

Russia/Central Europe Executive Guide

Including
Coverage of
Eastern Europe
and Central Asia

Articles

■ **BELARUS**—New Law Aims to Clarify Real Estate Registration Procedure. By Vassili Salei (Borovtsov & Salei) p. 6

■ **KAZAKHSTAN**—Taxation of Oil and Gas Shipped by Pipelines. By Gerard Anderson (Ernst & Young) p. 7

■ **REGIONAL**—Market Opportunities. By ASIDA Group p. 5

■ **ROMANIA**—The Clash between Romania's New Privatization Laws and its Bilateral Investment Treaties. By Mark Meyer (Herzfeld & Rubin) and Michael McNutt p. 11

■ **RUSSIA**—Legal Status of Foreign Citizens in Russia—Main Changes. By Elvira Kroes (KPMG) p. 2

New Law on Insolvency (Bankruptcy). By Max Gutbrod, Sergei Avramov, Maxim Kalinin and Igor Gorchakov (Baker & McKenzie) p. 3

Central Bank Clarifies Anti-Money Laundering Procedures. By Julia Romanova and Konstantin Konstantinov (Chadbourne & Parke) p. 14

Update of Russian Legislation. By Eric Michailov (White & Case) p. 14

Regular Features

The Fine Print p. 2

Creditor & Debtor Rights p. 3

Market Opportunities p. 5

Tax Perspective p. 7

Investor Perspective p. 11

HIGHLIGHTS

Delays for Companies in Russia Hiring Foreigners

Companies that want to hire foreign citizens may have to deal with more red tape before foreigners can start work. A new law changes the procedures for inviting foreign citizens to enter Russia for work purposes. As before, invitations will be approved and issued by the Russian government on the basis of quotas. While the new rules are expected to delay the process, the changes are expected to make it easier for foreigners to switch jobs in Russia under some special conditions. Page 2

New Russian Bankruptcy Law will Stimulate Mortgage Lending

A new bankruptcy law was signed into law in late October that will permit bankruptcy workouts for insolvent companies. The law also sets a new priority order for satisfying the claims of creditors—giving secured creditors preference in many cases. Page 3

Which Tax Regime for Oil Exports from Kazakhstan?

Kazakhstan is opening up an increasing number of its oil fields to development, and will soon sell off dozens more of its offshore blocks. Much of the oil will be exported via pipelines to tankers bound for Western ports. But Western companies, many of whom are operating in fields like Kazakhstan's Karachaganak oil field near Russia, have been frustrated by the failure of Kazakhstan to clarify its procedures for taxing oil exports. This article discusses the likely alternative tax regimes that Kazakhstan will choose for its oil shipped through pipelines. Page 7

Will Romania Revise its New Privatization Laws?

Romania's privatization and post-privatization laws, both passed earlier this year, appear to violate the spirit, and probably the letter, of the country's bilateral investment treaties with the U.S. and the U.K. Page 11

Belarus Simplifies Real Estate Registration

A new law places a single agency in charge of real estate registration, and sets strict time deadlines for the agency to process registrations. Page 6

Legal Status of Foreign Citizens in Russia—Main Changes

by Elvira Kroes

The Law On the Legal Status of Foreign Citizens in the Russian Federation entered into force on October 30, 2002.¹ Simultaneously the provisions of Law On the Legal Status of Foreign Citizens in the USSR² will be revoked. In addition, certain legal procedures regarding foreign citizens previously governed by the regulatory acts of various executive authorities will now be enshrined in Law.

The Law includes a definition of foreign citizens as: temporary visitors, temporary residents or permanent residents.

In accordance with the new Law, temporary visitors are not required to obtain a special permit to stay in Russia (the duration of such stay is limited to the period of the visa or to a 90-day-period for visa-free entry). Foreign citizens may temporarily reside in Russia provided they obtain a permit of temporary residence. Such permit is valid for three years. In order to obtain a permit for permanent residence in Russia (residency permit), a foreign citizen is obligated to stay in Russia for at least one year as a temporary resident permit holder.

Obtaining Invitations to Visit Russia

Invitations of foreign citizens to visit the Russian Federation will be issued by the local authorities of the Ministry of Internal Affairs (MVD).

Until the entry into force of the new Law, legal entities obtained such invitations through the Ministry of Foreign Affairs (MID), while MVD dealt only with personal invitations from Russian citizens. There was a significant difference in the amount of time needed to arrange such invitations: MID required several days, while MVD could require up to several months to process the invitation.

In view of the change in procedures for obtaining the invitations, it is not yet clear what impact it will have on the process of obtaining a Russian entry visa for foreigners. Previously the invitation was obtained directly through MID and the same department was responsible for issuing Russian entry visas; the transfer to MVD of responsibility for processing invitation requests will require coordination of activity of both authorities (MVD

and MID) and, as a result, may complicate the process or require more time for processing documents.

Conditions for being Employed in Russia

The new Law contains a detailed description of the procedure for obtaining invitations for foreign citizens to enter Russia for employment purposes.

In order to hire foreign employees in Russia, the employer must obtain invitations for those employees to enter Russia, which are issued on the basis of quotas approved by the Russian government. Also, the employer will be obliged to inform the tax authorities about the

The new Law contains a detailed description of the procedure for obtaining invitations for foreign citizens to enter Russia for employment purposes.

application for invitation of a foreign citizen to enter Russia for employment purposes, within ten days from the date of the application submission.

The employer must obtain a work permit for each foreign employee at the same time that it obtains an invitation for entry for employment purposes.

Currently the procedure for obtaining a work permit for each foreign employee is governed by the regulatory acts of local government authorities. According to the new Law, however, the procedure for obtaining such permits must be approved by the Russian federal government.

A significant aspect of the new law is the fact that foreign citizens will have the right, in the event their employers discontinue operations or lose the right to employ foreigners, to conclude a new employment agreement in Russia with another employer that does have such a right, provided that the foreign citizen's work permit received by the former employer does not expire for at least three months.

Enterprises with Foreign Investment

Under the old legislation, enterprises with foreign investment were exempt from the need to obtain permission to hire and employ foreign citizens to work as man-

Elvira Kroes is Tax Manager at the Moscow office of KPMG.

Continued on page 18

CREDITOR & DEBTOR RIGHTS

New Law On Insolvency (Bankruptcy)

by Max Gutbrod, Sergei Avramov, Maxim Kalinin and Igor Gorchakov

On October 26, 2002, President Vladimir Putin signed into law a new version of the Federal Law On Insolvency (Bankruptcy) (New Bankruptcy Law), which was substantially revised by State Duma deputies based on the president's comments after being introduced in Parliament by the Russian government on December 24, 2001. Appearing in *Rossiyskaya Gazeta* on November 2, 2002, the statute (with the exception of several transitional provisions and a few provisions applicable to natural monopolies and individuals other than self-employed entrepreneurs) will come into force 30 days after its official publication date (December 2, 2002).

On that date, the New Bankruptcy Law will supersede its predecessor, Federal Law No. 8-FZ On Insolvency (Bankruptcy), dated January 8, 1998. Another federal law, Law

No. 122-FZ On the Distinctive Features of Insolvency (Bankruptcy) of Natural Monopolies in the Fuel and Power Sector, dated June 24, 1999, will likewise be repealed effective January 1, 2005.

General Issues

Scope

The New Bankruptcy Law will apply to a broader array of debtors, including all legal entities other than state-owned enterprises, political parties, and religious organizations. The law will generally not have retroactive effect, applying only to newly-opened bankruptcy cases. However, those provisions of the statute that govern bankruptcy procedures (e.g., financial rehabilitation) may also be applied to proceedings initiated before the New Bankruptcy Law's implementation.

Priority of Creditors' Claims

Priority Categories

Article 140.4 of the New Bankruptcy Law provides that creditors' claims be satisfied in the following order of priority:

- personal tort claims, including compensation for pain and suffering;

Continued on page 4

Max Gutbrod is a Partner and Sergei Avramov is an Associate, in the Moscow office of Baker & McKenzie. Maxim Kalinin is a Partner and Igor Gorchakov is an Associate, in the St. Petersburg office of Baker & McKenzie.

PUBLISHER: Gary A. Brown, Esq.
MANAGING EDITOR: Scott P. Studebaker, Esq.
ASSISTANT EDITORS: Edie Creter and Dana Pierce

ADVISORY BOARD: Scott C. Antel, Esq., *Ernst & Young, Moscow*
 Bruce W. Bean, Esq., *Clifford Chance, Moscow*
 Dr. Marshall I. Goldman, *Harvard University, Russian Research Center*
 Max Gutbrod, *Baker & McKenzie, Moscow*
 Scott Horton, *Patterson, Belknap, Webb & Tyler*
 Alexander Marquardt, Esq., *Kramer Levin Naftalis & Frankel*
 Eric Michailov, *White & Case, Moscow*
 John H. Morton, *Burstein Technologies, Inc.*
 Robert C. Odle, Jr., Esq., *Weil, Gotshal & Manges*
 John Sheedy, Esq., *Coudert Brothers*
 Robert Starr, Esq., *Salans Hertzfeld & Heilbronn, London*

Published twice-monthly (22 times per year) by WorldTrade Executive, Inc., P.O. Box 761, Concord, MA 01742
 Phone: (978) 287-0301; Fax: (978) 287-0302; E-mail: info@wtexec.com; Website: <http://www.wtexec.com>
 Copyright © 2002, Rights of reproduction and distribution of any article contained herein are reserved. (ISSN 1067-635X)

Bankruptcy *(from page 3)*

- claims for severance pay, outstanding wages and authors' royalties; and
- claims from other creditors.

Pledges

The third priority category brings together claims previously spread among three separate categories: claims secured by a pledge of the debtor's property (i.e., secured claims), tax claims, and other claims. However, the Law requires that secured claims be satisfied "before other creditor claims." While previously secured claims were satisfied as a third priority claim, these claims will now be satisfied out of the pledged assets' value before first and second priority claims, unless these latter claims arose before the execution of the corresponding pledge agreements. This new provision will help support the development of mortgage lending in Russia.

Government Involvement

The New Bankruptcy Law gives the state, represented by federal executive bodies authorized by the Russian government, as well as duly authorized agencies of Russian regions and local bodies, a say in bankruptcy cases in order to protect its rights as a creditor. Yet the state's claims for taxes, levies, and customs duties will have equal priority with other general unsecured claims and will be satisfied on a pro-rata basis with all other third priority claims.

Financial Rehabilitation

The New Bankruptcy Law adds a new procedure for legal entities, financial rehabilitation. Under this procedure, a debtor's governing bodies will exercise their powers subject to certain statutory restrictions. Unlike with other bankruptcy procedures, a court order initiating financial rehabilitation should set a period, not exceeding two years, during which this regime will be in effect, and prescribe a schedule for debt repayment.

Procedural Changes

Amounts Claimed

The threshold minimum for a bankruptcy claim has been raised considerably—to RUR 100,000 for legal entities (earlier it was the equivalent of 500 minimum monthly statutory wages) and a fixed RUR 10,000 for individuals (earlier it amounted to the equivalent of 100 minimum monthly statutory wages).

Limit on Debt Collection

The right to file an action with an arbitrazh court is not permitted until 30 days after a creditor has sent a court order to the officers of justice and a copy to the debtor. This provision allows for the withdrawal of assets by a debtor acting in bad faith.

Notice to Debtor

A creditor must send a copy of its claim to the debtor. This will enable the debtor to obtain earlier notice of the initiation of bankruptcy procedures and, thus, to defend its lawful rights and interests more effectively.

Bidding

Whereas previously a bankrupt liquidating enterprise was sold by public bidding, unless otherwise provided for by an external management plan, it will now be sold by public auction. The New Bankruptcy Law is restricted only with regard to property turnover and property, the balance sheet value of which is less than RUR 100,000.

Termination of Bankruptcy Proceedings

Upon the New Bankruptcy Law's implementation, a state arbitrazh court may terminate any bankruptcy proceeding if the debtor pays all of the claims of record in the register of creditor claims.

Arbitrazh Managers

Self-Regulatory Organizations (SROs)

The New Bankruptcy Law authorizes the establishment of SROs consisting of arbitrazh managers. Membership in these SROs would be limited to those individuals who meet specific professional criteria and who have been approved to serve as arbitrazh managers. The SROs will be authorized to represent the interests of their members, but will also be required to adopt and enforce obligatory rules for their members' professional activity as arbitrazh managers, as well as to monitor compliance with the requirements of the New Bankruptcy Law.

Procedure for Endorsing Arbitrazh Managers

Under the New Bankruptcy Law, SROs will play an important role in the appointment of arbitrazh managers. The SROs will, in response to a request, produce a list of candidates for arbitrazh manager for a specific bankruptcy proceeding. This list must include at least three nominees, with the debtor and the creditors each having the right to challenge the nomination of one of the candidates.

Liability Insurance

The New Bankruptcy Law increases the financial liability of arbitrazh managers. They must now obtain liability insurance in a sum that depends on the book value of the debtor's assets, but which may not be lower than specified minimums. The minimum sum of the financial responsibility of the arbitrazh manager's liability cannot be less than RUR 3,000,000 per annum. SROs will be required to ensure that an adequate compensation fund has been established, or that the mutual insurance company providing coverage to arbitrazh managers is sufficiently capitalized to satisfy claims. These funds and companies will be exclusively funded by contributions from each SRO member equal to RUR 300,000. □

MARKET OPPORTUNITIES are compiled by ASIDA Group. ASIDA Group provides investment intelligence, market strategies, and analysis of Russia, CIS and emerging markets, through its Moscow staff and a network of 200 industry sources throughout the region.

MARKET OPPORTUNITIES

Banking and Finance

Hungary

OTP establishes line of credit for acquisitions. OTP Bank Rt., Hungary's largest lender, will set up a 125 mln euro (\$126 mln) line of credit with BNP Paribas (France) and Bayerische Landesbank (Germany) to help finance plans to expand and buy rivals in neighboring countries. OTP has already announced it has an interest in acquiring Postabank, Hungary's second largest retail bank, and Banks DSK EAD, Bulgaria's largest bank. OTP is also believed to be pursuing banks in Yugoslavia and establishing a new bank in Romania.

Postabank may exceed book value in sale. Julia Kiraly, chair of Hungarian Postabank, said the bank could bring in more than its book value of 35 bln forint (\$147 mln) when the government sells it. According to Kiraly, the book value listed by state postal service Magyar Posta, Postabank's owner, is equal to the bank's net assets. The bank had been transferred to the postal service after the previous government had rejected a bid from OTP Bank, Hungary's leading lender. Postabank is the eighth largest bank in the country. OTOB has indicated it is still interested in buying Postabank. Erste Bank der oesterreichischen Sparkassen (Austria), Hungarian Budapest Bank and Central European International Bank, the Hungarian units of GE Capital Corp. (U.S.) and IntesaBci (Italy), and UniCredito (Italy) have also said they may buy Postabank.

Stock market ownership limit to be eliminated. Hungarian Finance Minister Csaba Laszlo announced that a limit on ownership of the country's stock exchanges will be dropped, allowing for a Western European rival to acquire a stake in the Budapest bourse. Under a rule imposed by the previous government, single investors may not own more 10 percent of an exchange, limiting alliances with foreign bourses. That will now be dropped, subject to approval by parliament, according to Laszlo. The Budapest Stock Exchange needs partners to help increase investor interest and attract new listings. Daily trading volumes have fallen to a third of their levels of two years ago as slowing economic growth hurts demand for stocks worldwide and takeovers reduce the number of listed companies.

HVB to expand Hungarian unit. The German HVB Group plans to spend 5.3 bln forint (\$22 mln) over the next five years to expand its retail business in Hungary, according to Matthias Kunsch, CEO of HVB Bank Hungary. HVB will expand its branch network and improve

its computer system in Hungary, Kunsch said. The bank is targeting 15 percent of the market for individual clients and small businesses. HVB expects to have a combined 224,000 clients in the two divisions by 2007.

Russia

Vneshtorgbank in multiple financing strategy. Vneshtorgbank (VTB), the state-owned bank that finances and services Russian export/import traders, plans to offer as much as \$700 mln of five to seven-year Eurobonds, according to bank president Andrei Kostin. The issue would be the first for the bank in the international market. In addition, VTB intends to sell 2 bln R (\$63 mln) of two-year domestic bonds early in 2003 and wants to borrow \$240 mln from a group of 32 banks before the end of 2002, according to Kostin. The Russian government wants to merge VTB with Vneshekonombank, another state bank operating as the debt paying agency and more recently has moved into commercial banking.

Alfa Bank to continue borrowing after successful Eurobond debut. Alfa Bank, Russia's largest private bank, plans additional borrowing after selling \$175 mln in Eurobonds in early November, according to a statement from bank CEO Alex Knaster. Alfa on November 5 became the first Russian bank with no government ownership to sell bonds since Russia defaulted on \$40 bln of domestic treasury bills in August, 1998. The bank's Eurobonds have a three-year maturity and were issued at an annual yield of 10.95 percent. The offering was managed by Merrill Lynch (U.S.) and UBS Warburg (Switzerland). Knaster said that Alfa would continue tapping capital markets, although perhaps with syndicated loans rather than additional Eurobond issues.

Communications

Romania

OTE to acquire controlling stake in Romtelecom. Hellenic Telecommunications Organization (OTE) will pay \$273.5 mln to take control of Romtelecom (RTC), Romania's unprofitable fixed-line monopoly, in its latest move to become the dominant phone company in the Balkans. OTE agreed to invest \$242.6 mln to RTC to increase its stake to almost 51 percent from 35 percent, Romanian Communications Minister Dan Nica said after the government approved the transaction. OTE will also pay the government \$30.9 mln for a 3.12 percent stake. The Greek company wants to take control of RTC so it can cut jobs, sell assets and raise rates to make the Roma-

Continued on page 18

New Law Aims to Clarify Real Estate Registration Procedure

by Vassili Salei

The Belarusian Parliament recently passed a law entitled "On the State Registration of Real Estate, Rights Thereto and Transactions Therewith" (Real Estate Law), which was officially signed by the president on July 22, 2002. The enactment of the Real Estate Law was necessitated by a number of provisions set forth in the 1998 Belarusian Civil Code. The purpose of the Real Estate Law is to establish a unified procedure for the state registration of real estate in order to: (a) eliminate the current unreasonable number of agencies involved in the registration of real estate transactions; (b) eliminate the confusing division of registration duties among such agencies; and (c) reduce delays in the registration of real estate.

Foremost, the Real Estate Law establishes a single body to oversee real estate registration. Second, it sets forth an exhaustive list of the types of real estate and rights thereto that are subject to state registration. Notably, the Real Estate Law establishes so-called "double" registration of certain real estate transactions by requiring the registration not only of the onset, transfer and termination of the rights to real estate (this obligation existed before the adoption of the Real Estate Law), but also re-

Vassili Salei is Head Partner of the firm of Borovtsov & Salei in Minsk. The firm is affiliated with Chadbourne & Parke.

quiring the registration of agreements that are, or may become, grounds for the onset, transfer or termination of such rights. For example, agreements subject to state registration now include real property alienation agreements (purchase and sale, exchange, gift, leasehold, etc.), mortgage agreements, real property trust agreements, and land tract lease/sublease agreements, etc. Third, the Real Es-

Agreements subject to state registration now include real property alienation agreements, mortgage agreements, real property trust agreements, and land tract lease/sublease agreements.

tate Law introduces time limits for all steps in the registration process and imposes liability on the registration agencies in the event of a violation of these time limits.

Unlike the eponymous Russian law, the Real Estate Law does not treat incomplete construction sites such that, by their status, they would constitute real estate. In accordance with the norms of Russian legislation, if a transaction is to be concluded in respect of an unfinished construction site, then the right to such unfinished construction site must be registered prior to the conclusion of such transaction. Belarusian legislation deems an unfinished construction site to be only an "aggregate of construction materials," and, therefore, does not require any registration prior to the conclusion of any related transactions.

The Real Estate Law will become effective on February 1, 2003. □

Practical European Tax Strategies

WorldTrade Executive, Inc. is pleased to announce the publication of **Practical European Tax Strategies**, a monthly report on how leading edge companies are reacting to changes and developments in European tax practice.

Each issue of **Practical European Tax Strategies** is packed with articles like these to help you solve your European tax issues:

- What do the latest tax developments mean for your operations and planning?
- Coordinating tax results with financial accounting rules
- Choice of entities for your European transactions
- Using tax incentives to boost your bottom line
- Dealing with tax authorities in major European countries
- Tax issues for European acquisitions and joint ventures
- Managing VAT recovery procedures to reduce cash flow impact
- Tax planning for the cross-border grouping of companies

For more information, please contact
WorldTrade Executive, Inc. at
(978) 287-0301,
or visit our web site at:
www.wtexec.com.

Monthly, \$764 per year U.S. addresses, \$814 non-U.S. addresses

Taxation of Oil and Gas Shipped by Pipelines

by Gerard Anderson

Kazakhstan has a number of export options for its expected increases in oil production over the next few years. The purpose of this article is to look at the tax issues that will need to be considered, both by Kazakhstan and by investors, in developing those options.

Until the break-up of the Soviet Union in 1991, international pipelines owned and operated by multinational oil companies were rather unusual. The break-up of the Soviet Union immediately focused attention on issues of international energy transit, and was one of the key factors that led to the adoption of the Energy Charter Treaty in 1994, and the decision of the Charter Conference in December, 1999, to further expand the transit provision of the treaty with the Transit Protocol.

Types of Pipeline Tax Regimes

Today there are three basic models of international pipeline taxation regimes. Each solution has been developed in quite specific circumstances. The Norwegian solution is the simplest, and it amounts to simply creating a corridor subject to certain aspects of Norwegian law along which the pipeline runs. This corridor is treated as part of Norway for tax purposes rather than part of the tax territory of the nation through which the pipeline runs. This simple and practical solution caused relatively little disruption to the tax systems of the host countries, because the Norwegian pipelines are largely on the seabed in international waters, and the corridor that is cut out of the host country tax regime would only need to run through the territorial water over the beach and to the onshore stabilization plant, probably no more than about 12 miles.

The second model, the "my backyard approach," is one in which each country through which the pipeline runs treats the pipeline within its territory as a taxable activity subject to its general tax regime in respect of the activities carried out on its territory. The owners, operators, and shippers are in general terms subject to the tax

regime of the country across which the pipeline runs, without special tax privileges. The main tax focus has to be on creating contractual ownership arrangements that adequately allocate income, costs and assets to the different jurisdictions and making the host country tax systems actually work with a type of business that has some very unusual features that do not fit into the type of tax regimes that have been established in the CIS since 1991. Nor do they fit comfortably into typical double taxation treaties.

The third model, the "our shared backyard" approach, creates, to a greater or lesser extent, a completely new tax regime for pipeline owners, shippers, and potentially their subcontractors and employees. This regime will be negotiated with each of the host countries and

The second model, the "my backyard approach," is one in which each country through which the pipeline runs treats the pipeline within its territory as a taxable activity subject to its general tax regime for activities carried out on its territory.

will be designed to take account of the very specific features of the pipeline business, and the commercial needs of the companies and the political needs of the host countries, while establishing broadly similar principles for taxation of the pipeline activities in each state.

Tax Aspects of Charter Treaty

In December, 1999, the Energy Charter Conference recognized that there was a need for a more detailed approach to international energy transit issues in the CIS than the Energy Charter Treaty provided. So it embarked on the negotiation of the Transit Protocol, and in parallel with this, the creation of model agreements for international pipelines. The Transit Protocol itself will embody a commonly accepted set of legal principles specifically covering transit issues. The model agreements will not be binding, but will be intended to exemplify best practice. The working group dealing with the model agreements aims to finalize the

Gerard Anderson is a Tax Partner in Ernst & Young's Almaty and Moscow Tax Departments. This article is based on a speech he delivered in October at KIOGE 2002, the Kazakhstan International Oil and Gas Conference.

Continued on page 8

Pipelines *(from page 7)*

proposed text by the end of this year, and to invite interested parties, for example from industry, to comment on the texts later this year, before presenting them to the Charter Conference, hopefully early next year.

Conceptually, the model agreements facilitate the third of the structures outlined above, in that they consist of two agreements, an Inter-Governmental Agreement (IGA), which would have the status of an international treaty (and therefore would be sovereign over other laws of the host nations), and second, individual Host Government Agreements (HGAs) for each country. The HGAs would allow for the negotiation of specific details of the legal regime, including taxation, of the pipeline in each country. These might be merely clarifications, or fundamental changes to the host regimes. The IGA would be a relatively short document, one of the key roles of which would be to give legal force and effect to the specific terms of the HGA for each of the countries concerned.

Most of the CIS countries and the home countries of major investors are signatories to the Energy Charter Treaty, to which the protocol would be appended. The

One of the key lessons from the North Sea, both in the UK and in a Norwegian sector, is that the owners of the export infrastructure are in a position to secure most of the super profit of the upstream oil fields.

treaty has been both signed and ratified by Kazakhstan, Turkmenistan, and Azerbaijan, for example, and signed, but not yet ratified, by Russia. It has been both signed and ratified by the UK, The Netherlands, Italy, and France. The theme that runs throughout the treaty is non-discrimination and equality of treatment of foreign and domestic investors in energy matters. The taxation matters that the treaty covers are limited to indirect taxes such as VAT and customs duties. The treaty specifically does not apply to direct taxes such as corporate income tax or expatriate taxes. Hence, the protocol and the model agreements will mark a significant step forward.

Tax Policy Issues

One of the key lessons from the North Sea, both in the UK and in a Norwegian sector, is that the owners of the export infrastructure are in a position to secure most of the super profit of the upstream oil fields. For both Kazakhstan and the upstream investors doing business in Kazakhstan, the pipeline business is not an investment opportunity, but a necessary evil.

For several of Kazakhstan's export options, the bulk of any new pipelines is likely to lie outside of Kazakhstan. This would suggest that, in at least those cases, it would be very much in Kazakhstan's interests to seek a project-specific tax regime for a new pipeline. This is of course a political question for the government itself. However, there appears to be a strong common interest for upstream investors and the republic to work together to achieve favorable pipeline tax regimes outside of Kazakhstan. To achieve such favorable tax regimes, similar regimes will need to be created for pipelines within Kazakhstan.

The mid-stream tax regime will affect the economics of upstream projects for both investors and the Republic of Kazakhstan in a number of ways. Any increase in the mid-stream cost will, in a PSA, reduce the netback value of oil, which is used in a cost-recovery calculation. Accordingly, more cost-oil barrels will be needed by investors to achieve a given level of cost recovery. Consequently, there will also be less profit oil both for investors and for the state. If the profit-oil triggers in the contract are related to profitability rather than to volume, then again, the state will receive less profit oil because it will take longer to reach the profit-oil thresholds.

There also will be less value in each barrel of the profit oil for the state, because the state will also have to pay for export of its share of profit oil. Similarly, in an excess profit tax (EPT) type contract, both profit tax and the excess profit tax will be reduced, since higher export costs will mean a lower IRR for the upstream project, and so lower rates of EPT. Whether the contract is a PSA or EPT contract, higher export costs have a sort of "multiplier" effect. The taxation regime of the pipeline, both inside and outside of Kazakhstan, will have a significant effect upon those export costs.

Issues for Tax Regime

The tax issues that are important in a pipeline project are similar to those for any upstream investment. There is a high front-end investment. Anything that increases front-end construction costs will have a disproportionate effect upon the internal rate of return (IRR) of the project, and so will require a disproportionately higher level of tariffs. This will be particularly true if the project is bank financed, since in that case the covenants in any financing will demand specific IRR targets. Therefore, any tax that functions as a tax on investment is potentially seriously damaging. The taxes that most obviously do so are, of course, VAT at any level of the pyramid of sub-contractors, import customs duties, withholding taxes on technical, engineering and consultancy services from outside of the host country, and expatriate tax issues.

In the operational phase, it becomes important for some investors to maximize the amount of the government take in each country that is paid in the form of a tax on corporate profit. This is primarily an issue for foreign investors based in countries such as the UK and the U.S.,

Continued on page 9

Pipelines *(from page 8)*

and may not be an issue at all for some other investors, for example based in Italy or The Netherlands. By paying government take as a profit tax rather than a fee per barrel, provided the arrangements are correctly constructed, double taxation for UK/U.S. investors may be avoided. Of course, if the same profit is taxed both in the host country of the pipeline, and in the home country of the investor, the investor will need a higher profit in the first place to achieve the same rate of return.

The host countries, including Kazakhstan, potentially have the choice of dividing the wealth that a pipeline creates between two sets of parties—themselves and the investors—or three sets of parties: themselves, the investors, and the home governments of certain of investors. Clearly, if the latter happens, there will be less wealth to be divided between the investors and the host government. However, this objective will conflict with the objectives of the host government to realize early revenue, since the project will take some years to accumulate a taxable profit. Also, of course, in order to pay a reasonable amount of profit tax for a major pipeline project, a reasonable level of profit must be made in the pipeline project.

This may be a source of concern to upstream governments for the reasons given above, but it is a source of comfort to a bank financing the project. In fact, if the pipeline project is to be a bankable project, it will require a level of profit that should enable a substantial part of the government take to be delivered in the form of the profit tax. However, a fully tax-efficient answer is not likely to be achievable, but even a partially efficient answer will help. For those investors that do not face such a problem, The Netherlands, Italy, or domestic investors for example, the absence of this problem may represent a competitive advantage.

Other key tax issues for the operational phase include the avoidance of the taxation on shippers, minimization of withholding tax, the allocation of revenues between the host countries, provisions for the transfer of ownership of the pipeline to the agreed period to the host governments and the avoiding of taxation on the investors, both in the host country, and in their own countries, on that transfer and, of course, most important, the issue of stability throughout the project life. The key source of stability, if the model agreement structure outlined earlier is adopted, will be the IGA that governs the construction and operation of such a pipeline. Even the possibility of instability has a significant price in terms of the higher rate of return that investors would require.

VAT

After stability, the most important issue is VAT. Given that international transportation services are likely to either be exempt or zero rated, provided certain requirements are met, minimizing the VAT charged to both the pipeline and its subcontractors, and the obtaining of VAT refunds, will be major issues in both the development and operation phases of a pipeline project (unless the issue has been adequately dealt with in a project-specific tax regime).

Other tax issues that need to be considered include problems of quality banking and transfer pricing. Qual-

Any tax that functions as a tax on investment is potentially seriously damaging.

ity banking arises when varying quantities of oil are put into a pipeline but the oil has different qualities. In order to correctly share the value of the blended oil, which comes out the other end of the pipeline, quantities that the shippers take out of the pipeline will need to differ from the quantities they put in. Shippers that put in a given number of high quality barrels will need to receive more barrels of the lower quality oil that comes out of the pipeline than they put in, and the shipper who put in poorer quality oil will need to receive a corresponding reduction. The tax implications are complex.

Transfer pricing is a potential issue between upstream investors and a pipeline entity. This issue is likely to be particularly problematic in view of the very broadly drawn transfer pricing legislation in Kazakhstan, which is likely to apply to transportation tariffs even if international practice would deem the pipeline entity as not under common control with an upstream owner or group of owners acting collectively.

In an IGA/HGA structure, all of these issues can be dealt with full legal force—either by specific provisions if the domestic law creates fundamental obstacles, or with appropriate clarifications of the existing law that will avoid subsequent disputes.

Legal Structure

There are basically two legal structures for pipeline ownership and these have their own tax peculiarities. The first is the “common carrier” approach in which a single legal entity is created to own and operate the pipeline. That entity might be a company, or it could be a tax-transparent partnership. Usually, the real investors would own shares in that entity. This structure is typical of, for example, domestic pipelines in the U.S. The alternative solution is called “pipe within

Continued on page 10

Pipelines *(from page 9)*

a pipe” and in this case the actual metal of the pipeline would be owned and operated by the single pipeline company or group of investors, and each of the investors would also own an intangible asset, being a right to an amount of its own capacity within the pipeline.

The legal structure for such a model would generally be an unincorporated joint venture. This is typical, for example, in the North Sea. The importance of the difference is that in the “pipe within a pipe” solution, each investor is, within reasonable limits, free to use or not use its own capacity or to sell its capacity for the best price it can get to an affiliate or to anybody else, while in the “common carrier” approach it is the common carrier that would own the whole of the capacity and be responsible for selling it on behalf of its owners.

If the pipeline project is to be a bankable project, it will require a level of profit that should enable a substantial part of the government take to be delivered in the form of profit tax.

From a tax point of view, there is obviously a fundamental difference in that in the “common carrier” approach the investors will tend to be passive, and may not have any taxable presence in the countries of operation, while in the “pipe with a pipe” model each of them is actively carrying on a business within each transit country, and this is likely to have some tax consequences, even if they merely use their own capacity to transport their own oil. In reality, given the complexities of dealing with different transit streams, and the shift in the need for pipeline capacity between investors and the upstream state as projects mature and the state share of oil increases, there are strong practical arguments for favoring the “common carrier” approach.

However, there is one strong tax argument favoring the “pipe within a pipe” model. As noted earlier, double taxation of investors should be avoided, and this is a particular concern for investors based in countries that operate the “credit” system of double taxation relief such as the UK and the U.S. Typically, if the pipeline entity is a company, the investor needs to own at least 10 percent of the legal entity that is paying out a dividend. If the pipeline crosses several countries, several host governments are likely to want shares in the pipeline equity. If this happens, it becomes difficult even for quite a large investor to meet the 10 percent threshold. Accordingly, companies that are based

in countries that operate the credit system may well have a strong preference for the pipeline being a “pipe within a pipe” model.

Depending on the facts, it may be possible to get the best of both worlds, by adopting a common carrier model but using a partnership as the legal structure. Provided that the partnership achieves “pass-through” characterization so far as the home countries of the investors are concerned, they should be able to avoid double taxation. In the case of the U.S., it is likely that the well-known “check the box” rules would enable most types of legal entities to be treated as tax transparent, avoiding double taxation. The countries that are most likely to have a double tax issue are European ones that operate the credit system of tax relief.

Other thresholds may apply for other purposes. For example, the tax privileges that many multinational companies use under “participation” regimes in, for example, The Netherlands, depend upon specific levels of ownership being achieved. These issues will be important, regardless of the type of home country tax regime an investor enjoys.

Tax Treaties

Direct tax treaties may play a significant role in taxation of an international pipeline, if an IGA/HGA model is not adopted. In particular, tax treaties protect the shippers from being deemed to have a taxable presence for direct tax purposes in the countries to which their product is shipped. However, such treaties may not protect investors and in fact some investors are unlikely to want to be wholly sheltered from taxation in the host countries for the reasons outlined already.

The CIS indirect tax treaties define the VAT taxing rights on the export of product and give a taxing right on exports to within the CIS generally to the exporting country, if the material exported is a hydrocarbon. If the export is beyond the borders of the CIS, then Kazakhstan will treat the export as zero-rated for VAT and, since it is a temporary import for purposes of all CIS countries, they should not attract VAT or customs taxation in those countries.

Conclusions

The pipeline business does not fit comfortably with the ordinary domestic tax regimes that typically exist in CIS states today, and may well exist in host countries beyond the CIS. Extra tax costs incurred in the export pipeline business will increase the transportation tariffs significantly. Such increased tariffs will, in turn, transfer wealth from both Kazakhstan and upstream investors in Kazakhstan to pipeline investors and pipeline host governments outside of Kazakhstan. Accordingly, both investors and the government of Kazakhstan have a common interest in minimizing tax costs in almost any export solution, and of course in providing stability to that solution. □

The Clash between Romania's New Privatization Laws and its Bilateral Investment Treaties

by Mark Meyer and Michael McNutt

Romania has recently enacted a new privatization law (Law 137/2002) and post-privatization legislation (Law 506/2002). This article examines whether these new laws violate Romania's Bilateral Investment Treaties (BITs), which protect the investments of foreign nationals. Romania has entered into 62 BITs of which approximately two-thirds came into force between 1990-1996.

Many, if not all such treaties, have been ratified by the Romanian Parliament and, therefore, have the force of Romanian law, e.g., Law 110/1992 ratified the treaty with the United States. Although most of the treaties tend to contain similar terms, for illustration purposes, we have only examined how Law 137/2002 and Law 506/2002 possibly conflict with Romania's Bilateral Investment treaties with the United States (US BIT) and with the United Kingdom (UK BIT).

The primary objectives of the Bilateral Investment Treaties are to commit both parties to offer an unbiased and nondiscriminatory framework of transparent laws that promote and protect investment in a fair and equitable manner as provided by international law. In effect, the BITs' seek fair "rules of the game" and a "level playing field" ensuring that laws do not favor investors from one country (including the host country) over investors from another country.

Bilateral Investment Treaties apply to a broadly defined set of investments which include, but are not limited to, investments in privatization. In fact, the Romanian Commercial Code and Law 31/1990 are the basic laws concerning investments as privatization itself is an exception created by the transition from a state-controlled society to a freely democratic one based upon the private ownership of assets. The significance of these treaties can therefore not be understated as they provide the basis upon which Romania commits herself to the rule of law and obliges herself to ensure that Romanian law complies with international law.

Mark Meyer is a member of the New York law firm of Herzfeld & Rubin, P.C. and the Bucharest law firm of Rubin, Meyer, Doru & Trandafir, SCA. He is a member of both the New York and Bucharest Bars. Michael McNutt is a consultant who works with both firms.

Is More Favorable Treatment for State-Owned Companies a BIT Violation?

The new acceleration of privatization law and post-privatization legislation provide the basic framework for investments related to the acquisition of shares or assets of all enterprises in which the Romanian state owns an interest. Essentially, these laws treat state-owned enterprises more favorably than companies in which the state has no ownership interest.

The UK BIT states (Article 3 para (1)): "Neither Contracting Party shall in its territory subject investments or returns of nationals or companies of the other Contracting Party to treatment less favorable than that which it accords to investments or returns of its own nationals or companies or to investments or returns of nationals or

The new privatization law may illegally discriminate against foreign investors in similar enterprises.

companies of any third State." A similar provision can also be found in Article II para (1) of the US BIT. Romanian laws that provide special benefits to companies in which the state owns an interest are obviously discriminating against companies in which the state has no interest. For example, Law 137/2002 Chapter III Article 16 para (5a) requires that utility companies are prohibited from discontinuing the supply of the utility's output to state-owned companies that are undergoing privatization, while privately-owned companies are required to pay their bills on time and are threatened with the discontinuance of supply. But do such preferences in law for state-owned companies violate the BITs?

Law 137/2002 Art. 16 (para 5b,c) provides another example of a preference for state-owned enterprises. It specifies that encumbrances by the state on assets of a company being privatized must be lifted in order to "make them more attractive for privatization" and requires that the creditors suspend any steps taken regarding the enforcement of these encumbrances. The benefit accrues only to companies undergoing privatization and excludes any other investor. Once

Continued on page 12

BITs *(from page 11)*

again, this creates an unfair advantage for state-owned companies because they can use their assets to obtain financing through sale, while privately-owned companies in similar circumstances cannot. Does this preference violate the Bilateral Investment Treaties?

In cases where Romania's favoritism only benefits a state-owned enterprise, such conduct might be characterized as a technical violation of the BITs, even though all other companies, domestic and foreign, are treated in the same (less favorable) manner. But what about when that discrimination favors former investors over new investors, or vice versa? Law 137/2002 Articles 17 and 18, permits the conversion of debt into shares by budgetary creditors and other state-owned entities, if requested, and mentioned in the tender book of the privatization. This

The effect of Law 506/2000 is to retroactively change the playing field and the rules of the game.

provision does discriminate against companies previously acquired by investors in which the investors were required to repay the debt or carry that debt on their balance sheets instead of converting it to equity. Are these companies now entitled to convert their debt into shares?

The three examples provided above suggest that the new privatization law may illegally discriminate against foreign investors in similar enterprises. Indeed, it is the institutionalization of bias in the law that may conflict with the BITs because Romania is imposing a "non-level playing field" upon investors. Realistically, however, unless a specific investor makes a specific claim to his government, the issue of favoritism towards Romanian state-owned enterprises may never arise—but there are more challenging problems that may arise.

Do Special Government Ordinances Favoring One Particular Privatization Violate BITs?

Bilateral Investment Treaties permit negotiated contracts between two parties to have different terms and conditions for investments. For example, just because one investor negotiates the annulment, rescheduling or other modification of unpaid taxes of the company to be acquired, it does not entitle the same benefit to be granted to another investor who did not negotiate those terms.

BITs provide that investment laws must be transparent, nondiscriminatory and the same for all investors. Therein lies the conflict. Romania's privatization law and post-privatization law and related norms provide the basic framework for both the terms and conditions by which the state is allowed to sell its interests and the terms

and conditions in which an investor may invest in state-owned enterprises. Historically, any incentive granted to an investor that is not included in or specifically provided for in the law has been granted to the investor by way of a unique Government Ordinance. A Government Ordinance approved by Parliament has the force of law. As a result, special incentives granted to certain investors are no longer simply negotiated terms, but are embodied in a legal document that creates an exception to the basic law.

For example, in the privatization of Sidex (Romania's largest steel plant) in 2001, the government of Romania issued an Ordinance that was approved by Parliament. It permitted a "special" restructuring of Sidex's balance sheet. Sidex was granted these benefits because its sale was deemed crucial and this was what the buyer demanded in order to conclude the transaction. But the effect was to create a new law that favored one investor over all others in similar enterprises, despite the fact that both the US BIT and UK BIT call for the treatment of one investor to be no less favorable than an investor from a third country or the host country. Therefore, because the Sidex incentives were granted by the issuance of a law for the benefit of one investor, should not those same incentives be applied to similar enterprises (i.e., CS Restia, Otelul Rosu and COS Tirgoviste) so that investors in those enterprises receive no less favorable treatment than provided by the law?

Incentives granted by these special ordinances usually permit the recipient to receive commercial advantages over other concerns which are discriminatory by their very nature (i.e., no profit tax, rescheduled or deferred payments to budget creditors, etc.) and favor unfairly one enterprise against another. Special Ordinances for other privatizations have followed the same road, including the privatizations of Banca Agricola, Rafo Onesti and Petromidia.

The issuance and passage of Special Ordinances for individual investors destroys the level playing field for all investors in the affected industries. Because these Ordinances have the force of law and are not merely commercial terms, the question of Romania's compliance with its Bilateral Investment Treaty obligations is problematic. A foreign investor harmed by one of these Ordinances may well have a legitimate claim under his respective BIT that should be presented to his government.

Have Investments Been Impaired by Discriminatory Measures?

The US BIT Article II (1) states: "Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of investments." This provision is similar to the UK BIT in Article 2 para (2). Both articles require the state to maintain a legal infrastructure that does not arbitrarily ("unreasonably" in the case of the UK BIT) or in a discriminatory manner, impair an investment. The US BIT provides that

Continued on page 13

BITs (from page 12)

companies can hire the management of their choice and no performance requirements can be imposed on volumes of exports or on the allocation of production for the local market. In addition, the US BIT specifically provides that both parties must “make public all laws, regulations, administrative practices and procedures, and adjudicatory decisions that pertain to or affect investments.” One investor should be able to enter into negotiations with the same basic understanding as any another investor and negotiate on purely commercial terms within the confines of transparent and equally fair rules mandated by law.

Law 137/2002

The Romanian government has historically required clauses in new privatization contracts that require specific levels of production or levels of export (e.g., Sidex, Petromidia, CS Resita, and Rafo Onesti)—in seeming contravention of both the US BIT and the UK BIT. The new law requires that new investors maintain a minimum number of employees in a privatized company or obtain the consent of the unions prior to any modifications in the workforce.

Article 33 of Law 506/2002 requires Administration of State Owned Assets (APAPS) consent before a new investor can change the legal form of a company for the duration of the application of the sale Purchase Agreement. Article 19 requires APAPS’ approval for new investors to transfer fully paid and unencumbered shares to third parties. Chapter 3 of Law 137/2002 creates obligations for the management of a privatized company that other managers do not have, and carries severe penalties in Chapter 7 against managers for non-compliance with the requirements of Chapter 3. These obligations do not exist for managers of other compa-

nies and it can therefore be argued that these provisions are discriminatory and biased against managers of privatized companies.

It is hard not to reach the conclusion that these provisions, either singularly or collectively, create an encumbrance upon the asset of an investor in a discriminatory fashion. Investors who invest in a “green field” or “brown field” investment or who acquire shares from private persons or via a stock exchange, do not have the same restrictions on their shares.

Law 506/2002

The post-privatization law further complicates matters due to the fact that it applies—retroactively—to investors that concluded a sale Purchase Agreement before the law was issued. Specifically, Article 25 requires that Articles 11-24 apply to all contracts presently in force. The arbitrary issuance of legal provisions that retroactively affect investors and their investments without the agreement or consent of the investor to the provisions is highly questionable. The effect of Law 506/2002 is to retroactively change the playing field and the rules of the game. Investors made their decisions to enter into sale Purchase Agreements based upon one set of rules provided at the time.

Conclusion

With the likely entry of Romania into NATO and its continued integration into the European Union, Romania is entering a new phase in its transition. Unfortunately, the new privatization and post-privatization laws appear to contain provisions that favor some investors over others and restrict some investments compared to others. The less-than-level playing field created by the new privatization laws should be reviewed and efforts should be made to assist Romania in removing apparent contradictions in the law. □

Russia/Central Europe Executive Guide invites experts in CIS legal and business issues to submit articles. Authors will be advised promptly if the *R/CEEG* intends to publish the article. *R/CEEG* reserves the right to edit articles for clarity and style.

Please send manuscripts to the Editor, *Russia/Central Europe Executive Guide*, by e-mail, fax, or mail.

E-MAIL: info@wtexec.com
 FAX: (978) 287-0302
 MAIL: PO Box 761
 2250 Main Street, Suite 100
 Concord, MA 01742

Central Bank Clarifies Anti-Money Laundering Procedures

by Julia Romanova and Konstantin Konstantinov

The Central Bank of Russia (CBR) recently issued "Informational Letter No. 1" (Letter No. 1), which is intended to remove certain doubts about the breadth of implementation of the RF Law "On Prevention of Legalization (Laundering) of Proceeds Obtained Through Criminal Means," dated as of August 7, 2001, as amended (Anti-Money Laundering Law). According to Letter No. 1, the Anti-Money Laundering Law's reporting requirements apply to all qualifying transactions whether conducted by banks on their own behalf, or by legal entities, including leasing and insurance companies, or individual entrepreneurs, and regardless of the need for such transaction to be otherwise disclosed (e.g., in securities filings). In addition, Letter No. 1 explains that under the Anti-Money Laundering Law, the disclosure requirements re-

Julia Romanova and Konstantin Konstantinov are Associates in the Moscow office of Chadbourne & Parke.

garding any transfer to or from the bank accounts of a legal entity are also applicable to transfers to or from such accounts pursuant to the instructions of third parties (and not only of such legal entities).

Disclosure Filings

Letter No. 1 expressly states that banks must submit disclosure filings with respect to all transactions of a legal entity exceeding 600,000 rubles (approximately \$19,500) during the first three months following the entity's state registration. Banks themselves are now required to make their own determination as to the nature of transactions engaged in by a legal entity, and to determine whether such transactions are consistent with the nature of the entity's regular business (since these transactions fall within the criteria set forth in the Anti-Money Laundering Law). On the basis of this determination (for which the banks are solely responsible), banks must make the required disclosures.

Evidently, the CBR has taken the position that there will be no exceptions from the requirements set forth in the Anti-Money Laundering Law governing credit organizations regarding the disclosure of information about transactions that meet certain criteria; furthermore, the CBR has indicated that it will broadly interpret such criteria. □

Update of Russian Legislation

by Eric Michailov

Bank Holding

On September 19, 2002, the Central Bank issued Regulation No. 197-P "On the Submission of Information by Bank Holdings."

The Regulation was registered with the Ministry of Justice on October 18, 2002.

A "bank holding" is defined in the Federal Law "On Banks and Banking Activity" as an alliance between legal entities and one or more lending organization in which one legal entity (a head company or a special-purpose management company of the bank holding) directly or indirectly controls decisions of the governing bodies of the lending organizations within the alliance. Article 4 of the Law requires the head (or management) company of a bank holding to submit to the Central Bank information on the establishment of the group.

The Regulation further details the grounds and procedure for the submission of information on the partici-

pants of a bank holding. According to the Regulation, such information must initially be filed with the Central Bank within three months from the date of the entry into force of the Regulation.

The Regulation will come into force ten days after its official publication.

Mutual Investment Funds

On September 11, 2002, the Federal Commission on the Securities Market (FCSM) issued Resolution No. 35/ps "On Registration of Trust Management Rules of Mutual Investment Funds [...]."

The Resolution was registered with the Ministry of Justice on October 18, 2002.

The Resolution is issued pursuant to the November, 2001, Federal Law "On Investment Funds."

The Resolution establishes the procedure for FCSM registration of trust management rules of mutual investment funds and amendments to these rules. It specifies the requirements for information and documents to be filed by management companies of mutual investment funds applying for registration, according to the specific investment activity carried out by the funds.

The Resolution came into force on November 5, 2002.

On September 11, 2002, the Federal Commission on the Securities Market (FCSM) issued Resolution No. 36/ps approving the "Regulation on Additional Require-

Continued on page 15

Eric Michailov is a Senior Associate with the Moscow office of White & Case LLC, and a member of the *R/CEEG* Advisory Board.

Legislation *(from page 14)*

ments for the Procedure of Preparation, Convening, and Conduct of General Meetings of Equity Participants in Closed Mutual Investment Funds."

The Order was registered with the Ministry of Justice on October 18, 2002.

The Resolution sets forth a number of additional requirements to the procedures of preparation, convening, and conduct of general meetings of equity participants envisaged by the Federal Law "On Investment Funds" and trust management rules of mutual investment funds.

Participants meetings may be conducted by meeting or by absentee voting. The Resolution sets forth procedures for inclusion of items on the agenda of the meetings, registration of the participants, calculation of voting ballots, invalidation of decisions, as well as requirements as to the documents produced at the meetings.

The Resolution also introduces amendments to Regulation No. 20/ps "On Record Maintenance of Rights to Equity Participation in Mutual Investment Funds," which deal mainly with the compilation of lists of those who have the right to participate in general participants meetings.

The Resolution will come into force ten days after its official publication.

Banking

On July 30, 2002, the Central Bank issued Regulation No. 191-P "On Consolidated Accounts."

The Regulation was registered with the Ministry of Justice on October 11, 2002. The Regulation introduces new procedures for preparation and submission of consolidated accounts by lending organizations to the Central Bank and its territorial departments. It also sets forth the specifics of banking supervision over lending organizations on the basis of their consolidated accounts.

According to the Regulation, "consolidated accounts" means the reporting on debts, loans, equity capital (net assets), financial results, and calculation of risks prepared on a consolidated basis in accordance with the Regulation. The Regulation establishes three methods for the preparation of consolidated accounts: full consolidation method, proportional consolidation method, and equivalent value method.

Consolidated accounts shall only be prepared by the "head" lending organization of each "banking" and "consolidated" group and shall be submitted to the respective territorial department of the Central Bank on a quarterly and annual basis.

"Banking groups" are defined in the Law "On Banks and Banking Activity in Russia" as an alliance of banks in which one bank directly or indirectly controls decisions of the governing bodies of other banks within this

alliance. "Consolidated groups" are defined in the Regulation as an alliance of legal entities in which one lending organization directly or indirectly controls decisions of the governing bodies of other legal entities within this alliance. The "head" organization of each "banking" and "consolidated" group is determined in accordance with criteria set forth in the Regulation.

Consolidated accounts are prepared for the purposes of identifying how the investments of a lending organization in the charter capital of other companies, transactions with, and control over the other companies, may affect the financial standing of the lending organization. Consolidated accounts are also aimed at determining total amount of risks and equity capital (net assets) of "banking" and "consolidated" groups.

The Regulation will come into force ten days after its official publication, and will replace Regulation No. 29-P of May 12, 1998, on the same matter.

Licensing in Power Sector

On September 16, 2002, the Ministry of Energy adopted Order No. 309 "On the Organization of Licensing of Activities Under the Competence of the Ministry of Energy of the Russian Federation."

The Order is issued pursuant to the recent Government Resolution No. 637 establishing new licensing rules and procedures in respect of operation of electric power networks, operation of heat networks, the transportation, storage, and refining of oil and gas and their products. These activities are subject to licensing by the Department of State Energy Supervision, Licensing, and Energy Saving of the Russian Ministry of Energy.

The Order addresses certain procedural issues of licensing and approves a form of application for obtaining a license.

The Order will come into force ten days after its official publication and will replace Order No. 212 of August 28, 1996, on the same matter.

Licensing of Medical Activity

On July 26, 2002, the Ministry of Health issued Order No. 238 "On the Organization of Licensing Medical Activity."

The Order was registered with the Ministry of Justice on October 11, 2002. The Order is issued following the Federal Law "On Licensing Certain Types of Activities," pursuant to which medical activity in the Russian Federation is subject to licensing. The Order now lists medical activities (including pre-doctor care, institutional care, and out-patient services), which are subject to licensing, and approves the Regulation on the Central Commission at the Ministry of Health, which will be the licensing authority for these types of activities.

The Order will come into force ten days after its official publication.

Continued on page 16

Legislation *(from page 15)*

First Reading

On October 16, 2002, the State Duma adopted in their first readings the following draft laws:

Licensing—"On Amendments to Article 17 of the Federal Law 'On Licensing Certain Types of Activities.'" The amendments would exempt the sale and purchase of oil, gas, and their products from the list of licensable activities.

Intellectual Property—"On Amendments to the Federal Law 'On Authors and Related Rights.'" The amendments would bring the existing version of the Law into compliance with current Russian legislation and international treaties.

Minimum Monthly Wage—"On Amendments to the Federal Law 'On the Minimum Monthly Wage.'" The amendments would increase the minimum monthly wage in the Russian Federation from 450 rubles (applicable from May 1, 2002) to 600 rubles from October 1, 2003. The rate is used for calculation of labor remuneration and social payments.

Antimonopoly

On October 9, 2002, the president signed Federal Law No. 122-FZ "On Amendments to the Law 'On Competition and Restriction of Monopolistic Activity on the Commodities Markets.'"

The amendments further detail the definitions of affiliated persons, group of persons, and set forth a new definition of a monopolistically high price. The amendments extend antimonopoly controls into the area of public administration and strengthen restrictions on anti-competitive vertical and horizontal agreements (coordinated actions).

The amendments double the minimum threshold requirements applicable to antimonopoly controls over mergers and acquisitions. Preliminary approval is now required for an acquisition of more than 20 percent of voting shares, or a merger of commercial entities if the aggregate value of assets of the respective entities (and, in case of an acquisition, the aggregate value of assets of their group entities) exceeds 200,000 minimum monthly wages (approx. \$645,000). In addition, the threshold of the aggregate value of assets of the acquirer (and its group) and the target entity has been increased to 100,000 minimum monthly wages.

The amendments introduce the requirement that the establishment, merger or accession of non-profit organizations with a participation of at least two commercial entities, or changes in the participation structure of such non-profit organizations, shall be notified to the antimonopoly authorities in the event that the aggregate value of assets of the respective entities exceed 100,000 minimum monthly wages. The amendments also extend the notification period applicable to the establishment of commercial entities from 15 to 45 days.

Furthermore, the amendments strengthen antimonopoly control over horizontal and vertical agreements that limit, prevent or eliminate competition, as well as over the commercial policies of legal entities that enjoy a dominant position in a market. The amendments decrease, and in certain cases dispense with, the respective market share thresholds that previously applied to horizontal and vertical agreements (coordinated actions). At the same time the amendments introduce a new option of providing clearance for actual or potential anti-competitive agreements or coordinated actions in advance of their conclusion, and sets forth a procedure for doing so.

The amendments came into force on October 14, 2002.

Minimum Charter Capital of Banks

On October 2, 2002, the Central Bank issued Telegram No. 133-T stating the ruble equivalent for the minimum charter capital of credit organizations for the fourth quarter of the year 2002.

The amount of minimum charter capital for banks is set in euros and generally varies depending on the type of organization seeking a banking license.

By this Telegram the Central Bank decreased the ruble equivalent of the minimum charter capital for banks in order to adjust the minimum charter capital for depreciation of the Russian currency against the euro.

The ruble equivalent of the minimum charter capital for Russian banks, subsidiaries of foreign banks, as well as for equity of banks applying for a general banking license is set at 154,541,000 rubles.

Restrictions on Foreigners

On October 11, 2002, the government issued Resolution No. 754 "On Approval of List of Territories, Objects, and Organizations the Entry to Which Foreign Citizens Require a Special Permission" and Resolution No. 755 "On Approval of List of Objects and Organizations Where Foreign Citizens Cannot be Employed."

The Resolutions are issued under the recent Federal Law "On Legal Status of Foreign Citizens in the Russian Federation," which came into force on October 31, 2002.

According to Resolution No. 754, among the territories restricted for travel by foreigners without special permission are: (a) territories of the so-called "closed administrative regions;" (b) military cities; (c) zones of conduct of anti-terrorists military operations; and (d) border areas. The list provided in this Resolution is not exhaustive.

According to Resolution No. 755, foreign citizens may not be employed in departments (either of state authorities or legal entities) that deal with issues that are regarded as state secrets.

The Resolutions will come into force after the Federal Law "On Legal Status of Foreign Citizens in the Russian Federation" comes into force.

Continued on page 17

Legislation *(from page 16)*

Insurance

On September 25, 2002, the government issued Directive No. 1361-r approving the "Concept of Insurance Development in the Russian Federation."

The Concept provides an overview of the current Russian insurance market, sets forth priorities and goals for its development, and provides for the enhancement of regulatory standards and certain changes in insurance taxation rules. Among other things, the Concept envisages an expansion of the insurable risks that are tax deductible.

According to the Concept, priority directions for development of the Russian insurance market include ensuring effective mandatory state insurance as well as voluntary life and pension insurance. The Concept supports development of mandatory professional insurance for doctors, real estate agents, auditors, and arbitrazh managers. It stresses the importance of mandatory property insurance for industrial objects and enterprises, as well as mortgage lending and real estate lease insurance. The Concept foresees establishment of centralized insurance funds (reserves) for state guaranteed mandatory insurance payments.

The Concept was officially published on October 2, 2002.

Privatization

On September 25, 2002, the government issued Resolution No. 707 "On the Procedure for Realization of Leases of Federal Property with Purchase Rights [...]."

The Resolution is issued pursuant to the Federal Law "On Privatization of State and Municipal Property" and sets forth rules and procedures for the sale of federal property owned on the basis of a leasehold interest with a purchase right, entered into prior to the effective date of the Privatization Law.

The Ministry of Property Relations is required to render decisions on the sale of such property within two months from the date of an application for purchase, received from a leaseholder. The Ministry must carry out an independent appraisal of the property subject to sale. If the value of the property does not exceed ten thousand times the minimum monthly wage (approx. \$32,000), the Ministry must render a decision to sell the property. If the property value exceeds this amount, the Ministry is required to propose the establishment with the leaseholder of an open joint stock company (OAO) in which the leased property will constitute the capital contribution of the state. The leaseholder must consent to this arrangement within one month from the date of such notification by the Ministry, and provide the Ministry with a list of property

(independently appraised), which the leaseholder will contribute to the charter capital of such OAO.

After the registration of the placement of the OAO's shares, the Ministry must transfer the state share in the OAO to the Russian Fund of Federal Property for their subsequent sale to the leaseholder. The Regulation further details the steps involved in such sale and provides options in case the leaseholder refuses to purchase the OAO shares.

The Regulation came into force on October 10, 2002.

Deferral of Export Payments

On September 24, 2002, the government issued Resolution No. 699 "On the Procedure for Issuance of Permissions to Residents for the Deferral of Payment for a Period of More than 90 Days for the Export of Goods (Works, Services, and Results of Intellectual Activity)."

Article 6(2) of the Law "On Currency Regulation and Currency Control" authorizes the government (in consultation with the Central Bank) to establish a procedure for granting Russian residents a deferral of payment for more than 90 days under their export or import contracts with non-residents. The government has now given the authority to the Ministry of Finance to issue permissions for such payment deferrals and has set forth a procedure for issuance of such permissions.

This procedure does not apply to general export payments that, under the Law "On Currency Regulation and Currency Control," may be made without permission.

The procedure established by the Resolution shall apply from September 1, 2002 (without regard to the dates of export contracts).

Permissions issued by the Central Bank before this Resolution shall remain in force either until their respective expiry dates or until completion of operations envisaged by such permissions.

Audit

On September 23, 2002, the government issued Resolution No. 696 approving "Federal Rules (Standards) of Audit Activity."

The Resolution approves six federal standards of audit activity in the Russian Federation developed in accordance with international auditing standards. They constitute just a part of the 40 international standards that are to be implemented soon and adhered to by all audit companies operating in Russia.

The Rules define principles, goals, and scope of audits, requirements of audit documentation and the audit plan. They also determine the concept of "relevance" in audit practice and its relation to audit risk.

The Resolution will come into force seven days after its official publication. □

Foreign Citizens *(from page 2)*

ager, deputy manager, or divisional manager for such enterprises. The new Law does not stipulate such an exemption. As a result, it is not yet clear whether enterprises with foreign investment will need to go through the standard procedures to obtain permission to hire and employ foreign citizens for such positions. It is possible that when the Russian federal government clarifies the new Procedure for Issuing Work Permits, this ambiguity will be eliminated.

Representation Offices of Foreign Companies

The Law does not bring any clarity to the question of whether accredited representation offices of foreign companies in Russia will need to obtain work permits for each foreign employee holding personal accreditation.

Under the new Law, all employers are obligated to obtain such a permit for their foreign employees. For the purposes of the new Law the employer is defined as an individual or legal entity, employing foreign citizens based on labor contracts concluded with them. All foreign legal entities with representative offices in Russia, which have labor contracts with their foreign employees, meet this definition. The only exception provided by the Law relates to employees of diplomatic representatives, consular offices, international institutions and their domestic servants.

Based on the above, representative offices of foreign companies in Russia may be required to obtain work permits for their foreign employees who have personal accreditation. Official clarification on this is expected following implementation of the new law.

Registration of Foreign Citizens in Russia

The new Law sets the procedure for registering foreign citizens on their arrival in the Russian Federation.

The new Law also stipulates that if during a temporary stay in Russia a foreign citizen loses the documents on the basis of which he or she entered Russia, the individual is obligated to leave the country not later than 10 days from the receipt of a temporary document issued at the individual's written request.

In addition, the Law contains a list of categories of foreign citizens who are exempt from registration on entry into Russia. This list is somewhat shorter than the previous version given in the Rules for the Stay of Foreign Citizens in the USSR.³

Monitoring of Stay and Residence of Foreign Citizens in Russia

The new Law introduces a migration card—a document that contains information on foreign citizens entering Russia and which also serves to monitor their stay in Russia.

Now, on entry into the Russian Federation, a migration card will be completed on passing through passport control. These cards will be stamped at the time of foreigners' entry to and exit from Russia.

As before, the Law stipulates that for entry into specific areas of the country foreign citizens must obtain special permits.

Transitional Provisions

The Law stipulates that foreign citizens who arrived in Russia before the Law entered into force (i.e., before October 30, 2002) under a procedure that does not require a visa are obligated to apply for a migration card at the regional branch of the federal executive authorities where they are staying, within 60 days from the Law's entry into force. In this regard, the permitted duration of stay in Russia is a maximum of 90 days from the receipt of the migration card. If a foreign citizen has not applied for a migration card, then the 90-day period for his or her stay in Russia commences from November 1, 2002.

The entry into force of the new Law will bring a degree of uncertainty to the status of foreign citizens who work in Russia. Specifically, it is not clear whether foreign citizens having personal accreditation and working for a representative office of a foreign company in Russia will need to obtain a work permit. Also, the actual process to obtain entry visas and the processing time remains unclear.

¹Law No. 115-FZ of July 25, 2002.

²USSR Law No. 5152-X of June 24, 1981.

³Resolution of the USSR Council of Ministers No. 212 on April 26, 1991. □

Market Opportunities *(from page 5)*

nian company profitable. OTE initially said it was willing to pay about \$200 mln for control of RTC. The Romanian government owns 65 percent of RTC, and OTE has said the Romanian company could go bankrupt if the two shareholders didn't put more money into the company.

Ukraine

Kyivstar to sell new shares as bond issuance lim-

ited by political probe. Kyivstar GSM, a Ukrainian mobile phone company controlled by Telenor (Norway), said it would sell \$35 mln worth of new shares to finance work on its cell phone network. The company will offer the shares soon to current shareholders proportionally to their current stakes, said Kyivstar Financial Director Trond Moe. Telenor owns 54.2 percent of Kyivstar, Ukrainian company Storm (40.1 percent) and Omega (5.69 percent) own virtually all of the remaining issued shares. Kyivstar sold \$100 mln of bonds earlier in November, less than

Continued on page 19

Market Opportunities (from page 18)

the \$150 mln it had planned. The sale took place amid a probe into allegations that Ukrainian President Leonid Kuchma received bribes through Omega, one of Kyivstar's founders, according to Ukrainian media reports. Kyivstar competes with Ukrainian Mobile Communications (UMC), controlled by Russia's Mobile TeleSystems (MTS). The Russian company is expected to invest as much as \$400 mln in UMC during the next five years, according to a Ukrainian government report.

Manufacturing

Hungary

Hewlett-Packard to establish printer factory.

Hewlett-Packard (U.S.) is intending to establish a factory in Hungary, according to Hungarian newspaper *Nepszabadsag*. No sources were provided for the report. The newspaper said that Hewlett-Packard would spend \$100 mln on the plant as part of a \$1 bln project to develop about 50 models of newly designed printers. The company expects about 800 mln euros (\$810 mln) in annual sales from the plant, according to the report. Flextronics International (Singapore) has been making printers for Hewlett-Packard in Hungary, but shifted production to the Far East in April of this year because of increasing labor costs.

Russia

Ikea to end work if import duties are raised.

Ikea (Sweden) founder Ingvar Kamprad said the world's largest home furnishings retailer may stop work in Russia if the government raises import duties. Kamprad said that Ikea would have to halt operations if a proposal by the Russian Ministry of Science and Industry to double current import duties is approved. Kamprad added that Ikea is considering opening as many as 17 shops around Russia, including five in the Moscow region and one or two in St. Petersburg.

Metals and Mining

Poland

Steel holding stake to be bid this year. Poland will send invitations to investors by the end of the year to bid for an unspecified stake in the nation's largest steelmaker, *Polskie Huty Stali*, according to Economy Minister Jacek Piechota. The government will require the successful investor to buy the steel maker's 5 bln zloty (\$1.27 bln) of debt and raise its capital, according to Piechota. Poland has tried for five years to sell its steel-making assets, whose losses more than doubled to 2.2 bln zloty last year. *Polskie Huty* was created by a merging of Poland's four largest steel producers. Arcelor (France), LNM Holdings (Netherlands), Thyssen (Germany) and U.S. Steel are all likely bidders.

Oil and Gas

Poland

Raifineria Gdanska suggests selling stake to PKN.

According to the Polish daily business newspaper *Puls Biznesu*, Poland's second-largest oil refiner Raifineria Gdanska (RG) has proposed selling a 20 percent stake to its larger rival, PKN Orlen, as the government considers ways to sell its assets in the nation's oil industry. PKN would pay 320 mln zloty (\$81 mln) for the stake, according to the proposal by state-owned RG, the newspaper reported. The plan also calls for the government to give RG a 51 percent stake in Petrobaltic, the state's oil exploration company, as well as the selling of RG shares to the public within two years. PKN recently joined with Rotch Energy (UK) to bid for 75 percent of RG. Rotch has been in exclusive talks with the state over taking control of RG since June of 2001 and has offered about \$300 mln for the stake. In response to the latest RG proposal, Krzysztof Mering, spokesman at Nafta Polska (NP), stated the tender for the majority (75 percent) position in RG has to be concluded before any other options could be considered. NP is the Polish state agency in charge of oil industry assets.

Russia

Gazprom CEO expects agreement with EC on natural gas trading. Alexei Miller, CEO of Russian natural gas giant Gazprom, said he expects by the end of January, 2003, to reach a final agreement with the European Commission (EC) to remove barriers to natural gas trading in Europe. The EC is the executive agency of the European Union and has been attempting to end agreements that limit the number of natural gas sellers in Europe, a move expected to increase prices. Gazprom is the source of more than 50 percent of Europe's natural gas and has relied upon long-term contracts that prevent customers from selling natural gas to other users. EU Competition Commissioner Mario Monti in July said Gazprom had agreed not to introduce territorial restrictions on future contracts and has started to renegotiate existing contracts. Long-term contracts may be allowed in some circumstances, Monti said at that time.

YUKOS may acquire Italian refineries. Eni (Italy) may raise 700 mln euros (\$708 mln) selling 50 percent of two Italian refineries to Russia's YUKOS Oil, according to a report in Italian newspaper *il Mondo*. The daily did not provide any sources for the information, but identified Gela on Sicily, Marghera near Venice, and perhaps Milazzo also on Sicily as the refineries of interest. Eni is the fourth-largest oil company in Europe, while YUKOS is the second largest producer in Russia. Luciana Santaroni, spokeswoman for Eni, refused to confirm the story, citing secrecy agreements, but did note that the suggested purchase figure bore "no reference to the reality of the facts." □

WTE | RUSSIAN PETROLEUM INVESTOR

Political and business intelligence for energy investors in the NIS

Turn to RPI as your In-House Consultant on the Russian and NIS Oil & Gas Industry

Whether you are currently active in the Russian-CIS region, or planning to re-enter this vital business arena, *Russian Petroleum Investor* provides you with the level of detail, breadth of coverage, and inside perspective you need to succeed. *Monthly coverage includes:*

- ✓ **Regional developments** that affect the oil and gas sector
- ✓ Complete coverage of **tax legislation and implications** for energy transactions
- ✓ **Extensive statistical information** on oil and gas production and exports in the region
- ✓ **Legal developments** that affect the energy sector
- ✓ Complete coverage of **market opportunities**
- ✓ Full text of **energy-related legislation**
- ✓ **In-depth interviews** with key decision-makers

For a free two month trial of **Russian Petroleum Investor**, or for more information, please email info@wtexec.com, call (978) 287-0301 or, visit our web site at www.wtexec.com.

Russia/Central Europe Executive Guide

Including Coverage of Eastern Europe and Central Asia

YES, sign me up risk-free for **Russia/Central Europe Executive Guide** today.
I understand I may cancel within 60 days for a full refund.

1 Year/22 issues – \$855 (*905 outside U.S.)

Name _____ Title _____

Company _____

Address _____

City _____ State/Country _____

Zip _____ Phone _____

Fax _____ Email _____

Billing Info: Company Check (US funds only) Bill me

Charge my card: Visa Mastercard Amex Diners Card

Card # _____ Expires _____

Signature _____

WorldTrade Executive, Inc.
PO Box 761, Concord, MA 01742 USA

Fax: (978) 287-0302
Phone: (978) 287-0301

Email: info@wtexec.com
Web: www.wtexec.com

Checks/money orders payable in \$U.S.
only to **WorldTrade Executive, Inc.**

NO-RISK GUARANTEE

If you are dissatisfied with **Russia/Central Europe Executive Guide** at any time in the first two months, we will cancel your subscription and refund your payment in full.