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# CIS AND CENTRAL EUROPE LEGAL NEWSWIRE

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RUSSIA

## Law on Concession Agreements — A Framework for Russian Projects

On July 21, 2005, the Federal Law on Concession Agreements (No. 115-FZ) was signed into law by Russian President Vladimir Putin. The law aims to provide a specific framework for the more effective use or upgrade of state property by allowing cooperation arrangements with private investors and operators. The law covers each type of transport infrastructure, pipelines, ports and airports, and public utility system infrastructure, as well as facilities for medical, recreational and educational purposes.

The Concession Agreement scope. Concession agreements would allow a party (a

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UKRAINE

## Simplified Visa Procedures Are Established for Citizens of the U.S. and the EU, Among Others

On June 30, 2005, Ukrainian President Victor Yushchenko issued Decree No. 1008/2005, "On the Introduction of a Visa-free Process for Citizens of the United States of America," as amended (the "Visa Decree"). The possibility of visa-free travel to Ukraine for US citizens had been brought up by the new government months earlier and has been eagerly awaited by US citizens who frequently travel to Ukraine. Although the initial version of the Visa Decree issued on June 30 was slightly unclear, and implied that visa-free travel would only apply to a return

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POLAND

## Use of Central and Eastern European Stock Exchanges as a Private Equity Exit Alternative

During the economic downturn of the early years of the new millennium many commentators were predicting the demise of Central and Eastern European ("CEE") stock exchanges. Private equity investors in CEE were lamenting the incipient loss of a potential exit route for CEE investments. Fortunately, CEE exchanges have rebounded from their moribund state to

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cessionaire), including a foreign entity, to build or reconstruct and operate, at its own cost, immovable property belonging to the state (the concession provider) for a fixed term and to share in the returns. The underlying real estate would be leased to the concessionaire, and the concession provider may transfer other property only if it is an integral part of the operations.

**Form.** The concession agreement will be a two-party agreement governed by Russian contract law. In addition to setting out the obligations and rights of the parties based on the tender terms, the agreement may contain any other terms consistent with Russian law and the tender terms. The law (Article 10.4) envisages a 'model concession agreement' for some types of concessions, although they are not listed; but generally, it allows for the negotiation of the legal and financial terms.

**Restrictions.** The concessionaire may not modify the use of the underlying assets or pledge them or any of its rights under the concession agreement. The concessionaire's rights over the concession assets are subject to state registration as security.

**Rights.** The concessionaire is guaranteed equal rights and a legal regime that is non-discriminatory which allows it to enjoy the economic benefits of the agreement and compensation against adverse changes in law (other than technical regulations and the protection of subsoil, human health and the environment). The concession provider has the right of unrestricted access to the concession and all documents related thereto, but may not interfere in the "economic activities" of the concessionaire and must respect confidentiality.

**Procedure.** In general, the right to a concession will follow an "open" (any person may participate) or "closed" (by invitation) tender. A closed tender is envisaged when a concession may involve state secrets or matters of strategic importance. Information on an open tender may be disclosed through an official Internet site that would set out in advance:

1. the tender documentation, including the terms and conditions of the concession agreement (listed in Article 23) that must not create preferential terms for one participant over another;
2. the procedure and criteria (listed in Article 24); and
3. the composition of the body conducting the tender (listed in Article 25).

At least two tender proposals must be submitted unless there is only one (Article 32.7) and generally, a deposit would be required (but is not always refundable). The provisions on procedures and documentation are generally very prescriptive.

A copy of an unofficial translation into English is available on request. /C. Owen

## New Law Allows Authorities to Liquidate Dormant Companies

On July 2, 2005, RF President Putin signed into law amendments to the law "On State Registration of Legal Entities and Individual Entrepreneurs," dated August 8, 2001 (the "Registration Law Amendments"). The Registration Law Amendments establish a new procedure (the "Removal Procedure") for removing Russian legal entities that are no longer active (so-called "dormant companies") from the Unified State Register of Legal Entities (the "Register").

Prior to the Registration Law Amendments, a dormant company could be removed from the Register based only on a court order to liquidate such company. The liquidation of a company through the courts is very time-consuming; using existing procedures, analysts say it could take at least 15 years to liquidate all dormant companies.

Under the Registration Law Amendments, the RF registration authorities, the functions of which are currently conducted by local tax inspectorates (the "Registration Authorities"), may remove dormant companies from the Register based solely on a resolution adopted by the Registration Authorities; such a removal would constitute the formal liquidation of the entity. According to the Registration Law Amendments, a legal entity that has "de facto" terminated its activity (an "Inoperative Entity" or dormant company) is a Russian legal entity that, over a 12-month period, has simultaneously provided neither financial and tax reports to the tax authorities nor conducted operations through at least one bank account.

The Registration Law Amendments require the Registration Authorities to take the following steps to remove an Inoperative Entity from the Register:

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- Approve a preliminary resolution (the "Preliminary Resolution") to remove the Inoperative Entity from the Register;
- Publish the Preliminary Resolution (within three days of the date thereof) in the mass media that usually publish Russian legal entities' state registration information. Such publication must contain information regarding the procedure and period for filing an application (an "Application") opposing the removal with the Registration Authorities by any interested party whose rights and interests may be affected (including the Inoperative Entity itself, its creditors, *etc.*) by removal of the Inoperative Entity from the Register. The publication must also indicate the address to which an Application should be sent. Interested parties have three months from the date of the publication of the Preliminary Resolution to file an Application; and
- Adopt a final resolution (the "Final Resolution") to remove the Inoperative Entity from the Register if no Applications are received. A Final Resolution may be appealed by interested parties during a one-year period following the time the party discovered, or should have discovered, the violation of its rights. If, however, the Registration Authority receives an Application from any interested party, the Final Resolution may not be adopted and the Inoperative Entity may not be removed from the Register. In such a case, the entity may be liquidated only by following the general liquidation procedure established by Russian law.

Although the purpose of the Registration Law Amendments is to create a simplified administrative mechanism for the liquidation of dormant companies, and in that respect it is very helpful, it is not clear whether such a mechanism will guarantee the protection of the legal rights and interests of all interested parties. It is further unclear whether the Registration Authorities must take any action to contact the Inoperative Entity prior to adoption of the Preliminary Resolution in with an attempt to clarify the status of such entity. In addition, the Registration Law Amendments do not specify how all other state registrations of the Inoperative Entity, for example with the social funds, would be terminated, as well as how the Inoperative Entity's bank accounts would be closed and any remaining funds distributed. /E. Korotkova, E. Zamoshkina

## Inheritance and Gift Tax Reform

The Government of the Russian Federation (the "RF") began to implement significant tax reforms in 1999 that have, *inter alia*, reduced tax liabilities for most Russians. In June of 2005, the State Duma expanded such reform to include inheritance and gift taxes.

On June 15, 2005, the Duma adopted amendments to the Tax Code (the "Tax Code Amendments"), thereby abolishing the inheritance tax and significantly reducing gift taxes. The Duma had previously discussed such Amendments, but the enactment process gained momentum in April of this year, when President Vladimir Putin affirmed his support for the Tax Code Amendments in his annual address to the Federal Assembly. Putin indicated that there is no economic value in retaining the inheritance tax, or the gift tax at the current rates, because the Government expends more money enforcing such taxes than it gains from the payment of such taxes. Moreover, average Russian citizens do not have money to pay inheritance or gift taxes, so they are often forced to sell the property that they inherit.

Abolishing the inheritance tax will have a significant impact, as the current tax rate is up to 40% of the value of all inherited property.

The gift tax, which is presently as excessive as the inheritance tax rate, has not been abolished, but has been considerably reduced. First, the Amendments specify the list of taxable property, which includes immovable property, vehicles, stocks, shares and participation interests. Second, certain family members and close relatives are exempt from paying taxes upon obtaining a gift. Such relatives include a spouse, parents, children (biological or adopted), grandparents, grandchildren, and full or half siblings. Other relatives would pay gift taxes at a reduced tax rate of 13%.

The Tax Code Amendments enter into force on January 1, 2006. /E. Zamoshkina

## Russian Credit Bureaus

As of September 1, 2005, all Russian banks are required to have a signed agreement with at least one credit bureau which may be 50% owned by the lender (Federal Law No 218-FZ "On Credit Histories," dated December 30, 2004, amended on July 21, 2005.) A central clearinghouse and register of licensed credit bureaus should be established in Q4 2005./C. Owen, D. Gubarev

## Possible Decrease in Statute of Limitations for Void Transactions

Under Russian law, a transaction will be considered null and void if executed in violation of law. A null and void transaction is invalid from the moment of its execution and does not require the issuance of a court judgment with respect to its invalidity. Any interested party is entitled to submit a claim with a court seeking to apply the consequences of the null and void transaction, which generally means the restitution of both parties to the transaction. A court may also impose such consequences on its own initiative. Most importantly, the restitution may result in the rescission of all transactions consummated on the basis of the null and void transaction. According to current Russian law, the statute of limitations for applying the consequences of a null and void transaction is ten (10) years from the beginning of consummation of the challenged transaction.

On May 17, 2005, the RF Government submitted a draft law with the RF State Duma seeking to amend Article 181 of the RF Civil Code and decrease the statute of limitations for applying the consequences of null and void transactions from the current ten (10) years to three (3) years, consistent with the general three-year statute of limitations for bringing claims with a court. The main purpose behind amending Article 181 of the RF Civil Code has been to prevent the on-going redistribution of property in Russia on questionable grounds and to provide greater comfort to foreign and domestic investors alike that these transactions will not be unfairly challenged.

Although it is always difficult to predict timing of the enactment of a draft law (which can take from several months to several years), given that the above amendments to Article 181 of the RF Civil Code were prepared pursuant to Presidential instructions, it seems likely that the adoption of the draft law with the RF State Duma will be hastened. /A.  
Kelina

## Constitutional Court Considers Statute of Limitations on Tax Offenses

**Ruling No. 8-P of the Constitutional Court of the Russian Federation of July 14, 2005 concerning the constitutionality of Article 113 of the Tax Code**

Under Article 113, as a general rule, a person cannot be held liable for a tax offence if three years (the limitation period for tax liability) have expired.

The Constitutional Court found Article 113 to be constitutional but that the provisions of the article do not prevent a court from finding that a tax authority has legitimate reasons for breaching the period of limitation and later on imposing tax sanctions for offences where a taxpayer obstructs tax monitoring or a tax audit. The court left unclear what could constitute evidence of obstruction and therefore allowed the tax authorities to pursue claims if they can prove obstruction by the taxpayer.

The Court further indicated that the limitation period for tax liability expires at the moment the tax audit is completed and the tax authorities prepare a tax audit report, or in case of a desk audit from when a decision is formally adopted. In other words, if the audit is made after the end of three-year limit, the taxpayer can still be held liable, if the taxpayer allowed a tax audit to be made.

Overall, the finding of the Constitutional Court is a negative development because the ruling makes it easy for the tax authorities to claim obstruction (*e.g.* failure to provide all documents when requested) and opens without limit the prior periods the tax authorities can revisit, making it difficult for companies to close their accounting/tax years. / C. Owen, T. Sharipov

## UKRAINE

### Simplified Visa Procedures Are Established for US Citizens and

*(Continued from page 1)*

visit to Ukraine, such that a first-time visitor might nonetheless need a visa, the President amended the Visa Decree on August 18 to resolve this ambiguity. The Visa Decree now clearly provides that US citizens may enter Ukraine without a visa if the duration of their stay will not exceed 90 days.

The stated aim of the Visa Decree is to simplify US citizens' travel to Ukraine and to stimulate bilateral contact in various spheres between Ukraine and the United States. The decree also seeks to put into practice the principles of strategic partnership between the two countries, as set out in the joint statement "A New Century Agenda for the Ukrainian-American Strategic Partnership,"

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confirmed by the Presidents of both countries during President Yushchenko's visit to Washington in April 2005. In that statement, Ukraine indicated that it would eliminate visa requirements for US citizens, while the US indicated it would reduce visa fees for Ukrainian citizens.

The visa-free regime established for US citizens follows a successful trial period for visa-free travel instituted by Ukraine earlier this year for citizens of the European Union and Switzerland, which was designed to facilitate travel to Ukraine for the Eurovision 2005 song contest held in Kyiv and to develop tourism. This temporary measure was recently replaced by Decree No. 1131/2005, issued on July 26, 2005, according to which citizens of the European Union member states, the Swiss Confederation and the Duchy of Lichtenstein can enter Ukraine without a visa starting from September 1, 2005, if the duration of their stay will not exceed 90 days.

Similar measures have also recently been introduced with regard to citizens of two other countries. Specifically, decrees establishing visa free travel for citizens of Japan and Canada were issued, respectively, on July 19 and July 26. Beginning on August 1, 2005, citizens of Japan and Canada no longer require a visa to enter Ukraine if the period of their stay will not exceed 90 days. /Adam M. Mycyk, R. Ostapenko

## New Law Increases the Authority of the Antimonopoly Committee

The Ukrainian Parliament recently adopted a new law on the protection of economic competition, which considerably strengthens the authority of the Law on Protection of Economic Competition (the "Competition Law"), dated January 11, 2001, and the Customs Code of Ukraine, dated July 11, 2002 (the "New Law"). The New Law, which is currently in effect, was adopted on May 31, 2005, and was signed by President Yushchenko on June 22.

A draft of the New Law had been submitted to the Parliament in February 2004, and while it was passed during the first reading on June 24, 2004, no further action was taken for almost a year. However, the combination of protests by major gasoline traders against the state regulation of gasoline prices and a price increase in the sugar market led the government to resuscitate the New Law.

Below we summarize the most significant changes to Ukrainian legislation introduced by the New Law.

The New Law amends Article 308 of the Customs Code, to require that the customs authorities submit, at the request of the Antimonopoly Committee of Ukraine (the "AMC"), information on the import and export operations of an entity under AMC investigation. Previously, only authorities investigating criminal activities could gain access to such information. Thus, the amendment to the Customs Code expands the sources of information available to AMC for antitrust investigations.

The New Law also focuses attention on the activities of "alliances." According to the amendment to Article 5 of the Competition Law, the establishment of an alliance for the purpose of coordinating competitive behavior among members or between members of a similar alliance, as well as joining such an alliance, shall constitute a "concerted action."

Under current Ukrainian law, alliances of companies include associations, corporations, concerns and consortia, all of which are distinct forms of legal entities. Associations and corporations are based on an agreement among members, while concerns and consortia are charter-based alliances. Since the Law uses the term "alliance" broadly (rather than limiting the term to an alliance of companies), members of any informal alliance may also be considered participants of concerted actions.

The Competition Law prohibits any concerted actions that may constrain competition. Consequently, the AMC may, under the Article 5 amendment, initiate an antitrust investigation against any company that participates in an alliance that is suspected of conducting concerted anticompetitive activities.

The definition of "concerted anticompetitive actions" was also amended by the New Law. Pursuant to the New Law, "similar" actions and omissions with respect to a particular commodity market that cause, or may cause, the disturbance, elimination or limitation of competition, may be regarded as a concerted anticompetitive action, if, based on an analysis of such market, the AMC determines that objectively, such behavior was unjustified. This provision does not, however, specify which private institution or state body would actually perform the "objective" market analysis for the AMC and whose market analysis would prevail in the case of a conflict between analyses.

In fact, this amendment authorizes the AMC to establish a

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finding of anticompetitive behavior based on circumstantial evidence. The lack of clear criteria and a method of market analysis could lead to a situation in which a simultaneous price increase by several market players for valid economic reasons could be viewed as anticompetitive collusion.

Prior to the enactment of the New Law, the Competition Law provided that certain transactions, referred to as "concentrations," could only be undertaken with the AMC's approval. Based on Article 22 of the Competition Law, the following transactions constitute concentrations for antitrust purposes:

- (1) a merger or joinder;
- (2) the act of one entity obtaining control over another by means of:
  - a. the direct or indirect acquisition of, or the obtaining of, leasehold, management, concession or other rights to use an integral property complex or a structural sub-division of an enterprise (including the acquisition of assets of an entity that is being liquidated);
  - b. the appointment or election of an executive or supervisory body's director who concurrently holds a similar position at another company, or the creation of a situation in which more than 50 percent of the executive or supervisory positions in several companies are held by the same persons;
- (3) the creation of a new company by two or more founders; or
- (4) the direct or indirect acquisition of title or management rights to an equity share that results in obtaining either 25% or more shares (in the case where share ownership was less than 25% prior to the acquisition) or 50% or more shares (in the case where share ownership was less than 50% prior to the acquisition).

Under the previous version of the Competition Law, the AMC's approval of a concentration was only required if, generally speaking, the annual value of assets or the volume of sales of all of the participants in the concentration exceeded 12 million Euros.<sup>1</sup>

The New Law preserves these requirements, while essentially establishing another type of transaction that requires AMC approval. In this case, irrespective of the value of the assets or sales volume of the participants to the concentration, the participants will be required to obtain preliminary AMC approval for their concentration if the share of any such

participant, or the aggregate share of all of the concentrating participant, on a certain commodity market exceeds 35 percent, and the concentration occurs on that market or a similar one. Furthermore, in determining a respective company's market share, the AMC will include any affiliates of that company.

Hence, the acquisition of a controlling interest or a property complex, as well as other concentrations of natural monopolies or companies operating on markets with limited competition, would be subject to prior AMC approval, even if the financial thresholds that generally trigger the prior AMC approval requirements are not met.

Finally, the New Law strengthens sanctions against violators of the law. The New Law authorizes the AMC to use "administrative information that is obtained from other sources" to evaluate a company's income, which provides the basis for calculating AMC penalties. Prior to this amendment, companies accused of antitrust violations were required to report their income to the AMC. If they failed to do so, the AMC applied penalties that could not exceed 20,000 times the minimum wage (UAH 340,000 or USD \$61,818). Given that the New Law fails to specify the methods to calculate this income or the sources from which the AMC may obtain a company's income information, there is a risk that the AMC's calculation of a company's income could be arbitrary, and thus result in a significant increase in the amount of penalties.

The effect of the New Law is to confer greater control on the AMC over large industrial companies and their affiliates. To further this purpose, the New Law enables the AMC to use numerous analyses, assessments, market monitoring reports and other information as indirect evidence of anticompetitive activities. However, the New Law fails to specify any criteria for what constitutes valid, rather than circumstantial, evidence of anticompetitive activity. This could lead to a distorted assessment of the market situation and, consequently, arbitrary decision-making on the part of the AMC. /A. Mycyk, A. Ryshova

<sup>1</sup> The Competition Law sets out the following financial thresholds: (i) the aggregate value of assets or the aggregate volume of the sale of goods of all of the concentrating entities within and outside of Ukraine exceeds 12 million Euros for the most recent fiscal year; and provided that (ii) the aggregate value of assets or the aggregate volume of the sale of goods of no less than two concentrating entities within and outside of Ukraine exceeds one million Euros each for the most recent fiscal year; and (iii) the value of assets or the volume of the sale of goods of at least one concentrating entity within Ukraine exceeds one million Euros for the most recent fiscal year.

## POLAND

### Use of Central and Eastern European Stock Exchanges as a Private Equity Exit Alternative

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become a legitimate exit vehicle for private equity investors in CEE.

#### Development and legal convergence of CEE equity markets

The indices of the three most important CEE exchanges, the Warsaw Stock Exchange ("WSE"), the Budapest Stock Exchange ("BSE") and the Prague Stock Exchange ("PSE") significantly outperformed world indices in 2004. For example, compared to 2003 by the end of October 2004, the BSE's BUX had gained 38 percent, the WSE's WIG 20 was up 13 percent and the PSE's PX 50 had gained 37 percent. The gains for all of 2004 ultimately were 57 percent (BUX), 25 percent (WIG 20) and 56 percent (PX 50). The largest exchange, the WSE, was home to 32 IPOs in 2004 and 2005 is predicted to be strong there as well.

Reasons for resurgence of these key CEE exchanges include the high growth attributed to European Union accession countries, favourable valuation multiples being realised in these CEE markets and the large cash inflows into equities and bonds in these CEE countries. Recent successful, sizable transactions in Poland, Hungary and Czech Republic, such as those by BorsodChem Rt. (Hungarian chemical company, €388m secondary offering and dual listing on the WSE), Cesky Telecom (Czech telephone company, €684m ABB), Telekomunikacja Polska S.A. (Polish telephone company, €350m ABB), MOL (Hungarian oil company, €275m ABB and dual listing on the WSE), Zentiva (Czech drug maker, €174m IPO) and PKO (Polish bank, €283m IPO) have given needed credibility to equity offerings in the region.

Legal convergence of these equity markets is taking place as part of these countries accession to the European Union ("EU"). The harmonisation of securities laws as part of the accession process is aimed at integrating EU equity markets to establish the legal framework for offering of foreign securities in these jurisdictions and the admission of such securities into public trading on regulated exchanges. In particular, Directive 2001/34/EC of the European Parliament

and the European Council, dated May 28, 2001, addresses the admission of securities to an official stock exchange and the information to be published about those securities. The laws resulting from implementation of this Directive address both mutual recognition of prospectuses and use of abbreviated prospectuses with the clear benefit of allowing companies to list securities on more than one exchange with relative ease. As a policy matter, legislation arising from the Directive allows a fast track timetable for dual listings and promotes the future strength of these regional markets as they work together to provide a strong investment community. Economically, such "dual listings" are thought to (i) create additional interest in, and visibility of, a company, (ii) access additional pools of investor demand, (iii) increase liquidity and aftermarket support, and (iv) provide a company with an additional acquisition "currency". Supported by this positive economic and legal backdrop, it is now a value creating exercise to use these equity markets when private equity exit opportunities arise.

#### Exchange related exits versus trade sales

The exchange related exit will need to make its economic case that it is preferable to a trade sale in a particular exit. Moreover, while the pros and cons of a trade sale are relatively easy to assess, the risks and rewards of an exchange related exit are more complex. The major advantage of an exchange related exit is access to a distinct investment community to facilitate sell-down by a selling shareholder and/or financing for the corporate. The major disadvantage is the inherent execution risk and complexity of the process. Breaking down the pros and cons of an exchange related exit reveals substantial opportunities and at the same time illustrates the complexity of the process:

##### Pro:

- Access to large and distinct external funding
  - geography
  - investment style
  - investment type (institutional/retail)
- Facilitates efficient capital structure
- Flexible structure
  - IPO metrics can be tailored to reflect market sentiment
  - control/influence can be maintained with additional

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stakes monetised over time

- mix between primary/secondary share issues possible

- Market valuation on assets and comfort following a public exercise that the optimum price has been achieved
- Enhanced company profile

**Con:**

- Execution risk – damaging to pull back from IPO
- Complexity – substantial time and resource requirements
  - valuation/equity story
  - financial/operational structure
  - corporate governance
  - due diligence
- Exposed to market sentiment
  - price/rationale
  - corporate governance
  - legal/accounting standards
  - sector/market issues
- Increased disclosure requirements and continuing reporting obligations

The cons of an exchange related exit are mitigated in some respects by the corporate governance reforms generally initiated at the time of investment by private equity investors as part of the normal investment control process – implementation of reforms to increase transparency, adoption of IAS or GAAP accounting standards, addressing off balance sheet liabilities, and the like. Other potentially negative aspects of the exchange related exit are less controllable, such as market sentiment, but nevertheless are reasonably predictable (barring catastrophic events). Deal size is also an issue since the transaction costs of an exchange related exit are high in comparison to the trade sale route.

The trade sale route will generally offer the advantage of a relatively short timetable with the potential of a valuation premium. Where an investor seeks a complete exit in many instances a straight trade sale will be preferable. On the other hand where an investor desires a sell-down of interest as opposed to a sell-out, the exchange related exit can have strong appeal by allowing an investor to sell-down while retaining both substantial influence on the company and

creating a liquid investment with a market attributed value as well as keeping the company otherwise independent of a dominant shareholder.

This particular consideration has been a driving force in many of the transactions cited earlier where the government was privatising a state-owned enterprise but desired to keep a substantial stake and influence over the company for some period of time. This allows a government to simultaneously contribute to the growth of its capital markets while maintaining control/influence and reaping cash for its sale of shares. This process has been informed and legitimated by western-trained financial advisers and investment bankers and has accelerated the renaissance of CEE exchanges to the benefit of both private investors and CEE governments. Those governments in many cases still hold many fundamental industrial concerns as state-owned enterprises and view an exchange related exit as a method of assuring the receipt of appropriate value when it sells. The retention of a sizable stake and concomitant influence is often an important consideration in these governmental privatisations through the capital markets.

The single largest exchange related exit in CEE by a private investor illustrates the applicability of these issues outside the context of governmental privatisations. BorsodChem Rt. ("BorsodChem") is one of the largest listed industrial companies in Hungary in terms of both sales and market capitalisation and is a leading European producer of both commodity and specialty chemicals. The secondary offering of BorsodChem took the form of global offering of ordinary shares and GDRs pursuant to Rule 144A and Regulation S under the US Securities Act of 1933, as amended.

Prior to the secondary offering in October 2004, BorsodChem was listed on the BSE and in depositary receipt form London but more than 91 percent of its shares were ultimately owned by Vienna Capital Partners ("VCP"), a private equity/investment banking house with a focus on investments in CEE opportunities. VCP was invested into BorsodChem for some four years during which substantial improvements to the business and its growth were achieved. A number of approaches by strategic investors had been made regarding the potential disposal of VCP's BorsodChem stake. It was a natural time for VCP to evaluate its position and consider exit opportunities. It would be critical to the eventual choice of an exchange related exit (a secondary offering which was in essence a "re-IPO" that dramatically increased the free-float of BorsodChem) that

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VCP was confident in BorsodChem's ability to continue to develop as an independent, leading CEE chemical company such that VCP would consider keeping a minority stake in BorsodChem.

In the final analysis the confluence of VCP's bullish view of the future for BorsodChem and the attractive development of the BSE and the WSE convinced VCP to embrace the exchange related exit for its sell-down resulting in a successful global offering of 51,700,000 ordinary shares and GDR's of BorsodChem while at the same time implementing a dual listing of BorsodChem on the WSE. The implementation of this additional listing generated additional investor interest, tapped captive liquidity in the Polish market (where open pension funds are estimated to contribute some €200m per month to the market) and positioned BorsodChem for future consolidation opportunities. The use of an exchange related exit allowed VCP to sell down its stake below 24 percent while still maintaining a significant voice in the future development of BorsodChem as the single largest stakeholder.

### Lessons for private equity investors in CEE

The development of CEE capital markets and their convergence as part of the EU accession process has created a newly robust exit alternative for private equity investors in CEE. Recent transactions have signalled the convergence and consolidation of CEE equity markets to an international audience while at the same time confirmed the investment appetite and capacity of indigenous investors in CEE. The success of the BorsodChem global offering in London further demonstrated the broad demand geographically for investment in high quality CEE-based companies. This is a trend that will continue. These developments signify a CEE capital market that is maturing in a very positive fashion for private equity investors. The coming consolidation of CEE exchanges should only accelerate this process. While an exchange related exit will never be a "one size fits all" solution for private equity investors in CEE it can now be an attractive option which should only become more viable as the integration of CEE accession countries into the EU becomes more complete.

This article was co-written by **David Dixon**, a partner in our Warsaw office, and **Heinrich Pecina**, a founding partner of Vienna Capital Partners with two decades of experience as a bank board member responsible for developing investment-banking activities and entering new markets. It first appeared in *Financier* in June of 2005.

## European Company Regulation Adopted in Poland

On March 4, 2005, the Polish Parliament adopted the Act on the European Company and the European Economic Interest Grouping (the "Polish SE Act"), which entered into force as of May 19, 2005. While many of the Polish SE Act's provisions conform to existing regulations, primarily the Commercial Companies Code, others are quite novel in the Polish legal system and may be considered almost revolutionary.

The European Community's ("EC") Council Regulation (EC) No 2157/2001 on the Statute for a European company (SE) ("Regulation 2157/2001"), which entered into force on October 8, 2004 and constitutes binding law in any EC jurisdiction, allows for the establishment of European public limited-liability companies (*Societas Europea* (European Company), or "SE") within any territory of the Community under the conditions and in the manner set forth in Regulation 2157/2001 and subject to that territory's applicable statute. The Polish SE Act is the applicable statute for Poland (which Poland was to enact to ensure the effective application of Regulation 2157/2001), providing the policy and regulatory framework for the establishment, organization and operation of an SE in Poland.

An SE's equity is composed of shares, with the subscribed capitalization of not less than 120,000 EUR. Regulation 2157/2001 allows a Member State to require a greater subscribed capitalization from SEs with registered offices in that Member State that perform certain types of activities (such as banking and insurance, among others, in Poland). A shareholder is not liable for more than his contributed equity amount. An SE may itself establish one or more subsidiaries in the form of SEs.

The registered office of an SE must be located within the European Community, in the same Member State as its head office. An SE with its registered office in Poland is considered registered in Poland; such registration is performed via a decision of the registry court of the registered office's jurisdiction. In Poland, the necessary registration must be entered into the Register of

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Entrepreneurs - a division of the National Court Register. Notices of an SE's registration in and deletion from the Register of Entrepreneurs, as well as the updates of company data required by Polish regulations, are published in Poland's official newspaper. Notices on registration and deletion of an SE as well as change of its registered office are also published in the Official Journal of the European Community. An SE can be governed either by a supervisory organ and a management organ (the "two-tier system") or by an administrative organ (the "one-tier system"), depending on the form adopted in the SE's articles of incorporation. The two-tier system is in general analogous to the governance of joint-stock companies ("JSCs") under the Polish legal system, with identical names for the ruling bodies - a supervisory board and a management board. The supervisory board supervises the company as a whole and opines on major decisions, whereas the management board manages the company's day-to-day activities and generally represents it in front of others. In the one-tier system, the SE's administrative organ (the administrative board, according to the Polish SE Act) performs all of the above functions together. Several powers are accorded to the administrative board of an SE by the Polish SE Act, including adoption of resolutions on setting business plans for annual or longer time periods. In matters not regulated by Regulation 2157/2001 or the Polish SE Act, the Polish SE Act refers to the provisions of the Polish Commercial Companies Code with regard to both supervisory and management board funding.

The administrative board may appoint a managing director or directors to whom it entrusts management of SE matters. Managing directors are responsible for day-to-day management of the SE, and may be members of the administrative board (yet the number of managing directors being members of the administrative board may not exceed one half of the total number of its members). Such a combination of management and supervisory functions is a completely novel approach in the Polish legal system, in which their separation used to be strictly observed.

Managing directors who are not members of the administrative board may represent and bind the SE with respect to third parties; the Polish SE Act mandates that such directors be disclosed in the Register of Entrepreneurs. If there is more than one managing director, one of them may be appointed general managing director and thus receive the power to direct the actions of other managing directors. Legal (nonphysical) persons may not act as directors or officers of a Polish-registered SE.

The general meeting of shareholders is held at least once each calendar year to vote on major company matters, pursuant to the requirements of Regulation 2157/2001 and the relevant Polish regulations (including the applicable provisions of the Commercial Companies Code). Notably, shareholders voting at a general meeting may not issue binding orders to the administrative board or the managing directors relating to the regular day-to-day management of the SE's affairs.

The involvement of employees of SE in its matters as provided by the Council Directive 2001/86/EC has the goal of protecting the SE's employees' rights which might be affected by the creation of an SE. Employees' participation may be divided between provision of information, consultations and participation. Rules of involvement should be agreed between the parties. Upon drawing up a plan for the establishment of SE, the administrative organs of the participating companies are obliged to commence negotiations with the representatives of the companies' employees on the arrangements for the employees' involvement in SE. Employees are represented by a special negotiating body representative of the employees of the participating companies. The required contents of the agreement to be ultimately achieved are specified in the Polish SE Act which in this respect implements rules set forth in the Council Directive 2001/86/EC; if such the agreement is not reached or should the parties so decide, standard rules provided by the Polish SE Act will apply. The SE's governing organs must (i) convene a meeting with the employee representative body at least once a year, to inform it of the SE economic situation and prospects, and (ii) notify the representative body of any extraordinary circumstances that affect the employees. Under the Polish SE Act, employees are also empowered to appoint, recommend appointment, designate or oppose appointment of some of the members of the SE's supervisory or administrative organ. Overall, the Polish SE Act introduces an extensive regulation of employees' involvement in the management of the SE, as employee-targeted provisions may be found in 50 out of total of 130 articles of that Act.

The SE may be considered first really cross-border entity introduced to the Polish legal system. It may be established through merger of companies governed by the laws of different Member States and having their registered offices in different states. Thus it has also a dualistic legal nature as it is regulated by both Community and domestic law. The

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establishment and governance of the SE are unified on the grounds of the Regulation 2157/2001, implementation of which is facilitated by introduction of domestic regulations. SE, not only in Poland, but across the Community, is still at the beginning of the road so the broad experience with this new institution is still to be gained. /L. Oldakowski

UZBEKISTAN

## Reforming the Business Environment in Uzbekistan

The President of Uzbekistan recently issued several edicts and decrees in the hope of improving the business environment in Uzbekistan, which, according to a recent statement of the International Monetary Fund (the "IMF") Executive Board,<sup>1</sup> "continues to be difficult, as private businessmen complain about serious governance problems."<sup>2</sup> Reform of the Uzbek business environment has been a core focus in the IMF bilateral discussions with the Government of Uzbekistan under Article IV of the IMF Articles of Agreement since the year 2002. In order "to strengthen economic reforms and liberalize the economy,"<sup>3</sup> it appears that the Government will issue other normative acts within a year to meet the requirements of the Program on the Implementation of the Goals and Tasks to Democratize and Revitalize Society and Reform and Modernize the Country,<sup>4</sup> a program created by the Government of Uzbekistan a few years ago to streamline reform in the country to meet the demands of the rapidly changing political and economic realities of Central Asia, particularly in the investment climate.

The President has been promoting legal reform affecting business since he issued a June 2, 2000<sup>5</sup> edict on reforming the economy, and many such changes have been implemented in accordance therewith. Last year, by Presidential order, a specially-created Council analyzed the then-existing legislation and proposed legal changes to "establish a democratic State with a developed, socially-oriented market economy". Most recently, in applying the IMF's proposals under the Article IV discussions, as described below, one particular recent Presidential edict recommended a number of legislative acts that should be adopted, amended, replaced or repealed within a year to promote a business-friendly environment in Uzbekistan. It

appears that the past, current and contemplated normative acts reflect the Uzbek Government's continuous efforts to develop a market economy and to implement the IMF's recommendations identified in the course of its recent discussions with the Uzbek Government.

The recent recommendations of the IMF Executive Board called upon the Uzbek Government to implement the following reforms: to liberalize domestic and foreign trade; to improve the business climate and governance; to reduce taxes, fees and administrative burdens on imported goods; to abolish restrictions on withdrawing cash from banks; to eliminate mandatory cash deposits and foreign exchange surrender requirements; to free banks from their role in tax administration and financial oversight (Uzbek banks are currently required to ensure their clients' due payment of taxes and compliance with Uzbek accounting standards in their financial reports and statements); to eliminate the distinction between cash and non-cash payments, which distinction devaluates non-cash payments (*i.e.*, wire transfers); to prevent the government from forcing farmers to grow only certain agricultural products; to abolish the mandatory requirement to sell such agricultural products to the State; and to liberalize laws permitting farmers to acquire inputs for their production needs without any restrictions and to freely sell their agricultural products on the market.

The IMF Executive Board embraced the Uzbek Government's

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- 1 Under Article IV of the IMF Articles of Agreement, the IMF holds bilateral discussions with its members, generally every year. A team visits each member country, collecting information on financial data, economic development and policies, and the Executive Board sends its findings to such member country.
- 2 The IMF Executive Board Concludes 2005 Article IV Consultation with Republic of Uzbekistan. - Public Information Notice (PIN) No. 05/73 of the IMF, June 10, 2005.
- 3 Preamble of Edict No. PF-3618 of the President of the Republic of Uzbekistan "On Measures to Accelerate the Implementation of Market Reform Priorities and the Strengthening and Further Liberalization of the Economy," dated June 14, 2005.
- 4 It appears that this Program has never been published.
- 5 Annex 2 to Edict No. PF-2612 of the President of the Republic of Uzbekistan "On Measures to Implement the Programs on Liberalizing and Strengthening Reforms in the Political, Economic and Intellectual Spheres of Society, and to Provide Security for the Country," dated June 2, 2000.

goals embodied in the four most recent Presidential acts<sup>6</sup> that restrict the executive branch's authority to indiscriminately interfere in business activities or to apply penalties that discourage business development, including penalizing businesses in the absence of a court judgment for certain infractions, requesting an excessive number of documents unrelated to an authorized audit of a company, requesting unnecessary tax and financial reports that are not required by law and imposing fines on businesses for minor tax violations or violations committed in error in good faith, and setting limits on withdrawing cash from commercial bank accounts.

Through its Small and Medium Enterprise Survey and Policy Project, the International Finance Corporation ("IFC") conducted a survey last year on obstacles facing small businesses in Uzbekistan. Following such survey, on June 3, 2005, IFC outlined the problems of small businesses to the Uzbek Government and provided recommendations on improving the business environment in Uzbekistan. Several of IFC's recommendations were implemented in the recently issued Presidential edicts and decrees, such as how often businesses should submit tax and financial reports to the relevant authorities, the ability to withdraw cash from commercial bank accounts without restriction, etc.

However, the current reforms are not sufficient. For example, under the current legal regime, company executives may incur personal liability for flawed business decisions. Since 1995, the President of Uzbekistan had issued a number of edicts ordering law enforcement agencies to pursue administrative and criminal charges against company executives for actions undertaken in the course of their business activity, assigning a substantially higher level of liability to executives than is typical in most western countries. Imposing criminal charges for flawed business decisions has led to a pattern of business executives becoming risk-averse in their decision-making, which substantially decreased companies' growth and profitability. Business executives anticipate that the Uzbek Government may adopt the western concept of the business judgment rule, drawing a distinction between violating a law and merely making an unfavorable business decision in good faith, to protect business executives from unnecessary interference by the government in commercial business decisions.

The Presidential edicts and decrees also provide for the implementation of the following legislation:

- (i) approval of the concept of indemnification for damages by the State for harm caused by State agencies or officials. The Civil Code of Uzbekistan has provided for such indemnification since 1997, but it had never been enforced against the State regarding commercial matters because the State was unofficially immune from indemnification claims;
- (ii) authorization of dispute resolution through private arbitration to resolve conflicts between companies. Uzbek law had not previously restricted such arbitration, but companies were required to settle their disputes in State commercial courts because no regulations existed to enforce arbitral awards;
- (iii) decrease in the frequency with which small businesses are required to submit their tax and accounting reports from every month to once a quarter, or in the case of financial reports, to once a year;
- (iv) distinction between taxes paid by small businesses versus large businesses. Small businesses will be required to pay only a "single tax fee" in most cases at the rate of 13% of gross sales, as opposed to large businesses, which must pay all republican (*i.e.*, centrally collected) and local taxes, such as corporate income tax, VAT, ecology tax, water tax, land tax, and other taxes, levies, royalties to the Pension Fund, the Road Fund and the Non-Budgetary Fund for Education;
- (v) deferment for a year of the "single tax fee" payment applicable to newly established small businesses. Such deferred payments may be paid in equal installments over twelve consecutive months;
- (vi) approval of a scheme to exempt a company from further liability upon agreement to indemnify the State for damages resulting from tax evasion; and
- (vii) punishment of commercial banks by revoking or

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<sup>6</sup> Edict No. PF-3619 of the President of the Republic of Uzbekistan "On Measures to Further Perfect the Legal Protection of Businesses," dated June 14, 2005; Decree No. PP-100 of the President of the Republic of Uzbekistan "On Perfecting the System of Submitting Reports by Businesses and Strengthening the Liability for the Illegal Request of Such Reports," dated June 15, 2005; Edict No. PF-3622 of the President of the Republic of Uzbekistan "On Liberalizing the Financial Liability of Businesses regarding Commercial Misconduct," dated June 24, 2005; Decree No. PP-147 of the President of the Republic of Uzbekistan "On the Guarantees of Unrestricted Cash from Deposit Bank Accounts," dated August 5, 2005.

terminating their banking licenses for systematically failing to provide cash to their clients.

Further, the President has instructed the Uzbek Government to decrease the number of required permits and to simplify the procedures for certain business activities, to equalize the rates of court fees that foreign and Uzbek companies pay,<sup>7</sup> to simplify the procedure to submit tax and financial reports, and to decrease the penalty for tax violations by businesses. It appears that the Uzbek Government intends to change commercial law in a way that "people may see a concrete, positive outcome of economic reform."<sup>8</sup> /J. Askarov

BELARUS

## Presidential Decree Limits State Aid

With the stated aim of reducing "unjustified" demands upon and use of aid or subsidies (sponsorship), whether public or private, on July 1, 2005, Belarusian President Lukashenko signed Decree (Ukase) No. 300 ("Decree No. 300") into law with immediate effect. Decree No. 300 purports to regulate all forms of sponsorship.

Decree No. 300 both defines a finite (although still broad) set of purposes for which sponsorship may be appropriated and specifies a set of purposes for which sponsorship may never be appropriated. Any purposes not found on either list may only be sponsored with the express consent of the President. The permissible purposes include improvements in material and technical infrastructure generally, rural development, the support of sports, health cultural, educational, scientific, environmental protection and individual social welfare programs, as well as emergency response and religious programs. Sponsorship is prohibited for non-constitutional purposes, for war and military propaganda, and, significantly, for the preparation and holding of elections, referendums and other political purposes. In addition, sponsorship is not permitted without a sponsorship agreement between the sponsor and the recipient, which must be in accordance with the government-approved model form of a sponsorship agreement, including a statement of the purpose of the sponsorship. Recipients are required to report on the results achieved as a result of the sponsorship proceeds.

Any prospective sponsor that is 50% or more state owned must have governmental consent to act as a sponsor, and is limited to providing no more than 1% of its revenue in sponsorship annually. All other prospective sponsors are exempt from these particular restrictions.

Decree No. 300 is applicable to all potential sponsors, both state and private, even including individual entrepreneurs. However, Decree No. 300 does not apply to certain forms of grants and transfers, such as aid to employees, transfers between state-owned entities or agencies, transfers to companies within a consolidated group and financed by the state. /A. Vashkevich

## Obligatory Insurance for Residential Construction

Effective on January 1, 2006, developers that build on contract (finance or prepaid by individuals or other legal entities) are required to obtain developer's liability insurance to cover any failure to perform or breach of contract. The stated purpose of this rule is to secure the interests of individual and legal entities that invest in residential property.

An insurance contract is required to be concluded at the expense of the developer for every residential object that is constructed. The cost of the insurance contract is approved by the Government and must equal 0.31% of the cost of the premises at the moment.

Only state owned insurance companies or insurance companies with a share of not less than 50% state ownership can be insurers for this sort of insurance contract.

According to Decree No. 287, dated June 20, 2005, an insured event occurs in the case of non-performance of the obligations by the developer. Thus, if the developer fails to perform its obligations, the insurance company would

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<sup>7</sup> Decree No. 161 of the Cabinet Ministers of the Republic of Uzbekistan dated July 18, 2005, has equalized such rates.

<sup>8</sup> Section 6 of Edict No. PF-3618 of the President of the Republic "On Measures to Accelerate the Implementation of Market Reform Priorities and the Strengthening and Further Liberalization of the Economy," dated June 14, 2005.

reimburse the individuals or legal entities up to the amount of the insured structure. Thereafter, the developer becomes liable to the insurance company. Unfortunately, Decree No. 287 does not clearly state the types of obligations that are covered under the contract.

The Decree leaves many questions unanswered. For instance, it does not contain any guidelines on the disposition of the premises in case of an insured accident - *i.e.* whether or not the insurance company will acquire the premises.

The insurance is required only for residential contracts concluded after January 1, 2006. /A. Vashkevich

## RECENT DEVELOPMENTS

# Chadbourne Establishes Kazakhstan Office Expanding CIS and Energy Practices

## Welcomes Managing Partner and Five Associates

New York, NY – July 8, 2005 – The international law firm of Chadbourne & Parke LLP today announced that it has opened an office in Almaty, Kazakhstan. The office is being staffed by six attorneys all of whom have been associated with Coudert Brothers in Kazakhstan.

The Almaty team, led by Kenneth E. Mack, the managing partner of the office, include associates Victor Mokrousov, Tatiana P. Muratova, Yerzhan Kumarov, Elshat Seksembayeva and Sergei Vataev. The establishment of the Almaty office extends Chadbourne's significant presence in the CIS where it currently has offices in Moscow, Kyiv and Tashkent, and expands its capabilities in oil and gas and infrastructure projects.

Kazakhstan is the second largest energy market in the CIS, and has grown 9% per year for the past three years. It is a major oil exporting country, with growing reserves and production. As a result, Kazakhstan is a vital region for many major pipeline and other infrastructure projects in the CIS, as

well as for the development of other industry sectors.

"With the Kazakhstan energy sector attracting many foreign companies and with its growing economy, the opening of this new office is part of our strategic plan to better satisfy the needs of our clients in the CIS," said Charles K. O'Neill, Chadbourne's managing partner. "In addition, by bringing on board Ken and his team who have extensive experience handling matters in the region, we have expanded our network in the CIS and can offer our clients increased capabilities."

Mr. Mack, 43, is a partner in Chadbourne & Parke, the affiliated multinational partnership of Chadbourne & Parke LLP. He has spent eight years of his career in Kazakhstan and has extensive experience in the oil and gas, minerals, electric energy and telecommunications sectors. His work has included negotiating and drafting production sharing agreements, oilfield asset purchase contracts, joint venture agreements, and other contracts. Mr. Mack has been counsel to multinational companies in a variety of investment disputes with private entities in Russia and Kazakhstan. He also works on domestic and international corporate matters. Prior to working at Coudert Brothers, Mr. Mack served as the managing attorney of Steptoe & Johnson's Almaty office.

Mr. Mack received his B.A. from Hampshire College, an M.A. from Columbia University, and a J.D. from Northeastern University.

"I am excited and pleased to be joining such a preeminent law firm with its strong energy and project finance practices," said Mr. Mack. "Chadbourne has the depth and breadth of experience, particularly in the CIS to provide a full range of legal services to client. I look forward to overseeing the Kazakhstan team, and working with the Firm's international network of attorneys to provide the highest level of service to our clients."

Ms. Seksembayeva, 47, has more than 20 years experience practicing law in Kazakhstan, including more than 10 years working with prominent Western law firms. Her practice focuses on corporate transactions related to energy, natural resources and telecommunications in Kazakhstan and other CIS countries, and she also has extensive experience representing clients on litigation matters.

Ms. Seksembayeva earned her J.D. from Kazakh State University School of Law, and Ph.D. from Tashkent State University.

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## RECENT DEVELOPMENTS

Mr. Mokrousov, 32, advises clients on a broad range of legal issues with particular emphasis on corporate and energy matters. He has worked on a number of cross-border transactions involving mergers and acquisitions in oil and gas, telecommunications and banking sectors. He also participated in privatization of state oil companies and drafting of commercial laws for Kazakhstan in connection with a World Bank project.

Mr. Mokrousov earned his LL.B. from Kazakh State National University Faculty of Law and his LL.M from the University of Minnesota Law School.

Mr. Vataev, 38, advises clients on complex project finance transactions. He advises clients on structuring financial transactions, including municipal financing and securitization. Mr. Vataev has advised on insurance law and was involved in restructuring a major bank in Kazakhstan.

He received his LL.B. from Kazakh National State University and a LL.M. from the University of Virginia.

Ms. Muratova, 37, specializes in financial leasing, corporate finance, telecommunications and banking in Kazakhstan. She has extensive experience on tax issues pertaining to business in Kazakhstan and also advises clients on setting up joint ventures in the oil and gas sector. On behalf of major foreign companies, Ms. Muratova has successfully conducted numerous negotiations with various Kazakhstan national companies on corporate, contractual and licensing issues. She regularly assists major national and international companies in securities-related matters, project finance and intellectual property licensing.

Ms. Muratova received a Faculty degree from Almaty University of Foreign Language and a law degree from Almaty State University.

Mr. Kumarov, 36, represents clients on a wide range of legal and business issues in Kazakhstan. He has represented numerous financial institutions on syndicated financings and project finance transactions, and has counseled both issuers and underwriters in numerous Eurobond offerings.

He earned his J.D. from Kazakh State Law University and a LL.M. from Saint Louis University, School of Law.

“Chadbourne has handled significant transactions in Kazakhstan, especially in the oil and gas sector, since we

entered the CIS market in 1990,” noted Laura Brank, managing partner of the Moscow office. “The opening of the Almaty office will further increase our capabilities to service our clients in the CIS, as well as globally on M&A, project finance and other transactional matters.”

Chadbourne attorneys have been advising clients doing business in the CIS for the past 15 years. The Firm’s CIS practice with offices in Russia, Ukraine, Uzbekistan and Kazakhstan represents clients in large transactions as well as advising on day-to-day legal issues in a range of areas, including banking, capital markets and securities, investment funds, mergers and acquisitions, privatizations, general corporate and tax, joint ventures, secured/project and trade finance, energy, oil and gas, telecommunications, real estate and litigation.

## Chadbourne Secures Precedent-Setting Victory in RF Supreme Arbitration Court

Last week attorneys at the Moscow office of Chadbourne & Parke secured a precedent-setting ruling from the Presidium of the RF Supreme Arbitration Court in favor of our client on two related tax litigation matters.

Our client, a US company providing engineering services for the oil and gas industry, operates in Russia via several representative offices located in different Russian regions. All proceeds from the client’s Russian operations arising out of one contract (the “Contract”) were deposited directly into the client’s US bank account (with the relevant Russian profits tax paid), but each of the client’s representative offices indicated in its accounting records the amount of proceeds proportional to the amount of work provided by such office with respect to the Contract. For purely internal purposes, the corresponding amounts of proceeds were reflected by each of the representative offices on Subregister 79 (“Intraeconomic

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## RECENT DEVELOPMENTS

Settlements") of the Russian accounting standard balance sheets.

In 2003, local tax authorities in the Krasnodar Region ruled that all of foreign currency amounts reflected on Subregister 79 must be continuously re-calculated into Russian Rubles and that the corresponding forex differences must be reflected in the representative office's corporate profit tax base. As a result of that ruling, tax authorities ordered two of the client's representative offices to pay additional profit tax assessments and imposed severe financial sanctions in an amount exceeding US \$700,000. Chadbourne attorneys diligently fought tax authorities' decisions since early 2003, and even succeeded in the court of the first instance. Higher appellate and cassation courts, however, ruled against our client.

Having obtained positive feed-back from the RF Ministry of Finance, Chadbourne's Moscow-based litigators applied to the RF Supreme Arbitration Court requesting the Court to reconsider the case on the basis of its potential widespread effect for foreign companies operating in Russia. Although the RF Supreme Arbitration Court accepts less than 2% of appeals submitted for consideration, both our clients' appeals were accepted due to the importance of the issue for Russian court practice. On September 1, 2005, the Presidium of the RF Supreme Arbitration Court cancelled all lower court rulings rendered in favor of the tax authorities and upheld the initial decisions of the court of the first instance that confirmed that a foreign company is free from any obligation to account for forex differences on any amounts reflected on Subregister 79 of the Russian balance sheet purely for such company's internal financial accounting purposes.

## CIS AND CENTRAL EUROPE LEGAL NEWSWIRE

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