

# CIS AND CENTRAL EUROPE LEGAL NEWSWIRE

February 12, 2004

RUSSIA

## New Currency Control Law Liberalizes Currency Transactions

The new Russian Federation ("RF") Law "On Currency Regulation and Currency Control" (the "New Currency Control Law"), dated December 10, 2003 (to become effective on June 17, 2004), will introduce an entirely new framework for currency control regulation in Russia. The New Currency Control Law will replace the law of the same name, introduced on October 9, 1992, as amended, and clearly signifies a more liberal approach to currency regulation in Russia.

### I. Overview of the New Currency Control Law

The New Currency Control Law will impact existing currency regulations in all respect, including, most importantly, who will regulate currency operations, the types of currency operations that will be subject to regulation, and the manner in which currency operations will be regulated.

#### Who is Regulating

Under the New Currency Control Law, the RF Central Bank (the "CBR") and the RF Government are the only authorities empowered to regulate currency transactions. It is also noteworthy that the New Currency Control Law statutorily limits the regulatory authority of the CBR and the RF Government to issue regulations, which limitations are one of the main innovations of the New Currency Control Law. In particular, the CBR and the RF Government are now competent to approve regulations addressing matters covered by the New Currency Control Law only in those limited circumstances where the New Currency Control Law expressly provides. Further, the New Currency Control Law clearly delineates authority over currency regulation between the RF Government and the CBR.

#### What is Regulated

The New Currency Control Law regulates transactions in foreign currency and in Rubles between residents and non-residents, as well as internal transactions in foreign currency and, to a certain extent, transactions in foreign currency and in Rubles by non-residents. The category of Russian residents essentially covers, among others, all Russian citizens, companies established under Russian law and Russian authorities; all other persons are treated as non-residents. The New Currency Control Law also regulates transactions with securities, the internal currency market, the use of on-shore and off-shore bank accounts, and the currency repatriation obligations of Russian residents.

/continued on page 2

## How the Regulations Will Work

Broadly stated, the New Currency Control Law reverses the current approach on capital flow currency operations. The current regulatory regime provides for an exhaustive list of permitted transactions involving foreign currency (so-called "current currency transactions"), and all other transactions (except for a limited list of cases specified by law) are subject to prior receipt of CBR permission. The New Currency Control Law is based on the principle that all transactions involving foreign currency that are not subject to the restrictions under the New Currency Control Law may be undertaken by residents and non-residents without any restrictions. Thus, the New Currency Control Law abandons the system whereby individual licenses are issued by the CBR with respect to particular transactions.

The New Currency Control Law does set forth a list of transactions involving residents and non-residents that may be subject to one or both of the restrictions set forth below, and presumably a new regulatory framework will be adopted by the RF Government or the CBR, as the case may be, detailing how such restrictions will apply in practice:

**Ruble Reserve Requirement.** The essence of this requirement is that a resident or non-resident, as the case may be, in certain cases, is obligated to deposit a certain amount of Rubles in a separate Russian bank account for a specified period of time. No interest shall accrue on the amount deposited pursuant to the Ruble reserve requirement.

**Mandatory Use of Special Accounts.** This is a new regulatory measure in the currency control field in Russia. According to the New Currency Control Law, for certain types of transactions, the CBR may require that Russian residents or non-residents open and maintain special accounts with Russian banks or depositaries for transactions involving securities. The specific procedure for opening and maintaining these special accounts is to be implemented in the future and is currently unclear.

In addition, there is a requirement of preliminary registration under the New Currency Law, which applies in two circumstances: (a) preliminary registration with the tax authorities is required when a resident opens a bank account with a foreign bank located in countries other than OECD or FATF countries (the Financial Action Task Force (FATF) is an organization that combats money laundering and terrorist financing currently

comprised of 33 countries); and (b) in the case of the export and import of Rubles or domestic securities, in accordance with procedures provided by the RF Government and the CBR.

## II. Regulated Transactions

### A. Transactions Between Residents and Non-Residents

#### (1) Exports and Imports

According to the New Currency Control Law, foreign trade transactions where payment for exported goods is due in convertible currency more than 180 days from the date on which the goods crossed the RF border are subject to currency control regulations. In certain cases, the New Currency Control Law permits a longer payment period. For example, construction services performed by Russian residents outside of Russia may be paid for within five years of the services being performed. The New Currency Control Law generally retains the requirement that a transaction passport be maintained for each export or import transaction.

The RF Government may impose Ruble reserve requirements with respect to regulated transactions in an amount equivalent of up to 50 percent of the advance or deferred payments, but the maximum period to maintain such reserve fund is two years.

#### (2) Purchase of Equity Interests From Non-Residents

Purchases by residents from non-residents of equity interests (shares or participation interests) in Russian companies and purchases of interests in partnerships, cooperatives, etc. may be subject to the following restrictions: (i) the mandatory use of a special account; and/or (ii) a Ruble reserve requirement in an amount equivalent of up to 100 percent of the transaction value for a period of no longer than sixty days.

#### (3) Securities; Loans

Under the New Currency Control Law, through January 1, 2007, loans, transactions involving securities, and banking operations between residents and non-residents will remain regulated transactions. The following restrictions may be imposed upon such transactions: (i) mandatory use of a special account, and/or (ii) maintenance of Ruble reserves either in an amount equivalent of up to 100 percent of the transaction value for a period not to exceed sixty days, or in an amount

/continued on page 3

equivalent to up to 20 percent of the transaction value not to exceed one year, depending upon the specific type of transaction. The CBR is authorized to impose the mandatory use of a special account, while both the CBR and the RF Government are jointly authorized to impose the Ruble reserve requirement.

It should be noted that the New Currency Control Law introduces two notions with respect to securities: (i) "domestic" securities (defined as securities denominated in Rubles and registered in the RF, or securities confirming the right to receive proceeds in Rubles and issued in the RF), and (ii) "foreign" securities (defined as securities, including those issued in non-documentary form that may not be classified as domestic securities). As a general rule, the New Currency Control Law allows payment in foreign currency only for transactions involving foreign securities; and thus transactions involving domestic securities must be carried out in Rubles. However, in either case, the CBR may establish otherwise.

#### B. Transactions Between Residents

The New Currency Control Law establishes an exhaustive list of transactions involving payments in convertible currency or foreign securities (see above for an explanation of this term), which Russian residents may freely conduct among themselves. The permitted transactions include, inter alia, transactions between authorized banks or between residents and Russian authorized banks, various types of agency agreements relating to contracts with non-residents, certain transport transactions, transactions involving certain types of foreign securities if the rights to such foreign securities are recorded with a Russian depository, and certain permitted tax payments to the Russian budgets. Transactions between residents involving either payment in foreign currency or foreign securities that are not described in the New Currency Control Law are prohibited.

Although this exhaustive listing process is in contrast to the generally permissive spirit of the New Currency Control Law, it does have the advantage of codifying the rules on currency transactions between residents in a single legislative act and additionally offers some limited improvements over current restrictions.

#### C. Transactions Between Non-Residents

In contrast to existing currency control regulations, the New Currency Control Law establishes clear rules with respect to transactions between non-residents (for example, representative offices are non-residents). The New Currency Control Law permits the following transactions between non-residents: (a) any convertible currency transfers through Russian or offshore convertible currency accounts; and (b) any transactions involving domestic securities, but subject to compliance with antimonopoly and securities regulations. The New Currency Control Law also provides that the CBR may impose a requirement that payments between non-residents for domestic securities be channeled through a special account. Transactions in Rubles between non-residents are to be effected through Russian bank accounts as per the rules set out in the New Currency Control Law.

### III. Requirements for Bank Accounts

#### A. Offshore Bank Accounts of Residents

When the New Currency Control Law becomes effective, Russian individuals will be permitted to open and maintain accounts abroad with banks registered in OECD or FATF countries. One year later (i.e., on June 17, 2005) such right will be extended to Russian companies. The New Currency Control Law does provide that the account holder must notify the appropriate tax inspectorate within one month from the date of execution of the bank account agreement.

If a Russian resident wishes to open bank accounts in countries other than member countries of the OECD or FATF, then the resident must obtain a prior registration for such offshore bank accounts from the appropriate authorities in accordance with the procedure to be implemented by the CBR.

According to the New Currency Control Law, residents may transfer cash from their own Russian bank accounts to foreign bank accounts pursuant to the rules to be set forth by the CBR. It is also important that Russian residents will be permitted to fund their offshore bank accounts from sources other than their own bank accounts in Russia, if required under loan agreements entered into with residents of OECD countries.

/continued on page 4

The New Currency Control Law specifies that rules with respect to operation of offshore bank accounts may not impose requirements beyond a Ruble reserve of up to 100 percent of the amount to be transferred for a period of no longer than 60 days.

In general, Russian individuals are not permitted to direct payment from their offshore accounts to pay for assets or services in Russia. The authorities will want to ensure that domestic accounts are used so that accountability (for taxes, among other things) can be traced. Russian companies are allowed to use funds in offshore accounts on the terms set forth by the New Currency Control Law, except for those transactions solely between Russian residents.

#### B. Russian Bank Accounts of Non-Residents

According to the New Currency Control Law, non-residents are allowed to open and maintain Russian bank accounts in accordance with procedures to be set forth by the CBR. Non-residents may freely transfer their own funds from Russian bank accounts to offshore bank accounts and vice versa.

During the transitional period immediately after the implementation of the New Currency Control Law in July of 2004, the CBR and the RF Government are expected to adopt necessary implementing rules and abolish existing regulations that contradict the New Currency Control Law.

#### IV. Repatriation Requirements

Generally, Russian residents remain subject to repatriation requirements with respect to export proceeds and will still be required to comply with mandatory currency conversion rules. The only important exception from this rule under the New Currency Control Law is that Russian residents are released from their export proceed repatriation obligation if necessary to perform their obligations under loan agreements with residents of OECD countries if the maturity of the loan is greater than two years. Clearly, this exception will allow more flexible financing structures for Russian export-oriented industries. / O. Titenko, E. Abrossimova, K. Konstantinov

## Supreme Arbitration Court Clarifies Numerous Provisions of the Joint Stock Company Law

As reported in previous issues of the CIS Legal Newswire (see the August 2, 2001, and the August 16, 2001, editions), the Law "On Joint Stock Companies" (the "JSC Law") was significantly amended in 2001, with several other amendments introduced at a later date. In addition, the Plenum of the RF Supreme Arbitration Court (the "Plenum"), on November 18, 2003, adopted Resolution No. 19 "On Certain Issues of Application of the JSC Law" (the "Resolution") to further clarify provisions of the JSC Law. The Resolution replaces the previous Resolution of the RF Supreme Arbitration Court Plenum and RF Supreme Court Plenum No. 4/8, dated April 2, 1997 (as amended) (the "Old Resolution"). The Resolution contains important clarifications with respect to the newer provisions of the JSC Law, as well as new comments on the unchanged provisions of the JSC Law, which continue to raise questions both inside and outside Russian courts. At the same time, the Resolution repeats many provisions of the Old Resolution, (such as comments on the legal status of the foundation agreement, the change of legal form from an open joint stock company into a closed joint stock company and vice versa, etc.). The clarifications contained in the Resolution also provide mandatory guidance for state arbitration courts.

Establishment of Joint Stock Companies. The Plenum specifies the agreements which may be concluded by a joint stock company prior to payment of 50 percent of the charter capital (which, according to the JSC Law, must be paid within three months from the date of the company's State registration). The Resolution names the following permitted agreements: agreements on placement of shares among founders of the company, agreements on purchase or lease of business premises or office equipment, agreements on the opening of bank accounts, and other agreements, which do not directly relate to the business activity of the company. Any other agree-

/continued on page 5

ments, concluded by a joint stock company in violation of the provisions of the JSC Law and the Resolution's recommendations, may be invalidated.

The Resolution broadens the list of companies, with respect to which RF federal laws (other than the JSC Law) may establish special regulations on establishment, legal status, reorganization and liquidation, which now includes, people enterprises ("narodnye predpriyatiya"), joint stock companies with the participation of foreign investors and shareholder investment funds in addition to, joint stock companies in the banking, insurance and investment sectors, among others. In addition to special regulation on legal status, establishment, reorganization and liquidation, the RF banking legislation may introduce special regulations with respect to the rights and obligations of participants of credit organizations.

**Shareholders' Preemptive Rights.** With respect to the right of first refusal of shareholders in a closed joint stock company to purchase shares sold by another shareholder to a third party, the Resolution provides that such right does not apply to (i) sales of shares to another shareholder of the joint stock company, and (ii) gratuitous transfers of shares to a third party. At the same time, if an interested person is able to prove that the gratuitous transfer of shares was fictitious, and in fact the shares were transferred to a third party for consideration, such transfer will be deemed null and void according to the RF Civil Code, and the shareholder, whose rights were violated by such transaction, may demand return of its shares.

With respect to the violations of shareholders' preemptive rights to purchase additional shares (or securities convertible into shares) through open subscription, the Resolution provides the following. In cases where such shares (or securities convertible into shares) are sold to other persons before expiration of the period established for the realization of shareholders' preemptive rights, the state registration body may: (i) suspend the placement of shares or securities convertible into shares, or (ii) refuse to register the report on the results of the issuance. Also, within three months from the date of registration of the report on the results of the issuance of shares (or securities convertible into shares), a claim may be filed with a court to invalidate the issuance of shares (or securities convertible into shares).

**Payment of Dividends.** The Resolution also explains that in case of non-payment of declared dividends within the period

of time established by the charter or by a decision of the general shareholders' meeting, the shareholder may file a claim with the court on collection of dividends, along with interest arising from delayed payments. The interest accrues from the date following the day of expiration of the dividend payment period.

**Shareholders' Claims.** The JSC Law provides that, in certain cases, a shareholder may challenge a decision of a general meeting of shareholders in court, within six months from the date when the shareholder found out or should have found out about the adoption of such decision. The Plenum pointed out that if an individual shareholder misses such statute of limitations, in exceptional cases (such as serious illness of the shareholder, etc.), the statute of limitations may be waived by the court, and the filing of such a claim will be accepted. For a legal entity, the statute of limitations may not be waived in any case.

**Reorganization of Joint Stock Company.** It has long been debated whether it is possible to carry out a reorganization of a joint stock company in a so-called "mixed" form, that is: (i) through accession or merger with a legal entity having a different corporate form (such as a limited liability company or a production cooperative), or (ii) through the division of a joint stock company into another joint stock company and a legal entity having a different corporate form, or (iii) through a spin-off from a joint stock company of a legal entity, having a different corporate form. The Plenum clearly explains that such "mixed" reorganization is not permitted.

The Resolution also addresses situations when, during the reorganization, assets and obligations of the reorganized company are transferred to its legal successor (or successors) on an unfair basis (e.g., one company receives all assets, and another receives all liabilities). In such cases, all companies created through the reorganization (and in case of spin-off, the reorganized company) are jointly and severally liable for obligations of the reorganized company, in order to protect the rights of the reorganized company's creditors.

**Major and Interested Party Transactions.** The Resolution clarifies that the list of major transactions mentioned in the JSC Law (such as sale and purchase agreements, loans, and pledge and guarantee agreements), which must be approved by the general shareholders meeting or the board of directors,

/continued on page 6

is not exhaustive. The following agreements may also qualify as major transactions: agreements on transfer (assignment) of rights or obligations, contributions to the charter capital of another company and other agreements, if they may result in alienation of the joint stock company's property having a value in excess of the limits provided under the JSC Law. The value of the transaction should be calculated based on the value of the property to be alienated or acquired (pledged, transferred as a contribution to the charter capital, etc.), not including any possible fines, penalties or interest which may arise from improper fulfillment of obligations under such transaction.

Previously, major and interested party transactions which violated provisions of the JSC Law were treated as null and void, and the statute of limitations for challenging such transactions was ten years. Currently, major and interested party transactions are considered by the JSC Law as voidable. The Resolution stresses that the statute of limitations established for voidable transactions by the RF Civil Code will apply (which currently is one (1) year). / E. Korotkova, A. Trubitsina

## RF Government Intends to Ease Antimonopoly Requirements

Currently, RF Law No. 948-1 "On Competition and Restrictions of Monopolistic Activity on the Commodity Market," dated March 22, 1991 (as amended) (the "Antimonopoly Law"), requires the prior consent of the RF Ministry for Antimonopoly Regulation (the "MAP") for a wide range of transactions among entities, with little regard to the size of the entities and the economic impact of the transaction on the Russian market. However, proposed amendments to the Antimonopoly Law would increase the threshold for transactions requiring prior MAP consent, and would require antimonopoly filings with respect to licensing, registration of legal entities and duty free regulation.

Mergers and acquisitions involving commercial entities with a total balance sheet asset value exceeding 200,000 times the minimum monthly wage (which amounts to approximately 20,000,000 Rubles, or approximately US \$700,000 at

the current exchange rate) currently require the prior consent of MAP. Additionally, the Antimonopoly Law requires prior MAP consent for the following transactions among commercial entities with a total balance sheet asset value exceeding 200,000 times the monthly minimum wage: (i) an acquisition of voting shares (participatory interests) in a company by a person or group of persons holding more than 20 percent of the voting shares (participatory interest) in such company; (ii) an entity's (or group of persons') acquisition of a company's main production assets or intangible assets, if the balance sheet value of the acquired assets exceeds ten percent of the balance sheet value of the selling company's main production assets or intangible assets; and (iii) the acquisition by a person or group of persons of rights in a company which would allow the person or group of persons to determine the business activity of such company or influence how the functions of a company's executive body are implemented.

Obtaining MAP consent prior to a contemplated transaction is both time-consuming and burdensome. To obtain MAP consent, the parties to the contemplated transaction should submit a number of documents along with an application for prior MAP approval, and any document issued abroad must be apostilled. The parties must then wait thirty days for MAP's approval or denial of the application. Moreover, MAP has the authority to request additional documents, as well as to extend the period for the consideration of an application for a total of up to fifty days. Given the low threshold at which prior MAP consent is required, the current provisions of the Antimonopoly Law can complicate even simple transactions, causing business delays and additional expenses for the parties to a contemplated transaction.

The proposed amendments to the Antimonopoly Law provide that companies with total balance sheet assets valued at over 200,000,000 Rubles (approximately US \$7,000,000 at the current exchange rate) need only notify MAP of the above-mentioned transactions and need not receive prior MAP consent before concluding such transactions. Under the proposed amendments, prior consent will be required for companies with assets valued over 3,000,000,000 Rubles (approximately US \$105,000,000 at the current exchange rate), and MAP would then have three months during which to consider the application. By increasing the threshold at which the prior consent of MAP is required for a transaction,

/continued on page 7

the RF Government would effectively reduce the volume of transactions that MAP must approve by 85 percent and ensure that MAP is more focused on large transactions which could have an anticompetitive effect on the Russian market.

It is not entirely clear, however, when the amendments to the Antimonopoly Law will be submitted to the RF State Duma. Some Russian publications suggest that the RF Government plans to submit the amendments after the RF Presidential elections this March. Further, the RF Government is also considering other major amendments to the Antimonopoly Law (or even redrafting the law) which would dramatically change MAP's status and its authority in the sphere of antimonopoly regulations. We will, as always, closely monitor developments in this area of law. / S. Sineva, E. Trubitsina

## Russia Prepares to Join the WTO

In anticipation of joining the World Trade Organization (the "WTO"), the RF State Duma has been adopting new trade and other laws to conform to WTO rules. On December 8, 2003, President Putin signed two new bills into law: the Law "On the Fundamentals of State Regulation of Foreign Trade" (the "Foreign Trade Regulation Law"), which comes into force on June 18, 2004, and the Law "On Special Protective, Antidumping and Compensatory Measures in Commodity Imports" (the "Antidumping Law"), which became effective on December 17, 2003. These Laws will replace outdated rules with respect to the regulation of foreign trade, such as the RF Law "On State Regulation of Foreign Trade Activity," dated October 13, 1995, and the RF Law "On Measures for Protection of Economic Interests of the Russian Federation in Foreign Trade in Commodities," dated April 14, 1998. In drafting the new Laws, Russian legislators looked to various agreements aimed at removing barriers to trade in goods and services, such as the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS) and the Agreement on Import Licensing Procedures.

A positive feature of both Laws is the separation of powers with respect to the regulation of foreign trade between the federal and regional levels. Also, both Laws define the competence of the President and Government in regulation of foreign trade at the federal level.

The Foreign Trade Regulation Law establishes the fundamental principles, methods and forms of state regulation over foreign trade in general. State regulation of foreign trade is expressly proclaimed to be conducted solely through customs tariffs, non-tariff measures, bans and restrictions on trade in services and intellectual property rights, as well as other specified economic and administrative measures. Further, the Foreign Trade Regulation Law specifies situations where the right to engage in certain foreign trade is subject to licensing requirements on the part of both exporters and importers. For example, if the Government introduces temporary quantitative restrictions on the export or import of certain goods, then the right to export or import such goods is subject to a licensing requirement.

The Antidumping Law replaced the RF Law "On Measures for Protection of Economic Interests of the Russian Federation in Foreign Trade in Commodities," dated April 14, 1998. In comparison with the old rules governing foreign trade, the Antidumping Law sets forth more advanced rules with respect to special measures, such as protective measures, antidumping measures, as well as compensatory measures, applicable to the importation of certain products. In particular, antidumping measures may be used against foreign products that are being "dumped" on the Russian market. Dumping is defined as selling the product at below "normal value" which will be determined during the investigation procedure. Generally, the goods are considered as being dumped if the export price of such goods is lower than the comparable price of analogous goods on the market of the country from which such goods are exported.

As a preliminary stage for the imposition of any special measure, the Russian authorities, to be defined by the Government, must hold an investigation in accordance with the Antidumping Law. The investigative procedure could be initiated by a Russian producer(s) of goods competitive with the imported commodity. The purpose of the investigation is to discover facts which may constitute the basis for the adoption of special measures against importers. In particular, during the investigation, it must be ascertained that a respective Russian industry has been "significantly injured" by the imports of the commodity in question. Further, the Antidumping Law clarifies the requirements for an application for antidumping relief, the terms for consideration of an application, and the

/continued on page 8

procedure for publications, hearings and the adoption of decisions. According to the Antidumping Law, the Government, by its resolution, may adopt decisions with respect to the introduction, application, revision or cancellation of any special measures. It appears that no other State authority may adopt such decisions. The State arbitration courts have jurisdiction over all matters arising out of the application of the Antidumping Law.

In another WTO-related development, Russia has amended its key insurance legislation as described below. / S. Sineva, E. Abrossimova

## Russian Insurance Law Amended

The close of 2003 brought about major amendments to RF Law No. 4015-1 "On the Organization of the Insurance Business in the Russian Federation," dated November 27, 1992 (the "Insurance Law"), which had been significantly amended by RF Law No. 172-FZ, dated December 10, 2003 (the "Amended Insurance Law"). With certain exceptions, the Amended Insurance Law came into force on January 17, 2004.

Adopted expressly for the purpose of satisfying certain conditions for Russia's entry into the WTO, the Amended Insurance Law relaxes a number of restrictions on foreign participation in Russian insurance companies. In addition to the WTO-driven changes, the Amended Insurance Law also establishes tighter fiscal requirements on insurance companies primarily designed to ensure their financial stability. In particular, the Amended Insurance Law increases the minimum charter capital of an insurance company. Additionally, the Amended Insurance Law prohibits insurance companies that provide life and health insurance from offering other types of insurance.

### A. Foreign Participation

The participation of foreign insurance companies in the Russian insurance market is limited to a fixed percentage of the combined charter capital of all Russian insurance companies (the "Market Quota"). The Insurance Law previously set the Market Quota at up to 15 percent of the total insurance market. Also, in order to establish a presence in Russia, or to acquire a stake in a Russian insurance company, a foreign insur-

ance company was required to receive the prior approval of the RF Ministry of Finance (the "Prior Approval").

The Insurance Law imposed certain other restrictions ("Additional Restrictions") on Russian insurance companies with foreign participation, such as: (i) prohibiting such companies from engaging in certain types of insurance activities, including, inter alia, life insurance and various types of mandatory insurance; (ii) limiting foreign investors to making contributions to the charter capital of such companies solely in cash in Russian Rubles; and (iii) requiring that the general directors and chief accountants of such companies be Russian citizens.

The restrictions on the participation of foreign insurance companies in the Russian insurance market established by the Insurance Law were universally recognized as one of the main obstacles to Russia's membership in the WTO. As a result, the issue of abolishing such restrictions and opening up the Russian insurance market to foreign investors has been debated within the Government for some time.

In order to relax the requirements with respect to the participation of foreign insurance companies in the Russian insurance sector, the Amended Insurance Law raises the Market Quota from 15 percent to 25 percent. Moreover, even though the requirement for Prior Approval for foreign insurance companies remains unchanged, the Amended Insurance Law limits the scope of applicability of the Additional Restrictions. Thus, the Amended Insurance Law lifts the Additional Restrictions on (i) Russian subsidiaries of foreign companies incorporated in European Union countries, and (ii) Russian companies in which EU foreign companies own more than 49 percent of the equity.

According to the calculations of the RF Ministry of Finance, the level of foreign participation in the Russian insurance market does not currently exceed 4.1 percent. It is hoped that the Amended Insurance Law will make the Russian insurance market more appealing to foreign investors.

### B. Financial Status Requirements

As noted above, the Amended Insurance Law also sets forth more stringent requirements for insurance companies, which are aimed mainly at ensuring their financial stability. For example, the Amended Insurance Law establishes a minimum

/continued on page 9

charter capital requirement in a fixed amount equal to 30 million Rubles. This amount may be changed by federal law, but not more often than twice a year. The requirement for insurance companies providing life and health insurance is twice this minimum charter capital amount (i.e., 60 million Rubles) and the requirement for companies offering re-insurance policies is four times the amount of the minimum charter capital (i.e., 120 million Rubles). All insurance companies are required to increase their charter capitals up to the required amount established by the Amended Insurance Law by July 1, 2007.

The Amended Insurance Law also introduces an internal company position of an insurance actuary, who will act as an appraiser of insurance tariffs, insurance reserves and investment projects of an insurance company. The Amended Insurance Law provides that, commencing in 2007, insurance companies must submit the results of an actuary's appraisal of insurance obligations (insurance reserves) to the appropriate governmental monitoring agencies, with appraisals to be conducted at the end of each fiscal year.

The Amended Insurance Law imposes new requirements regarding the chief executive officers and chief accountants of insurance companies, who now must have a university degree in economics or finance and at least two years of relevant working experience.

Finally, for the purposes of ensuring financial stability of insurance companies, the Amended Insurance Law allows companies to organize insurance pools (based on partnership agreements) with respect to certain types of insurance activities.

#### C. Permitted Activities

One of the main innovations of the Amended Insurance Law is the prohibition on simultaneously conducting two types of insurance activities: life/health insurance and property insurance. In accordance with the Amended Insurance Law, insurance companies providing life/health insurance are now prohibited from offering property insurance. In connection with this strict separation between personal insurance and property insurance, the Amended Insurance Law introduced a new classification of insurance activities, which has now been extended to 23 different types. The types of activities allowed to be pursued by a particular insurance company must be re-

flected in a license issued to such company in accordance with the new classification. Therefore, it now appears that almost all insurance companies will need to obtain new licenses pursuant to the Amended Insurance Law.

Finally, the Amended Insurance Law now specifies in more detail the procedure for issuing and denying licenses and the procedure for restricting, suspending or revoking licenses. In addition, in order to avoid consumer fraud, the Amended Insurance Law prohibits insurance companies from using names (or any part thereof) belonging to other insurance companies. The use by an insurance company of another company's name may constitute a sufficient basis for denial by the licensing authorities of an application for an insurance license. / E. Korotkova, E. Abrossimova

## Rules Regulating Duty-Free Shops Simplified

The new RF Customs Code, effective as of January 1, 2004, replaces Russia's former, 10-year old Customs Code which has long been criticized for its ambiguous provisions and lack of detailed regulations. The new Customs Code addresses a number of issues of concern to both Russian and foreign businesses (see the May 14, 2003, issue of the CIS Legal Newswire). Among the novelties introduced by the new Customs Code are new regulations with respect to Russia's regime of duty-free shops. Most importantly, the new regulations appear to simplify the procedure for opening duty-free shops.

The previous Customs Code required a company wishing to open and operate a duty-free shop to submit an application to the State Customs Committee, along with consents from numerous governmental organizations and agencies, including local customs authorities, border guards, the fire department, etc. If the State Customs Committee granted the application, then a duty-free license would be issued for a maximum term of three years.

Provisions of the new Customs Code simplify the procedure for opening and operating a duty-free shop by abolishing the requirement of obtaining a duty-free license. Now a company wishing to open a duty-free shop simply submits written notice to the local customs authorities. As a general rule, such

/continued on page 10

notice should be submitted at least 15 days prior to the actual opening of a duty-free shop. The receipt of the notice is certified by a letter issued by the customs authorities. In practice, the letter from the customs authorities serves as approval to open and operate a duty-free shop and should be used when importing goods into the RF for sale at a duty-free shop.

Despite the new Customs Code's simpler administrative procedures, the new Code still contains economic impediments to opening and operating a duty-free shop. Now in order to open a duty-free shop, a company must provide security for the payment of customs duties with respect to foreign goods imported by the company into the RF. The amount of required collateral depends on the exact location of the storage premises of the duty-free shop. When the store is located outside of the RF State boundary entry point, the amount of the security must total the amount of customs duties and taxes to be paid by the operator if the goods were to be released for free circulation in the RF.

When the store is located within the RF State boundary entry point, and the legal entity has been acting as the operator of a duty-free shop for at least one year, then the operator may provide "general" security (it is still unclear how the amount of the security in a situation where a legal entity has been acting as an operator of a duty-free shop for less than a year will be calculated). The amount of the general security must total the amount of customs duties and taxes to be paid by the operator if excise goods located in the duty-free shop were released for free circulation in the RF. To calculate the general security, the amount of excise goods imported into the RF during the preceding year should be divided by the number of months during which the excise goods were actually placed in the duty-free shop. Notwithstanding, the foregoing, the exact amount of the collateral required of a duty-free shop operator is determined by the State customs authorities.

The new Customs Code permits various forms of security: (i) a pledge of goods or other property; (ii) a bank guarantee; (iii) a transfer of monetary funds to the account of the State customs authorities; and (iv) a surety. The operator of a duty-free shop may choose the specific form of collateral at its sole discretion. Most operators favor a bank guarantee or surety.

Since the new Customs Code came into effect only very recently, and the customs authorities have issued few imple-

menting instructions, certain practical issues remain unclear. For example, it is unclear whether the operator of a duty-free shop should notify the customs authorities with respect to any changes, such as, e.g., the renaming of the operator, as was the case under the old Customs Code. Apparently, such notification will no longer be required under the newly-adopted regulations.

It is anticipated that under the new Customs Code, competition on the duty-free market will increase. However, due to the new requirements with respect to providing collateral, small operators of duty-free shops may be forced out of business. / S. Sineva, A. Kelina

#### UKRAINE

## Ukraine Joins the Hague Convention Abolishing the Requirements of Legalization of Foreign Public Documents

On December 22, 2003, the Convention Abolishing the Requirement of Legalization for Foreign Public Documents (concluded on October 5, 1961) (the "Convention") became effective for Ukraine. As between the states that are parties to the Convention, no legalization is required for public documents that have been executed in one state and that need to be presented in the territory of another state. Such public documents include: (a) documents emanating from authorities or officials connected with the courts or tribunals of a state, including those from a public prosecutor, a court clerk or a process-server; (b) administrative documents; (c) notarial acts; and (d) official certificates placed on documents signed by persons in their private capacity, such as those recording the registration of a document or the fact that it was in existence on a certain date, as well as official and notarial authentications of signatures.

/continued on page 11

Currently, nearly 80 states are parties to the Convention. As a result of Ukraine acceding to the Convention, official documents from those states (with the exception of Belgium and Germany) no longer need to be legalized in order to be presented in Ukraine (and, similarly, documents from Ukraine no longer need to be legalized for presentation in those states). Under the Convention, the only formality that may be required in order to certify the authenticity of a signature, or the capacity in which the person signing the document has acted, or the authenticity of a stamp or seal on the document, is the attachment of a certificate (an "apostille") to the document by the competent authority of the state from which the documents emanates.

Documents with an apostille are acceptable in all other countries where the convention is in force, and no additional authentication is required. This development greatly reduces the time and expense of authenticating documents by means of the "chain" authentication procedure of legalization, which requires seals from multiple bodies to be placed on a document for use in another country. However, as both Germany and Belgium raised their objection to Ukraine's accession to the Convention, legalization is still required concerning documents presented from Ukraine in those states and documents presented from those states in Ukraine.

In Ukraine, the state bodies that have been granted authority to place apostilles on documents are the Ministry of Education, for public documents issued by educational institutions, the Ministry of Justice, for public documents issued by courts, notaries and other judicial institutions, and the Ministry of Foreign Affairs for all other types of documents. / A. Mycyk, A. Globina

## Laws on Electronic Documents and Signatures Take Effect

Two laws that create the legal framework for the use of electronic documents in commercial relations, and that will aid in the development of electronic commerce in Ukraine, came into effect on January 1, 2004: the Law "On Electronic

Documents and Electronic Documents Circulation" (the "Electronic Documents Law") and the Law "On Electronic Digital Signature" (the "Electronic Signature Law").

Although electronic documents and electronic signatures have been in use in Ukraine for some time, their use has mainly been limited to the banking system, particularly for transfers of money. These new laws, however, build upon Article 207 of the new Civil Code, which provides that a contract is deemed concluded in written form if the will of the parties has been expressed with the assistance of teletype, electronic or other technical means of communication. Relying on these laws, parties may now conclude a variety of binding agreements and contracts by electronic means.

Under the Electronic Documents Law, an electronic document is just as legally effective as its hard copy equivalent, provided that the content and details of each are identical. Such documents may be the primary means of creating virtually any type of document, and will, at the outset, most likely be used for concluding contracts and signing acts of transfer and acceptance for completed works and services. However, electronic documents may not be used as originals for the following types of documents: (a) certificates concerning the right to an inheritance; (b) documents that, according to law, may be created only in one original copy (except in cases where a centralized depository of original electronic documents has been created); and (c) other cases provided for by law. In terms of their enforceability, the law provides that an electronic document may not be challenged, nor may its admissibility as evidence be denied, solely because of its electronic form.

In addition, although parties are generally free to agree when an electronic document has been sent or received, the Electronic Documents Law establishes rules to be followed in the absence of such agreement. For example, although an electronic document is deemed sent at the date and time when the sending of the document cannot be cancelled by the sender, the date and time of receipt requires confirmation of that fact from the recipient. If the parties have not agreed in advance as to the manner of confirming receipt, such confirmation may be accomplished by any automated or other means in electronic form or by a paper document, and should specify both the fact and time of receipt as well as inform a-

/continued on page 12

tion about the person sending the confirmation. If the sender does not receive confirmation of receipt, the electronic document will be deemed to have not been received by the recipient.

Complementing the Electronic Documents Law, the Electronic Signature Law specifies the legal status of electronic digital signatures as well as establishes the organizational and legal basis for providing services related to the creation of electronic signatures. According to the law, an electronic signature (which is, perhaps, the most important detail of an electronic document) has the same legal effect as a handwritten signature when the following conditions are met: (a) the authenticity of the electronic signature has been confirmed with the use of an enhanced key certificate through reliable electronic signature means; (b) an enhanced key certificate valid at the moment of affixing the electronic signature has been used for verification; (c) the personal key of the signatory corresponds to the open key specified in the certificate.

The Electronic Signature Law also contemplates the establishment of governmental agencies and private entities to provide services related to the creation of electronic signatures and key certificates, such as the Central Certification Agency, a governmental body, and the network of Centers of Certification of Keys, as non-governmental entities. The Central Certification Agency will be established by the Ukrainian Government and will be responsible for accreditation of the Centers of Certification of Keys, for the issuance of certificates of keys to such centers and for keeping the registry of keys issued by the agency. As for the Centers of Certification of Keys, upon certification of their own keys by the Central Certification Agency, they will be allowed to provide services connected with electronic digital signatures and key certificates on the market. / A. Mycyk, A. Putintseva

## New Civil and Economic Codes of Ukraine Effective as of January 1, 2004

On January 16, 2003, almost 12 years after its independence, Ukraine became the last among the former USSR republics to enact a new Civil Code. The event is all the more significant

because the new code replaces the Ukrainian Civil Code enacted in 1964. Concurrently, though, the Verkhovna Rada, the Ukrainian Parliament, also adopted a Commercial Code (also translated as the Economic Code). Although enacted last year, both Codes only recently took effect (on January 1, 2004) and, as discussed further below, may require companies to review their ongoing contracts entered into prior to that effective date.

Overall, the new Codes are expected to improve business conditions in Ukraine. However at the same time, they represent a challenge, with businesses facing a less than smooth transition to the new legal framework as both the lawyers who advise clients on their contractual relations, and the courts that enforce contracts, grapple in the coming months with the new issues posed by the Codes. The transition will also be complicated by the fact that Ukraine (alone among the countries of the former USSR) adopted both a Civil and a Commercial Code. The latter Code has been plagued by controversy, as it is widely seen as inconsistent with market-economy principles — and also as infringing on the subject matter of the Civil Code.

Generally, the law in effect before January 1, 2004 would continue to apply to the extent it is not inconsistent with the new Codes. Some statutes are repealed by the Codes expressly (e.g., the laws “On Enterprise” and “On Enterprises”), but as a general procedure, the Government is required to submit to the Verkhovna Rada a list of additional laws to be repealed or amended. In addition, the Government is to adopt various regulations specified in the Codes and to revise existing regulations of governmental agencies with a view to bringing them in line with the new Codes.

One of the issues raised by the new Codes that is likely to pose challenges for businesses in the coming months concerns their applicability to contractual and other legal relations entered into prior to the effective date of the Codes, that is, prior to January 1, 2004. Both Codes contain provisions stating that they apply, as one might expect, to civil and commercial relations that arise after that date. Surprisingly, however, both Codes also will apply to civil and commercial relations that arose prior to January 1, 2004, but only to the extent that the rights and obligations under those relations either arose or continue to exist after that date.

/continued on page 13

Thus, in the case of a contract made before January 1, 2004, a Code would apply to the rights and duties of the parties under the contract to the extent that the contract remains unperformed or that a right or duty only materialized, under the terms of the contract, in the period after January 1. Parties to contracts entered into prior to that date are not given the option to keep their contracts subject to the law in effect at the time of their making. If a company, then, has a contract entered into prior to January 1, 2004 that will not be discharged until after that date, the company's rights and duties under the contract may have automatically changed on January 1, either for the better or the worse.

The approach adopted by the new Codes is unusual. It runs counter to the general principle that a new law affects only rights and duties arising after the law's effective date – a principle that meets the reasonable expectations of parties that their respective rights and duties will be as they understood them to be when they entered into the contract. In this respect, the approach taken in the new Codes differs from most legal systems. By way of comparison, the Russian Civil Code (the "Russian Code"), enacted in 1994 and brought into effect on January 1, 1995, applies exclusively to rights and duties arising after its effective date. Unlike its Ukrainian counterpart, the Russian Code, in describing the rights and duties subject to it, made no mention of prior rights and duties continuing after its effective date.

Transition to the new Codes will also not be made easier by the less-than-perfect fit between the two. As a whole, the relation between the Civil and Commercial Codes is not easy to discern. The official position seems to be that the Civil Code relates to the Commercial Code as general law relates to special law, i.e., the Commercial Code is supposed to fill in the blanks left by the Civil Code. A review of the two texts, however, suggests that at times they will be difficult to reconcile. Because the topics covered by each Code often overlap, the regulation they produce – while not widely divergent – is certain to contain enough discrepancies to cause problems in their application.

Companies located, or otherwise doing business, in Ukraine are strongly urged to review their position under contracts governed by Ukrainian law and, if necessary, or where practical, update those contracts and other legal arrangements in light of the new Codes. Special attention should be paid to

areas of law coming under the dual regulation of the two. Hardest hit are likely to be on-going or simply unperformed long-term contracts entered into before the new Codes were enacted in January 2004, at a time when the parties could not possibly have known how the future Code would affect their relations. If such contracts or other legal arrangements need to be updated in light of the new Codes, and if a Ukrainian counterpart fails to cooperate in the effort, alternative procedures should be considered to neutralize, to the extent possible, a potential erosion of rights that might result from the applicability of the new Codes after January 1, 2004. / V. Fedichin, A. Mycyk

## Ukraine's New Mortgage Law

Ukraine's new Law "On Mortgages" (the "Mortgage Law") became effective on January 1, 2004. Enacted to improve and stimulate mortgage financing, the Mortgage Law simplifies the procedure for creating and registering mortgages, protects the rights of a prior mortgage holder, provides additional remedies and flexibility to a mortgage holder in selecting a method of enforcing a mortgage, and introduces a new type of security – a mortgage note – which may be freely transferred or pledged at the sole discretion of the holder of such mortgage note. The Mortgage Law also contains certain procedural innovations which are noted below.

A number of other new laws governing mortgages also became effective on January 1, 2004. First, the new Civil Code regulates general issues of pledging property. Second, several laws intended to expand credit and mortgage financing in the housing sector (collectively, the "Housing Laws") also came into effect.

### Expanding the Concept of Collateral

The Mortgage Law establishes that collateral may include traditional real estate, as well as objects located on and integrally related to the land. Airplanes, sea and river vessels and "space objects" (i.e., satellites and space craft) also fall within the definition of real estate under the Mortgage Law, and, therefore, provisions of the Mortgage Law are mandatory when pledging such objects.

/continued on page 14

Unfinished Construction. The Mortgage Law now establishes that unfinished construction may be mortgaged. Under the new law, the investment agreement of a purchaser of an apartment, for example, may constitute the essential condition for a mortgage agreement in which title to the apartment is acquired by the mortgagor in the future.

Land. Under the new law, land can be mortgaged, although the Mortgage Law requires that mortgage of agricultural land must comply with certain other legal limitations (Article 15) established by other legislative acts, primarily by the Land Code. These limitations include restrictions and prohibitions established by the Land Code with respect to alienation of agricultural land and its usage in accordance with its designated status (i.e., agricultural land may be used primarily for agricultural purposes). For instance, the Land Code does not allow foreign individuals or foreign companies to acquire agricultural land; thus, when foreclosing on agricultural land, such land cannot be sold to foreigners. Another limitation is that mortgaged agricultural land may be sold only through public auction, although other foreclosure procedures are available for other kinds of mortgaged property (see Section V below). In addition, the Mortgage Law establishes that agricultural land may be mortgaged only after January 1, 2005, although non-agricultural land may be mortgaged before that date. Finally, the Mortgage Law also amends Article 133 of the Land Code, which previously required all types of land to be mortgaged only to banks. Under the revised law, only agricultural land must be mortgaged to banks and non-agricultural land can be mortgaged to other financial institutions, other business entities and individuals.

Enterprise. While the Mortgage Law is itself silent on whether a company may be mortgaged, such a practice appears consistent with prevailing Ukrainian law. The Law "On Pledges" continues to apply to pledges of movable property, securities, goods in turnover and property rights, and the new Civil Code expressly stipulates that an enterprise, as an integral property complex, is real estate which can be sold, pledged, leased or otherwise used. Therefore, since an enterprise is expressly defined by the law as real estate, it follows that by analogy an enterprise should also be mortgagable under the Mortgage Law.

## Establishing a Mortgage, Priority and other Formalities

Establishing a Pledge. A contractual mortgage is established by a notarized written agreement, and the mortgage agreement becomes effective from the moment of its notarization. On January 1, 2004, the state duty for notarization was reduced from 0.1% to 0.01% of the contractual value of the collateral. Also, it should be noted that a mortgage is conditional on the underlying secured obligation and therefore is not enforceable where no valid debt exists. In addition, the Mortgage Law (Article 18) identifies a number of critical provisions which each mortgage agreement must contain (such as information about the mortgagor and mortgage holder, a detailed description of the collateral, a description and amount of the secured obligation, the term of payment, and issuance or non-issuance of the mortgage note), and failure to include any such provision in the mortgage agreement may cause the agreement to be declared null and void by a court. The mortgage agreement may also outline in detail the steps to be taken upon default with respect to taking custody of the collateral and its ultimate sale.

Registration and Priority. One new provision of the Mortgage Law is the requirement that mortgages must be registered with a state registry (to be established by a separate law) to secure priority before other secured creditors (Article 4). Although failure to register a mortgage does not undermine its validity, mortgages will lose priority against registered mortgage holders. The Mortgage Law does require, however, mandatory state registration in the following instances: (i) when a mortgage note (see Section III below) is issued, (ii) when an object of an unfinished construction is mortgaged, or (iii) when the mortgaged property will be owned by the mortgage holder in the future. Although, the Mortgage Law is not express on this point, failure to register a mortgage in such instances may undermine the validity of the mortgage, therefore, registration of a mortgage in the aforementioned cases is very much recommended.

Increase of Secured Obligation and Priority. Another new provision of the Mortgage Law is its requirement that the amount of the secured obligation and the terms of repayment be included in the notice to be filed when registering a mortgage with the state registry. The Mortgage Law also re-

/continued on page 15

quires that any increase of the principal amount of the secured obligation or interest also be registered with the state registry (Article 19). Article 19 further establishes that any increase of the secured obligation will be subordinated to all mortgages registered before the registration of such increase in the secured obligation.

**Appraisal.** Appraisal by a licensed appraiser will still be necessary in most instances when foreclosing on the mortgaged property. It should be noted, however, that one of the Housing Laws cancels the mandatory requirement of conducting an appraisal of all types of property before pledging, as required by the Law "On Appraising Activity," except for state-owned and communal property.

**Insurance.** The Mortgage Law requires the debtor to insure the mortgaged property against loss or damage unless such obligation is imposed by the mortgage agreement on the mortgage holder.

### Introducing Mortgage Notes

**New Type of Security.** The Mortgage Law introduces a new security (a transferable mortgage-backed security) – the mortgage note – which evidences an unconditional right of its holder (whether the initial mortgage holder or a subsequent purchaser of the mortgage note) to claim fulfillment of the secured obligation by the debtor, and in the event of default, provides the holder with the right to foreclose on the collateral. A mortgage note may be issued in respect of money debt only and where provided for in the mortgage agreement. The mortgage note is issued following execution of the mortgage agreement. Upon issuance of a mortgage note, only the current holder of such security may demand payment of the secured obligation and, upon default, foreclose on the collateral.

**Transferability.** The mortgage note may be transferred by the mortgage holder by endorsement to any third party. No consent of the debtor for such transfer is required. The new holder of the mortgage note would have the same rights as the previous mortgage holder. The mortgage holder-seller is required to notify the debtor about the transfer of the mortgage note and is also required to make sure that all subsequent payments under the secured obligation must be made to the new holder of the mortgage note, otherwise the new holder of the mortgage note will have a claim against the

mortgage holder-seller. The debtor can defend against the mortgage note holder's demand for payment only if the debt is already repaid or the mortgage note is issued as a result of fraud, coercion or threats aimed against the debtor, without knowledge or complicity of the holder of the mortgage note. Mortgage notes may also be pledged. These provisions for transferability and negotiability of mortgage notes create the basis for a secondary mortgage market in Ukraine.

**Registration.** Issuance of the mortgage note must be registered with the state registry of mortgages concurrently with the registration of the mortgage. State registration of a transfer of the mortgage note, however, is not mandatory and is left to the discretion of the new holder. Nonetheless, holders are well advised to register purchased mortgage notes if they intend to benefit from certain protections stipulated by the law (e.g., the right to receive notices in the event of foreclosure by other mortgage holders).

**Form and Substance.** A mortgage note is issued on special forms which will be introduced by the State Securities Commission and Stock Market and upon their registration, must be transmitted to the mortgage holder. When a mortgage note is issued, a notation about such issuance is put on each original copy of the mortgage agreement. The Mortgage Law specifies the information that must be included on the mortgage note, making it a negotiable document and providing the basis for a claim against the debtor with respect to the secured obligation and the collateral.

**Cancellation.** Upon fulfillment of the secured obligation, the mortgage note must be cancelled and returned to the debtor of the secured obligation. The returned mortgage note must be kept by the debtor as evidence of fulfillment of the secured obligation. If the debt is repaid in several installments, the holder of the mortgage note must maintain a registry of received payments and issue to the debtor receipts confirming received repayments. In the event of disputes between the registry and the receipts, since at present there seems to be no procedure for removing a lien. Therefore, the debtor should carefully collect and maintain such receipts.

### IV. Issuing Other Mortgage Securities

In order to enable a mortgage holder to attract financing (or "re-financing," as defined under the Mortgage Law), the

/continued on page 16

Mortgage Law provides that such a mortgage holder may, inter alia, issue other secondary mortgage securities in the form of either mortgage certificates or mortgage bonds, which may be secured by mortgage notes. However, only banks and other financial institutions are authorized to issue such mortgage securities under the Mortgage Law. The procedure for issuance and circulation of mortgage certificates will be established by a separate law.

The Law "On Mortgage Crediting, Transactions with Consolidated Mortgaged Debt and Mortgage Certificates," adopted after the Mortgage Law, provides detailed procedures for issuance and circulation of mortgage certificates, but not mortgage bonds.

## V. Simplifying Enforcement

**Alternative Methods of Foreclosure.** The Mortgage Law represents a significant breakthrough in foreclosure and mortgage enforcement procedures by expressly allowing the parties to the mortgage agreement to use alternative foreclosure procedures (described by the Mortgage Law) without necessarily turning to court. Now, in addition to the conventional methods of foreclosure by court action or enforcement of a notarial writ of execution, the mortgage holder may: (i) acquire the right of ownership to the collateral in satisfaction of the secured obligation as specified in the mortgage agreement, and (ii) also sell the collateral to a third party, if anticipated (or allowed) by the mortgage agreement. In other words, the debtor can agree in the mortgage agreement in effect to give up its ownership rights to the collateral by operation of the mortgage agreement as well as the law without initiation of court proceedings. Although if the mortgage holder's actions in acquiring the collateral or selling it to a third party are challenged by the mortgagee's actions in court, effectiveness of such mechanisms will probably be substantially undermined.

To assure the validity of all foreclosures, the Mortgage Law outlines mandatory general and specific enforcement procedures for each type of foreclosure.

**Default Notice.** The Mortgage Law (Article 35) applies a 30 day prior notice of default to all methods of foreclosure. The mortgage holder may initiate the foreclosure procedure only if the demand announced in the default notice is not fulfilled within the prescribed cure period. This 30 day freeze period, however, does not prevent the mortgage holder from taking

court action, such as seeking a preliminary injunction.

**Notification of other Mortgage Holders.** Prior to commencing a foreclosure procedure, the mortgage holder is required by Article 13 of the Mortgage Law to send a 10 day prior notice to all other mortgage holders registered with respect to the same collateral.

**Acquisition of Collateral by Mortgage Holder.** While acquisition of the collateral by a mortgage holder is not a new concept in Ukrainian law, now, the Mortgage Law expressly provides that a mortgage agreement which anticipates transfer of the collateral to the mortgage holder upon borrower's default is sufficient legal ground for registering the title to the collateral in the name of the mortgage holder. In practice, this should mean that presentation of such mortgage agreement to the registration authority (allowing acquisition of the collateral by the mortgage holder) will be sufficient for the mortgage holder to re-register the title to such collateral in the name of the mortgage holder, are when mechanics of such re-registration are established.

Another new provision of the Mortgage Law was enacted to protect interests of both prior and subsequent mortgage holders, although it may be troublesome for the mortgage holder acquiring ownership to the collateral. Now "registered rights and claims with respect to the mortgaged real estate" remain valid upon the acquisition of the collateral by the mortgage holder, subject to the following two rules: first, that the mortgage holder will be "liable" before all prior-registered mortgage holders, and, second, with respect to the claims of lower priority, claims of such lower priority must be satisfied to the extent of the difference between the value of the collateral, as determined by appraisal, and the claims of a higher priority.

**Sale of Collateral by Mortgage Holder.** Another alternative foreclosure method is the power of the mortgage holder to independently sell the collateral to a third party (Article 38). Before selling the collateral to a third party, the mortgage holder is required to send a 30 day prior notice to the mortgagor and all registered holders of any rights and claims with respect to the collateral. A registered holder of a right or claim to the collateral has a preemptive right to purchase the collateral, if an intention to exercise such right is expressed within the prescribed 30 day period.

/continued on page 17

A potential problem for the mortgage holder is the requirement that the price for the collateral in such sale may not be less than an "ordinary" price (as defined by the company income tax law) for that kind of property. Failure to achieve the "ordinary" price may make the mortgage holder liable before other registered mortgage holders and the mortgagor.

**Public Auction.** Foreclosure may also be executed pursuant to a court decision or a notarial writ of execution. Unless otherwise stated in the court decision, realization of the collateral must involve a sale through public auction. The Mortgage Law establishes rules and procedures for conducting a public auction (Articles 41 through 50), requiring, inter alia, that the auction organizer be a licensed company selected by the mortgage holder; that the initial requested price of the collateral at the auction may be not less than 90 percent of the value of the collateral appraised in connection with the auction; that if the purchaser is a mortgage holder, he is required to pay only the difference between the offered price and unfulfilled secured obligation; that the public auction is deemed to have taken place if there is at least one auction participant and, if so, that participant may acquire the collateral at the initial price. If the public auction fails to take place within 10 days after the scheduled date, the mortgage holders may, according to their priority, acquire the collateral by offsetting the amounts of secured claims against the collateral's initial price. If no mortgage holder exercises this right, a second sale must be conducted within one month, and if the second sale fails to produce results, the mortgage terminates. Presumably the mortgage holder will then still have a valid claim against the mortgagor but such claim will be unsecured and he will no longer be able to assert its claims against the collateral under the mortgage agreement.

Ukraine's new Mortgage Law is a substantial improvement over prior legislation. Ukraine's financial institutions and banks have praised the Mortgage Law as a sophisticated and well-developed instrument which should expand and streamline secured financing in Ukraine and provide a legal basis for creation of a secondary market in negotiable mortgage instruments. However, the merits and demerits (pros and cons) of this Law can only be fully evaluated after implementing legislation is adopted and with the accumulation of experience with the new law, including experience with enforcing mortgages. In the residential mortgage area, it will be necessary to determine how the Mortgage Law will be enforced

alongside the prevailing Housing Laws, whose provisions are in certain instances duplicative and contradictory. / O. Soshenko, V. Fedichin, J. Johnson

## Land Appraisal Law Signed

On December 11, 2003 the Verkhovna Rada of Ukraine passed the Law "On Land Appraisal" (the "Land Appraisal Law"), which was subsequently signed by the President and took effect on January 13, 2004. This law establishes the legal basis for carrying out appraisals of land, as distinct from other types of property, as well as the requirements for professional appraisal activity, and was enacted to bring the law on land appraisals in line with Ukraine's new Land Code passed in October 2001. Prior to the Land Appraisal Law, the appraisal of land had been regulated by the Law on Appraisal of Property, Property Rights and Professional Appraisal Activity in Ukraine, as well as by various acts of the Cabinet of Ministers and the State Committee on Land Resources.

Depending on the purpose and methods used to carry out an appraisal, the Land Appraisal Law provides for several types of land appraisal. Two types are relevant mainly for agricultural land and will play an important role in the classification and land use planning for such land plots. The first of these, "appraisals of soil," are comparative appraisals of the quality of soil based on its fundamental natural characteristics that have a significant effect on the productivity of agricultural crops grown under specific natural and climactic conditions. The results of such appraisals are included in the state land cadastre, are the basis for carrying out "economic appraisals" (described below), and are used to determine the ecological adaptability of soil for agricultural purposes. And the second, "economic appraisals," are appraisals of land as a natural resource and a means of production in agriculture and forestry by characterizing the productivity of land, the effectiveness of the land use and the profitability of a particular unit. Such appraisals are used to analyze the effectiveness of land utilization as compared to other natural resources and to determine the economic suitability of agricultural lands for the production of crops.

In addition to the foregoing, the law provides for two types of appraisals to determine the monetary value of land, and sets

/continued on page 18

out the instances when such appraisals are mandatory. The first of these, an "expert monetary appraisal," is carried out for the purpose of determining the value of a particular land plot when entering into certain transactions with land. Such appraisals are obligatory in a number of cases, including, among others, the following: (a) alienation and insurance of land in state and communal ownership; (b) pledge of land plots when required by law; (c) determining the value of land plots in state or communal ownership that are contributed to the charter funds of companies; (d) establishing the amount of damages to owners and land users in those instances required by law or by agreement; and (e) by court decision. Such appraisals are to be conducted on the basis of the following methodologies: (1) the capitalization of net operating income or rental income from the use of a land plot; (2) a comparison of sales prices for similar land plots; (3) a consideration of the expenses for land plot improvements (e.g., buildings and other structures, etc.).

The second type of monetary appraisal is a "normative monetary appraisal," and is used to determine the amount of land taxes, state duties on exchange, inheritance and gift transactions with land plots, and rent payments for land plots in state and municipal ownership. Normative monetary appraisals are carried out in accordance with state standards and rules.

The law also provides for a system of professional appraisers and, in particular, in the first category of expert monetary appraisals. The latter may be citizens of Ukraine as well as foreigners who have passed a qualification exam and have obtained a qualification certificate. In addition, the law seeks to limit the possibility of conflicts of interest by setting out a number of instances in which an appraiser may not carry out expert monetary appraisals, such as when the land plot subject to appraisal belongs to the appraiser or the appraiser has family ties to the person ordering the appraisal. Finally, the law envisions the creation of self-regulating professional organizations of appraisers that would advance the education and development of the profession, ensure the compliance of its members with the laws and standards of the profession, and monitor the qualifications of its members. /A. Mycyk and A. Putintseva

## Telecoms, Metallurgy and Oil Refineries to be Privatized in 2004

On January 21, 2004, the State Property Fund of Ukraine ("SPF") published a list of enterprises subject to privatization in 2004. One of the largest enterprises on the list, which the Ukrainian Government hopes will bring a significant amount of privatization revenue to the state budget, is Ukraine's telecommunications state monopoly, Ukrtelecom. Although a special law on the privatization of Ukrtelecom was passed in 2000, the Government has already twice postponed its privatization, citing unfavorable market conditions. A 42.86 percent stake is now scheduled to be offered in the second half of 2004 to "industrial investors," i.e., communications operators, or consortia of companies with a communications operator as part of the consortium, that have at least five years of operating experience and that meet certain other qualification criteria. Approximately 7.14 percent of the company's shares are already privately held as a result of a sale to company employees.

This year, the SPF's list contains over 300 Ukrainian enterprises in which the state will offer at least 25 percent of the state-owned stake for sale. A number of large enterprises are scheduled for privatization, including a 25 percent stake in the Zaporizhzhya Aluminium Plant, the sole producer of primary aluminum in Ukraine; a 98.29 percent stake in the Zhytomyr Chemical Fiber Plant; a 60.86 percent stake in the Makiyivska Metallurgical Integrated Plant; a 69.88 percent stake in Pivdieselmash, a manufacturer of diesel engines; and an as-yet-to-be determined stake in the Odessa Port Plant. Notably absent are the state-owned stakes in Ukraine's electricity sector and, in particular, the remaining distribution companies, or "oblenergospets."

In the mining and metallurgy industry, the SPF has announced that it will offer a 50 percent stake in the UkrRudProm Holding Company, which owns 100 percent of the Kryvyi Rih Iron Ore Mill and the Balaklava, Novotroitsky and Dokuchivske Ore Extracting Plants, a 50 percent + 1 share in Piv-

/continued on page 19

nichny and Central Ore Mining and Processing Plants (known as GOKs), a 50 percent share in the Inguletsky GOK, and a 25 percent share in each of the Pivdenny GOK and Sukha Balka. Plans are also currently being developed to privatize Kryvorizhstal, the largest integrated metallurgical plant in Ukraine, although the exact size of the stake has not yet been determined. These enterprises are expected to generate significant interest among foreign investors.

The SPF also announced its intention to privatize two oil refineries: a 25 percent stake in the Halychyna Oil Refinery and a 43 percent stake in UkrTatNafta, Ukraine's largest oil refinery. UkrTatNafta was established in 1994 by the presidents of Ukraine and Tatarstan, and is based at the Kremenchug Oil Refinery in the Poltava Oblast. The refinery has an annual refining capacity of 18.6 millions tons of oil, and the stake is valued at over US\$100 million. UkrTatNafta's other shareholders include the Tatarstan State Property Committee – 28.8 percent, Russia's Tatarstan-based oil company Tatneft – 8.6 percent, Switzerland's AmRuz Trading AG – 8.3 percent, and US-based Sea Group International Inc. – 10 percent.

A full list of enterprises subject to privatization in Ukraine may be found on the SPF's website: [www.spf.gov.ua/eng/](http://www.spf.gov.ua/eng/) / A. Mycyk

POLAND

## Polish Commercial Companies Code Amended

On January 15, 2004, the amended Polish Commercial Companies Code ("PCCC") came into force. There are 103 changes to the existing PCCC, out of which those with the greatest practical impact are as follows:

Minimum nominal value of shares decreased (Articles 154 and 308)

The nominal value of a share has been restored to the pre-PCCC level of PLN 50 from the PCCC imposed level of 500 for limited liability companies. Due to this amendment, companies with a nominal share value under PLN 500 are no longer required to raise it.

As regards joint stock companies, under the amendments they will be permitted to issue so called "penny shares" having a nominal value of PLN 0.01. Prior to these amendments, the shares had a nominal value of PLN 1.

Milder sanctions on the Failure to Obtain the Shareholders Consent to enter into major operations (Article 230)

Previously, the PCCC imposed a requirement for obtaining the consent of the shareholders' meeting for transactions in which a limited liability company was disposing of a right or contracting an obligation the value of which exceeded twice the amount of the share capital of such company. The failure to obtain such consent resulted in the invalidity of the company's action. The amendments to the PCCC now validate actions performed without proper shareholders' consent, or against their resolution, but the company will be entitled to claim damages from members of its management board for such actions in violation of the law.

The nature of the amendment is such that action taken by the management board in violation of Article 230 is valid in relations with third parties; however, if as a result of such action, the company incurs damages, it will have a cause of action against members of the management board. Third parties will not have any cause of action against the management board.

Notarial simplification (Article 173)

The amendments relax the previous rule applicable to limited liability companies with reference to ownership of shares. Previously, if all company shares were held by a single shareholder or a single shareholder and the company, all declarations of will of such shareholder addressed to the company had to be signed by an authorized person, i.e., the shareholder, and the document had to be notarized, otherwise it was considered null and void. The amendments allow for such declarations to be made in a simple written form, unless they relate to matters outside the ordinary course of the company's business, in which event the notarial certification of the signature is still required.

Sharpening regulations on forced buyout of shares belonging to minority shareholders in joint-stock companies (Article 418)

The previous regulation concerning the buyout of shares was extremely controversial. The amendments have made forced

/continued on page 20

buy-out much more difficult. Currently, shareholders representing no more than five percent of the share capital may be forced out of the company provided that their shares will be bought by no more than five shareholders holding jointly not less than 95 percent of the share capital (provided that none of them may hold less than five percent of the share capital). The resolution to this effect shall require a majority of 95 percent of the votes cast (and the statute of the company may provide for higher majority vote requirements).

Prior to the amendments, the shares of minority shareholders could have been bought out by way of a forced buyout by the shareholders representing not less than 90 percent of the share capital and the resolution required nine-tenths of the votes cast. / G. Wujek, M. Boruc

## KAZAKHSTAN

# Amended Tax Code of Kazakhstan Shifts Risks to Investor and Benefits to State

Amendments to the Tax Code of the Republic of Kazakhstan, No. 209-II, dated June 12, 2001, (as amended, the "Amended Tax Code") took effect January 1, 2004, and have created a more cohesive and prescriptive tax regime for oil and gas projects in Kazakhstan, but also have shifted the burden of risk for such projects toward investors, while shifting the up-side benefits to the State.

With the Amended Tax Code, investors now find almost all of the tax legislation that is relevant to "subsoil users" in Kazakhstan in one piece of legislation. Previously, investors were forced to look not only in the Tax Code, but also in a plethora of other legislative and executive acts. Note that although the Amended Tax Code defines "subsoil users" generally as those who perform subsoil operations, including petroleum operations, this article uses the term "subsoil users" to mean only those who perform subsoil petroleum operations.

The Amended Tax Code makes it clear that all subsoil users must pay taxes and other mandatory payments pursuant to

one of two models. Model One is applicable to all subsoil users that do not operate pursuant to a production sharing agreement and requires that subsoil users pay all taxes provided under Kazakh law that are applicable to subsoil users, except they are not required to transfer a share of their petroleum production to the State. Model Two is applicable to all subsoil users that do operate under a production sharing agreement. It requires them to transfer a share of their petroleum production to the State, but exempts them from paying excess profits tax, rent tax on exported crude oil, excise tax on exported crude oil and gas condensate, land tax and property tax.

The Amended Tax Code states generally that if Kazakhstan's tax legislation is amended, production sharing agreements may be revised to reflect such amendments, but only upon the mutual agreement of the parties to such agreements. However, it also specifically refers to legislative amendments that "improve the conditions of taxation of a subsoil user" and states that revisions to production sharing agreements "shall be made... to restore the economic interests of the Republic of Kazakhstan." It is not clear whether such revisions would be contingent on the agreement of all of the parties to the agreement.

## Amendments Affecting the Model One and Model Two Tax Regimes

**Bonuses.** As in the past, the Amended Tax Code makes it clear that there are two types of bonuses that subsoil users pay: subscription (signing) bonuses and commercial discovery bonuses.

Previously, the amount of the signature bonus was established in the relevant contract and was required only to consider the economic value of the petroleum deposit. Now, the amount of the signature bonus is determined after the tender process by a commission and is based on the value of the petroleum deposit that is established during the tender. It is not clear in the Amended Tax Code, however, whether the value of the petroleum deposit is based on proven, probable or possible reserves, or at what price the value should be calculated.

The Amended Tax Code requires that a commercial discovery bonus be paid by subsoil users in connection with each

/continued on page 21

commercial discovery they make, unless such subsoil user does not intend to extract the discovered petroleum. The amount of the bonus must be 0.1 percent of the value of the petroleum that may be extracted from such discovery. The Amended Tax Code requires that such value is determined based on the International Petroleum Exchange of London (London IPE) prices on the date that the payment is made. It does not, however, specify how the volume of petroleum is determined, except that the volume should be confirmed by an authorized state body. Prior to the Amended Tax Code, the required amount of the commercial discovery bonus was negotiated between the subsoil users and the Government, and the only legal mandate was that it be no less than 0.1% of such value.

**Royalties.** Royalties must be paid by subsoil users based on the value of petroleum that they extract, regardless of whether such petroleum is sold or used by the subsoil user. Such value is based on the weighted average realized price for the relevant tax period, excluding all individual taxes and transportation expenses. If the petroleum is not sold, various procedures are used to determine the value, but generally it is based on either the realized price for the preceding or succeeding tax period or the cost of production for such petroleum. The Amended Tax Code establishes particular royalty rates, depending on production levels during the relevant calendar year. The rates established in the Tax Code are:

<b>Crude Oil Production in Calendar Year</b>	<b>Royalty Rate</b>
up to 2 million tons	2%
2 million tons - 3 million tons	3%
3 million tons - 4 million tons	4%
4 million tons - 5 million tons	5%
5 million tons and more	6%

For the purposes of these calculations, associated gas hydrocarbons are converted to their crude oil equivalent at the ratio of 1000 cubic meters of gas to 0.857 tons of crude oil.

### Amendments Affecting the Model One Tax Regime Only

As noted above, the Model One tax regime applies to subsoil users that are not operating under a production sharing

agreement. The primary changes in the Amended Tax Code that are applicable only to the Model One tax regime concern the rent tax on exports of crude oil and the excess profits tax.

**Rent Tax on Crude Oil Exports.** The rent tax on exports of crude oil is based on the value of the exports. Such value is based on a basket of published market prices that take into account sales costs and the quality of the crude oil. The tax rate is determined on a sliding scale based on the price of oil per barrel:

<b>Market Price (per barrel)</b>	<b>Rent Tax Rate</b>
US\$19	1%
US\$20	4%
US\$21	7%
US\$22	10%
US\$23	12%
US\$24	14%
US\$25	16%
US\$26	17%
US\$27	19%
US\$28	21%
US\$29	22%
US\$30	23%
US\$31	25%
US\$32-US\$33	26%
US\$34-US\$35	28%
US\$36	29%
US\$37	30%
US\$38-US\$39	31%
US\$40 and more	33%

Although there was some concern during the debate of the Amended Tax Code that this tax would be applicable to

/continued on page 22

production sharing agreement subsoil users, the Amended Tax Code is explicit in exempting such subsoil users from this tax.

**Excess Profits Tax.** The Amended Tax Code requires that subsoil users under the Model One tax regime pay an excess profits tax on the amount of its net income that in excess of 20 percent of certain deductions. If the excess profits tax is payable by a subsoil user, the rate of taxation will be as follows:

Amount Exceeding 20% of Net Income Ratio to Deduction	Excess Profits Tax Rate
up to 5%	15%
5% to 15%	30%
15% to 30%	45%
40% and more	60%

### Amendments Affecting the Model Two Tax Regime Only

The Model Two tax regime is applicable to all subsoil users that operate pursuant to production sharing agreements with a competent authority of the Kazakhstan and requires subsoil users to transfer to the State a portion of their Production Petroleum (the petroleum that they produce pursuant to the production sharing agreement). The subsoil user retains a portion of the Profit Petroleum, which is Production Petroleum minus Cost Petroleum (the petroleum production that the subsoil user may use to offset certain of its costs), with the State receiving the remaining portion of the Profit Petroleum. The Amended Tax Code specifically addresses how each of those variables is calculated.

**Cost Production.** The Amended Tax Code now further restricts the total amount of Production Petroleum that may be used to offset a subsoil user's costs during any reporting period to a maximum of 75 percent prior to the payback of the subsoil user's capital investment ("payback") and 50 percent after such payback. If there are eligible costs that are not recovered in one reporting period, such costs may be carried forward to, and paid during, another reporting period. Prior to the Amended Tax Code taking effect, the maxi-

imum amount of Production Petroleum that could be allocated as Cost Production was 80 percent, both before and after payback.

The Amended Tax Code also further restricts the expenditures that are recoverable with Cost Production. For example taxes and other mandatory payments to the state budget, expenditures that violate local content rules, fines for environmental, technical, or safety regulation violations, social programs, and bonuses are not recoverable under the Amended Tax Code.

**Subsoil User's Profit Production.** The subsoil user's share of Profit Production under the Amended Tax Code is calculated based on the R-Factor, IRR, or P-Factor, depending upon which provides the least amount of Profit Production to the subsoil user.

According to the Amended Tax Code, the R-Factor (rate of revenue) is the ratio of the subsoil user's accumulated real income, less its actual aggregate income tax, to its accumulated cost-recoverable expenditures, each on an accrued basis. If the R-Factor is used to determine the amount of the subsoil user's share of Profit Production, such Profit Production is calculated based on the following sliding scale:

R-Factor (Rate of Revenue)	Subsoil User's Share of Profit Petroleum
Less than or equal to 1.2	70%
More than 1.2 and less than 1.5	70%-2.068* (RFactor-1.2)*100%
More than or equal to 1.5	10%

The Amended Tax Code provides that IRR (internal rate of return) is the annual discount rate at which the net present value of the project is zero. The Amended Tax Code also provides a specific formula for calculating net present value. If IRR is used to calculate the subsoil user's share of Profit Production, such share is determined based on the following:

/continued on page 23

**IRR (Internal Rate of Return)      Subsoil User's Share of Profit Petroleum**

Less than or equal to 12%	70%
More than 12% and less than 20%	70%-7.51*(IRR-12%)
More than or equal to 20%	10%

The Amended Tax Code defines the P-Factor (price factor) as the ratio of the value of the subsoil user's Cost Petroleum and share of Profit Petroleum to the value of the Production Petroleum, each during a specific reporting period and each without taking into account certain expenses (such as sales expenses). If the P-Factor is used to calculate the subsoil user's share of Profit Production, such share is determined based on the following:

P-Factor (Price Factor)	Subsoil User's Share of Profit Petroleum
Less than or equal to US\$12/barrel	70%
More than US\$12 and less than US\$27/barrel	70%-0.04*US\$27/barrel (PFactor-12) *100%
More than or equal to US\$27/barrel	10%

State Share of Petroleum. The Amended Tax Code requires that the total value of the Profit Petroleum allocated and the taxes payable to the State during each reporting period may not be less than 20 percent of the total Production Petroleum before payback and 60 percent after payback. The Amended Tax Code also provides an additional layer of down-side protection for the State. It requires that "if the performance of the production sharing agreement conditions become worse," the State's share of the Production Petroleum "may not be decreased below its fixed maximum point prior to the worsening of the conditions, except if such maximum point has been achieved by using the P-Factor" calculation. It is not clear exactly what that provision means, but it is clear that there is a minimum amount of Production Petroleum that the State should receive, regardless of the amount of Profit Petroleum. / K. Martin, K. Heimert

CIS LEGAL NEWSWIRE

For more on the information contained herein or about Chadbourne & Parke LLP and its affiliated offices throughout the CIS, please contact:

In Moscow

Laura Brank – lbrank@chadbourne.com

7-095-974-2424 or 1-212-408-1190

In Kyiv

Jaroslawa Johnson – sjohnson@chadbourne.com

380-44-230-2534

In Warsaw

Gabriel Wujek – gwujek@chadbourne.com

48-22-520-5000

In London

Laura Brank – lbrank@chadbourne.com

44-20-7337-8000

Or visit our website – [www.chadbourne.com](http://www.chadbourne.com).

To change an address, or to add or remove a recipient from this distribution list, please contact:

Marta Whelan , Marketing Coordinator

mwhelan@chadbourne.com

7-095-974-2424 or 1-212-408-1190

This bulletin is for informational purposes only. Readers should not act upon information in this publication without consulting counsel. The material in this publication may be reproduced, in whole or in part, with acknowledgment of its source and copyright.

© 2003 Chadbourne & Parke LLP