax benefits) tax profit rate of 24% provided by Article 284 of the RF Tax Code (the "Tax Code"). Although Russian tax authorities had attempted on numerous occasions in the past to challenge the practice of internal offshore tax optimization, for the most part, state arbitration courts in Russia generally ruled against such attempts by the tax authorities provided that taxpayers were acting within the scope of federal and regional tax laws.

Many have questioned why the Moscow Arbitration Court in the Yukos case would support the position of the tax authorities. According to the decision of the Moscow Arbitration Court, Yukos utilized tax benefits with a fictitious goal - *i.e.,* tax benefits were obtained not in return for investments in a particular region, but solely for tax evasion purposes, and numerous transactions among Yukos and its affiliates residing in such internal offshore zones had no economic value or purpose other than to decrease Yukos' taxable income. The Moscow Arbitration Court declared that Yukos' lawful sales of oil to 21 "internal offshore" companies "lacked scruples." Moreover, although the Yukos court file apparently contains no evidence that all 21 companies which had participated in transactions involving sales of Yukos' crude oil had any corporate connection to Yukos or were under its control, the Moscow Arbitration Court deemed these companies to be affiliated entities. On the basis of this assumption, the Court concluded that Yukos' control over these companies gives it effective control over their crude oil in all stages of their sales and, therefore, Yukos is the final beneficiary of all proceeds from sales of crude oil to consumers.

In its reasoning, the Moscow Arbitration Court referred to Decision No.138-O of the RF Constitutional Court, dated July 25, 2001, which dealt with a case in which an insolvent bank was unable to wire its client's tax payments to the government following the 1998 financial crisis. At this time, many insolvent banks were unable to transfer their clients' funds to the government, notwithstanding their clients' instructions. Pursuant to Articles 44 and 45 of the RF Tax Code, a taxpayer's obligation is deemed completed when such taxpayer instructs its bank to wire tax payments to the government. Many taxpayers took advantage of the situation and knowingly opened accounts with insolvent banks, instructing them to "wire" tax payments to the government. In response, the RF Constitutional Court instructed the courts to determine the "scrupulousness" of taxpayers to distinguish fraudulent activity. In its decision, the RF Constitutional Court ruled that the clients in the case under investigation had performed their obligations to pay taxes on the basis of Articles 44 and 45 of the RF Tax Code because they were "scrupulous" taxpayers, *i.e.* they did not knowingly use an insolvent bank to pay taxes.

The concept of "scrupulousness" has been widely used by the tax authorities in attempts to challenge taxpayers' applications for export VAT refunds, but courts mostly supported taxpayers when such matters were litigated in courts.

In the Yukos case, the Court stated that although Article 56 of the RF Tax Code provides taxpayers with the possibility to enjoy legally established tax benefits, "such taxpayers must utilize their rights to tax benefits scrupulously; meanwhile, it is clear from the court file that the taxpayers used their rights in bad faith." As evidence of Yukos' bad faith, the court noted that the activities of the 21 separate legal entities were not directed at "strengthening the economies" of the regions offering "internal offshore" tax benefits, but rather aimed at Yukos' tax evasion.

As a result, although Yukos and its "affiliates" apparently used regional tax benefits formally provided by legislation in effect, the Moscow Arbitration Court rejected such arguments on the basis that such enjoyment of tax benefits was unlawful because of a "lack of scruples" in Yukos' activity. Yukos has been unsuccessful in appealing this decision and on June 29, 2004, the Appellate Instance of the Arbitration Court of Moscow City upheld the decision of the first instance court.

Needless to say, the Russian business community has reacted to this dramatic change in court practice with serious concern. There is a possibility that if the third (cassation) court instance upholds the decision in question in September- October of 2004, the tax authorities will have a strong basis for pursuing other major Russian corporate taxpayers for tax benefits received in the past, which could have a major impact on the Russian stock market and the stability of investment in the country generally.

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Tax Legislation

Order No. SAE-3-01/356@ of the RF Ministry of Taxes and Duties, *On the Approval of the Procedure and Deadlines for the Submission to the Tax Authorities by an Investor in a Production-Sharing Agreement of Documents for an Exemption from Payment of the Tax on the Property of Organizations in Respect of Property Used Exclusively for Activity Stipulated by the Production-Sharing Agreement,* dated 7 June 2004 (Ministry of Justice registration No.5891,7 July 2004)

[*Note:* In accordance with RF Government Resolution No. 15 of 15 January 2004 "On the Approval of the List of Documents to be Provided by an Investor in a PSA to the Tax Authorities for an Exemption from the Payment of the Tax on the Property of Organizations, in Respect of Property Used Exclusively for Activity Stipulated by the Production-Sharing Agreement", the procedure and deadlines for the submission of such documents to the tax authorities have been approved. Also approved was the form of the register of fixed assets, intangible assets, stocks and costs held on the balance sheet of the taxpayer and used to perform activity stipulated by the PSA, which must be submitted by taxpayers to the tax authorities in accordance with the Resolution].

Order No. SAE-3-01/355@ of the RF Ministry of Taxes and Duties *On the Approval of the Procedure and Deadlines for the Submission to the Tax Authorities by an Investor in a Production-Sharing Agreement of Documents for an Exemption from Payment of the Transportation Tax on the Vehicles Belonging Thereto (Except for Passenger Cars) Used Exclusively for Activity Stipulated by the Production-Sharing Agreement,* dated 7 June 2004 (Ministry of Justice registration No. 5892, 7 July 2004)

[*Note:* In accordance with RF Government Resolution No. 14 of 15 January 2004 "On the Approval of the List of Documents to be Provided by an Investor in a PSA to the Tax Authorities for an Exemption from the Payment of the Transportation Tax on the Vehicles Belonging Thereto (Except for Passenger Cars) Used Exclusively for the Purposes of a Production-Sharing Agreement", the procedure and deadlines for the submission of such documents to the tax authorities have been approved. Also approved was the form of the register of vehicles, which must be submitted by the PSA investor to the tax authorities in accordance with the Resolution].

Ruling of the Constitutional Court of the Russian Federation, *On the Review of the Constitutionality of Certain Provisions of Part Two of Article 89 of the RF Tax Code in Connection with the Petitions of Citizens A.D. Egorov and N.V. Chuev,* dated16 July 2004

[*Note:* The Russian Constitutional Court has upheld the constitutionality of the provisions of part two of article 89 of the Tax Code, which govern the deadlines and duration of field tax audits. The petitioners had disputed the constitutionality of these norms, pursuant to which a field tax audit may not last for more than two months (in exceptional cases three months), but the time of performance of the audit includes only the time when the auditor is actually on the premises of the taxpayer being audited. The petitioners argued that this permits the tax authorities to suspend the performance of field audits for an indefinite time, which restricts the freedom of their business activity and threatens the stability of their financial position. The Constitutional Court established that the duration of the field tax audit is the sum of the periods during which the auditors were on the taxpayer's premises, and that the procedure of reckoning duration by the calendar was not applicable in this case].

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Customs Legislation

Letter No. 01-06/24278 of the RF State Customs Committee, *On Administrative Liability for the Failure to Fulfill the Requirements of the Export Customs Regime,* dated 1 July 2004

[*Note:* Until the Russian government establishes the procedure for settlements and transfers between residents and nonresidents on terms of a deferral of payment on foreign-trade contracts for a period exceeding that stipulated by article 7 of Federal Law No. 173-FZ of 10 December 2003 "On Currency Regulation and Currency Control", residents have the right without restriction (from 18 June 2004 until the establishment of the given procedure) to provide non-residents with deferral of payment for the goods transferred to them, for any period. The letter also stipulates that until amendments are made to effective legislation on administrative offenses, parties that before 18 June 2004 violated the requirements of the export customs regime regarding the mandatory import of goods, work, services, and results of intellectual activity, equivalent in value to the exported goods, pursuant to the procedure established by RF Presidential Decree No. 1209 of 18 August 1996 "On the State Regulation of Foreign-Trade Barter

Transactions", or on the remittance to accounts in authorized banks of foreign-currency proceeds from the export of goods in accordance with Russian Federation Law No. 3615-1 of 9 October 1992 "On Currency Regulation and Currency Control", may be subject to administrative liability under article 16.17 of the Code of Administrative Offenses of Russia].

Directive No. 246-r of the RF State Customs Committee, *On the Specifics of the Customs Clearing of Goods Exported by Rail,* dated 27 May 2004

[*Note:* A number of requirements on the documentation of the export by rail of goods from Russia have been approved. Among other things, the Directive establishes that if goods are exported on the basis of periodic customs declarations (including temporary declarations), the customs authorities are obligated to accept shipping documents that lack certain information, provided that the declarant undertakes to provide rail waybills containing complete information within five working days from the date the railway accepts the goods for shipment].

Letter No. 01-06/24875 of the RF State Customs Committee, *On the Collection of Customs Payments and the Accrual of Penalties,* dated 7 July 2004

[*Note:* An explanation of the procedure for calculating penalties for the non-payment of customs duties and taxes. If during the performance of certain forms of customs control it is disclosed that in respect of goods imported into Russia customs payments or taxes have not been paid or have been paid only partially after the release of the goods, penalties shall accrue from the day following the day of acceptance of the customs declaration by the customs authorities. If the customs declaration is submitted late while the goods are in a temporary storage warehouse, penalties shall neither accrue nor be payable].

Order No. 664 of the RF State Customs Committee, *On the Competence of the Customs Authorities on the Performance of Customs Operations in Respect of Excisable Goods*, dated 11 June 2004 (Ministry of Justice registration No. 5866, 27 June 2004)

[*Note:* Definition of which customs bodies possess the exclusive authority to provide excise stamps to importers, as well as those possessing authorities to perform customs operations in respect of excisable goods whose circulation is subject to licensing and marking with excise stamps, wine-making materials, and cognac spirits being transported across the customs border, and also beer imported into Russia (including non-alcoholic beer). The Order also determines the customs bodies that have the right to carry out customs operations in respect of imported goods for which a vehicle passport is issued].

Resolution No. 354 of the RF Government, *On the Approval of the Export Customs Rate on Crude Oil and Primary Oil Products Obtained from Bituminous Rock, Exported from the Russian Federation Outside the Member States of the Customs Union*, dated 15 July 2004. Effective: 1 August 2004

[*Note:* From 1 August 2004, the rate of export customs duties on crude oil and oil products produced from bituminous rock will be increased from USD 41.60 to USD 69.90 per ton].

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Miscellaneous

Advocates' Monopoly Proclaimed Unconstitutional

On July 16, 2004, the RF Constitutional Court ("the Constitutional Court") declared unconstitutional a provision that restricts lawyers from representing legal entities in Russian arbitration courts. Arbitration courts are not "arbitration" tribunals, but rather courts that hear commercial claims involving legal entities or individual entrepreneurs.

In its decision, the Constitutional Court focused on Part 5 of Article 59 of the RF Arbitration Procedure Code (the "APC"), which states that a legal entity may be represented in arbitration courts only by: **(i)** employees of such legal entity (such as in-house counsel); or **(ii)** advocates. Under Russian law, an "advocate" is a lawyer who is registered with the Bar Chamber in his/ her corresponding region and is admitted to practice after serving as a trainee for up to two years and passing

a qualifying exam. Lawyers who are not registered with the Bar Chamber are also permitted to practice in the RF; however, the provision of Part 5 of Article 59 of the APC prohibited lawyers who were not advocates from representing clients in arbitration courts.

When the APC was signed into law in September 2002, the provision limiting corporate litigants' access to legal assistance shook the Russian legal community. Traditionally, no special system has existed in Russia to admit lawyers to the practice of law. Any graduate of a Russian law school is entitled to provide legal services, including representing clients in courts of general jurisdiction. Prior to the introduction of the new APC, the same rules applied to legal representation in state arbitration courts. The limitations imposed by Part 5 of Article 59 were viewed by Russian attorneys as a serious prohibition on their ability to represent long-standing clients in court and by in-house lawyers as a restriction on their right to choose counsel to represent their companies in litigation. Since Part 5 of Article 59 restricts an in-house lawyer from representing any other company, it also disrupted the practice, common among large vertically-integrated Russian companies, of using one in-house counsel to represent subsidiaries and affiliated companies in state arbitration courts. This practice was particularly common in tax and administrative cases, which often involve intercompany sales and financial documentation with numerous subsidiaries and complex ownership structures.

In December 2002, the Constitutional Court accepted applications from several Russian law firms deprived by the APC of representing their corporate clients in arbitration courts, as well as from in-house counsel of major Russian companies, to consider the constitutionality of the law. The Russian press reported that an in-house counsel of TNK-BP, a joint venture between Tyumen Oil Company and British Petroleum, was one of the main driving forces in initiating the challenge to the constitutionality of the APC. All applicants sought to have Part 5 of Article 59 declared unconstitutional.

On July 16, 2004, the Constitutional Court finally issued its decision (the "Resolution"), stating that Part 5 of Article 59 of the APC contradicts the RF Constitution. The Resolution deems this provision of the APC discriminatory, since other participants in arbitration proceedings *(i.e.,* individuals, including individual entrepreneurs) are not subject to such restrictions and are free to choose their representatives. Moreover, in courts of general jurisdiction, all lawyers (including advocates) may represent clients in civil matters. Only in criminal proceedings are lawyers who are not advocates restricted from representing clients in accordance with the RF Criminal Procedure Code.

The Constitutional Court found that by arbitrarily placing advocates in a preferred position, Part 5 of Article 59 violates the constitutional principal of legal equality. By issuing the Resolution, the Constitutional Court demonstrated that the State may not restrict a legal entity's choice of representation in arbitration courts.

By D. Gubarev, A. Kelina,
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RF Supreme Arbitration Court Clarifies Court Bailiff's Scope of Authority in Enforcing State Arbitration Court Awards

Needless to say, without an effective procedure for executing court awards, a judicial system cannot function effectively. Russian bailiffs have long lacked uniformity in conducting execution proceedings when carrying out awards from state arbitration courts, often resulting in unsatisfactory results. The RF Supreme Arbitration Court has recently attempted to address the deficiencies in the system by issuing Informational Letter No. 77, "Overview of Practice on Cases Related to the Execution of Arbitration Court Awards by Court Bailiffs" ("Informational Letter No. 77") on June 21, 2004. Informational Letter No. 77 analyzes representative decisions by various arbitration courts in cases related to actions by court bailiffs who under RF Law No. 119-FZ "On Execution Proceedings," dated July 21,1997 (as amended) (the "Execution Proceedings Law"), are charged with executing court awards. In so doing, Informational Letter No. 77 provides much-needed guidance aimed at standardizing the approach of arbitration courts in enforcing state arbitration court awards.

Court Bailiff's Right to Terminate Execution Proceedings

The cases reviewed in Informational Letter No. 77 indicate that as a general rule, a court bailiff should be persistent in pursuing execution proceedings except in cases where enforcement is impossible or when termination is specifically provided for by applicable law.

A summary of some of the more important points covered is set forth below.

A pledge should be enforced by a court bailiff even if the subject of the pledge has left the possession of the debtor *(Section 9).* In this case, an arbitration court considered the legality of a court bailiff's decision to terminate execution proceedings with respect to foreclosure on pledged property. The court bailiff argued that because the debtor had disposed of the pledged property and no longer owned it, enforcement was impossible. The arbitration court ruled that this decision was illegal, pointing to Article 353 of the RF Civil Code which states that a pledge is transferred together with the pledged property. The arbitration court stated that since the court award was to enforce the pledge, the court bailiff should have enforced the pledge even if the pledged property was currently held by a third party *(i.e.,* not the original ledger).

Absence of debtor's property leads to termination of execution procedure on foreclosure *(Section 11).* An arbitration court, considering a case in which a creditor challenged a court bailiff's decision to terminate the execution procedure on a foreclosure, held that in the event that there are no assets to foreclose upon, execution proceedings should be terminated. In this particular case, the court pointed to the following evidence of lack of property obtained by the court bailiff from the tax inspectorate and real estate registration authorities: that the debtor had no personal or real property; that its bank accounts were closed; that accounting records had not been submitted for tax purposes; and that the location of its executive body was unknown. On the basis of such evidence, the court concluded that the court bailiff's decision to terminate the execution procedure was lawful and justified.

Initiation of a bankruptcy case does not provide grounds for returning execution writs to creditors, but only for suspending their enforcement *(Section 12).* In this case, a creditor challenged a court bailiff's decision to terminate execution proceedings when the debtor became subject to an observation procedure. An observation procedure is the first step in bankruptcy and is aimed at discovering all of the debtor's creditors, accounting and registering debtors' claims, and holding a meeting of creditors in which votes are assigned in proportion to the amount of the debtors' claims.

The arbitration court in considering the challenge concluded that the court bailiff's decision was unlawful. RF Law No. 127-FZ "On Insolvency (Bankruptcy)," dated October 26, 2002 (the "Bankruptcy Law"), specifically provides that commencement of an observation bankruptcy procedure suspends the enforcement of execution writs, but gives no basis for terminating execution proceedings.

Declaring a debtor bankrupt gives a court bailiff grounds to terminate execution proceedings against the debtor and deliver all execution writs to the receiver *(Section 13).*

An arbitration court considered a case in which a creditor challenged a court bailiff for failure to recover the amount awarded to it under the court judgment. In this case, the court bailiff terminated execution proceedings and delivered the execution writs to the receiver following a court's declaration of the debtor's bankruptcy. The court found the court bailiff's actions to be lawful and justified on the basis of Section 1of Article 126 of the Bankruptcy Law, which expressly provides for such actions by a court bailiff in the event that a debtor is declared bankrupt.

Enforcement Methods

The cases reviewed in Informational Letter No. 77 related to enforcement methods used by court bailiffs indicate that, in general, court bailiffs have broad authority to take enforcement actions, to the extent these actions are necessary and aimed at the execution of a court award.

A court bailiff has access to a bank's confidential information, but to a limited extent *(Section 19).* A commercial bank challenged a court bailiff's decision to impose a fine on the bank after the bank refused to issue an account statement of its client, a debtor against whom execution procedures had been initiated. The bank based its refusal on banking secrecy rules (specifically, Article 26 of RF Law No. 395-1 "On Banks and Banking Activity," dated December 2,1990, as amended), which do not specifically authorize banks to release bank information to court bailiffs.

While the arbitration court of the first instance satisfied the commercial bank's complaint, the court of appeals canceled this decision. The court of appeals based its decision on the Execution Proceedings Law and RF Law No. 118-FZ "On Court Bailiffs," dated July 21, 1997, which state that information, documents and their copies required by a court bailiff must be provided free of charge and within the time period requested. A bank's refusal to provide information on a debtor's account balances makes enforcement of a court award impossible, as only the bank is aware of the client's financial capacity. Consequently, a refusal to re-

lease such information constitutes grounds for administrative liability.

The court, however, specifically indicated that the court bailiff is only entitled to request information regarding the presence on a debtor's account of the amount granted by the award.

The list of enforcement methods is not exhaustive and the court bailiff is at liberty to use new ones *(Section 17).* In this case, a debtor challenged a court bailiff's decision obliging the debtor to transfer all cash received in the course of business activities to the court bailiff's deposit account until full repayment of the amount of the court award.

The arbitration court considering this case found that the decision complied with Article 45 of the Execution Proceedings Law, since it was aimed at actual execution of the court award. The court established that this law does not provide an exhaustive list of actions that may be undertaken by a court bailiff when enforcing a court award.

At the same time, Informational Letter No. 77 notes an arbitration court decision which indicated that a court bailiff's request for a third party (a lessee) to pay rent owed to the debtor to the court bailiff's deposit account was not legal, since the lessee was not a participant in the execution proceedings, and the court bailiff had other means of ensuring enforcement of the court award (namely, arresting and selling the debtor's claim for payment of rent).

A court bailiff has the right to arrest a debtor's property during a foreclosure on assets at its sole discretion *(Section 16).* An arbitration court considered a case in which a debtor challenged a court bailiff's decision to arrest the debtor's assets on the basis of Articles 91, 93, and 100 of the APC, which provide for the possibility of arresting assets only on the basis of a court ruling.

The court found the above provisions of the APC to be inapplicable to the situation under consideration and refused to satisfy the complaint on the basis of Article 48 of the Execution Proceedings Law, according to which foreclosure shall be made on the basis of a court ruling if such assets are in the possession of third parties. Taking this provision into account, the court concluded ex contrario that in the event that the assets to be arrested are in the debtor's possession, a decision of the court bailiff is sufficient grounds to impose an arrest upon them.

Right to Challenge a Court Bailiff's Actions

Any interested party (not necessarily being a party to the execution procedure) may challenge the actions of a court bailiff *(Section 3).* In an award issued against a debtor, a commercial bank serving as pledgee of the debtor's real property challenged a court bailiff's decision to arrest the pledged real property, which was being prepared for sale to satisfy the creditor's claim based on the award. The arbitration court of the first instance terminated the case, concluding that since the bank was not a party to the execution procedure, it may not challenge the actions of the court bailiff.

The court of cassation, however, overturned this decision and concluded that according to general procedural norms, the actions of a court bailiff may be challenged by any party whose rights and lawful interests are affected by such actions, even in cases where such party did not participate in the original dispute.

Payment of Execution Fees

Unjustified delay in voluntary execution of an award may trigger payment of the execution fee *(Section 28).* In this case, a debtor challenged a court bailiff's decision to recover the execution fee after voluntarily executing a court award. The debtor argued that since the execution was voluntary, no enforcement actions had been required by the court bailiff and therefore no execution fee should be charged.

The arbitration court concluded that the execution fee is not compensation for the court bailiff's expenses, but rather a penalty on a debtor for failing to voluntarily execute a court award within a specified time. Therefore, an unjustified delay in the voluntary execution of an arbitration award may result, inter alia, in recovery from the debtor of the execution fee. The court stated that such fee is not due in cases where the court bailiff has failed to notify the debtor of its right to execute the award voluntarily.

In addition, a decision by the RF Constitutional Court found that an arbitration court is entitled to decrease the amount of the enforcement fee which, in accordance with Article 81 of the Execution Proceedings Law, equals 7% of the awarded amount. This discretion is based on the principle that the fee is an administrative penalty and is aimed at ensuring that the amount of such penalty is adequate and not excessive. The court, however, is required to substantiate any decision to decrease the fee. The RF Constitutional Court also confirmed that the fee is only payable after satisfaction of the creditor's claim awarded by the court.

Conclusion

In issuing Informational Letter No. 77, the RF Supreme Arbitration Court has taken an important step in filling a crucial gap in Russian execution proceedings. The letter provides clarity on important areas such as a court bailiff's right to terminate execution proceedings, the acceptable methods for enforcing court awards, and the right to challenge a court bailiff's actions. If the guidelines are properly implemented and followed, they should give parties to Russian contracts increased confidence in their potential not only to resolve disputes in Russian courts, but to realize their awards once granted.

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New Law Extends Insurance to Depositors of Bankrupt Banks

In mid-July, RF Law No. 96-FZ "On Payments by the Central Bank of Russia for Deposits Made by Individuals to Bankrupt Banks, Not Participating in the Mandatory Insurance System for Individual Deposits in Banks of the Russian Federation" (the "Supplementary Deposit Insurance Law") was shuttled through the RF State Duma and RF Council of Federation, and signed by the RF President on July 29. The Supplementary Deposit Insurance Law, which is supported by both the RF Government and the RF Central Bank (the "CBR"), is aimed at protecting the deposits of individuals maintaining accounts in banks that do not participate in the mandatory deposit insurance system, established by RF Law No. 177-FZ "On Insurance of Deposits of Individuals in Banks of the Russian Federation" (the "Deposit Insurance Law") (see the April 19, 2004 issue of the *CIS and Central Europe Legal Newswire* for a discussion of the Deposit Insurance Law).

Under the initial Deposit Insurance Law, the mandatory deposit insurance system is scheduled to start functioning in 2005 and coverage will be provided only to depositors of banks that have been formally admitted to the system. However, the recent suspension of bank licenses of several Russian banks and general tensions in the Russian banking sector prompted the RF Government and the CBR to introduce the Supplementary Deposit Insurance Law, which extends the scope of insurance coverage and expedites the insurance system's launch. The Supplementary Deposit Insurance Law will enter into force within one month from the date of its official publication. An accompanying draft law, introducing certain changes to relevant legislation (including the RF Civil Code) pursuant to the Supplementary Deposit Insurance Law, was also passed and executed by the RF President.

According to the Supplementary Deposit Insurance Law, the state guarantee of a maximum of 100,000 Rubles (approximately US $3,500) will be extended to depositors of banks not participating in the deposit insurance system which become bankrupt. Certain types of bank deposits are excluded from the state guarantee, such as deposits made by individual entrepreneurs in connection with their commercial activities, certain bearer deposits, deposits to branch offices of Russian banks abroad, and certain other types of deposits. Under the Supplementary Deposit Insurance Law, the CBR will issue payments if two conditions are fulfilled: (i) a state arbitration court has issued a decision declaring the bank bankrupt; and (ii) the period for making preliminary payments to first priority creditors of the bank has expired (in accordance with RF Law No. 40-FZ "On the Bankruptcy of Credit Organizations," dated February 25, 1999 (as amended), this period is three months after preliminary payments begin). After making payments, the CBR acquires the right to claim reimbursement from the bankrupt bank and becomes a creditor of first priority against it.

The Supplementary Deposit Insurance Law also applies retroactively to banks which became bankrupt after the entrance into force of the initial Deposit Insurance Law (that is, after December 27, 2003). Therefore, it could apparently provide protection to individual depositors of those banks which have recently had their licenses suspended by the CBR *(e.g.,* Sodbusinessbank, Credittrustbank). However, since the mere suspension of a bank's license is not sufficient for individual depositors to receive guarantee payments, depositors of these banks will be covered only in the event that these banks undergo bankruptcy proceedings.

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