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RUSSIA

Supreme Arbitration Court Clarifies Application of Bankruptcy Law

As discussed in previous issues of the *CIS Legal Newswire* (see the July 15, 2002, and February 14, 2003, issues), the RF Law "On Insolvency (Bankruptcy)" (the "Bankruptcy Law") was amended in 2002, and, with the exception of certain provisions, these amendments came into force on December 3, 2002.

In a resolution issued on April 8, 2003 (the "Resolution"), the Supreme Arbitration Court clarified several key issues on the application of the Bankruptcy Law. In particular, the Supreme Arbitration Court addressed the inconsistency between the new provisions of the Bankruptcy Law and the RF Civil Code on the priority of secured creditors' claims. The Court also discussed inconsistencies between the new Bankruptcy Law provisions and the RF Arbitration Procedural Code with respect to various procedural issues.

As we reported in the February 14, 2003 issue of the *CIS Legal Newswire*, the Bankruptcy Law altered the legal status of secured creditors and the priority for satisfaction of creditors' claims, but the application of these new provisions was unclear. In the Resolution, the Supreme Arbitration Court explained how to apply these provisions of the Bankruptcy Law and the RF Civil Code to the distribution of a bankrupt company's proceeds among different classes of creditors. The Court confirmed that different distribution rules apply to bankruptcy proceedings, as opposed to other forms of liquidation. Secured creditors, therefore, have priority over other creditors of the same or lower class in the recovery of proceeds from the sale of property secured in their favor, but only in bankruptcy proceedings. In the case of other forms of liquidation, the arbitration courts must apply the relevant provisions of the RF Civil Code, which do not grant this priority to secured creditors with such priority in the distribution of proceeds arising from the sale of property secured in their favor.

In the Resolution, the Supreme Arbitration Court also addressed certain procedural issues that are not covered by the RF Arbitration Procedural Code. The Court established that a court ruling issued during the course of bankruptcy proceedings and not mentioned in the RF Arbitration Procedural Code may be appealed within fourteen days of its issue. The decision of the appeal court is deemed final. The Court further established that rulings on the extension of external management, the invalidity of creditors meetings' decisions, etc. may also be appealed.

The resolution went on to specify the requirements for qualifications of court manager candidates as well as court requirements for approving a court manager. Among other things, the Supreme Arbitration Court confirmed that a court manager's lack of liability

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insurance for damages and losses caused by him/her to the participants of a bankruptcy proceeding could serve as a basis for the court to dismiss such person as a manager.

Bankruptcy cases now represent a significant number of the cases on court dockets. Tatyana Trefilova, Head of the Federal Financial Recovery Service (a federal agency charged with monitoring ongoing bankruptcy proceedings involving various types of Russian legal entities) confirmed that the number of bankruptcy proceedings has increased twofold since January 1, 2002. In light of the rapid growth in the number of bankruptcy cases, the clarifications provided by the Supreme Arbitration Court will be appreciated by both the courts and litigants in bankruptcy proceedings. Although the Russian court system does not recognize legal precedent, in practice, lower courts tend to follow the recommendations of the RF Supreme Arbitration Court, which is the highest court charged with hearing commercial disputes between legal entities. /S. Sineva, E. Abrossimova

Ruble Deposits Become More Profitable in June

As of June 28, 2003, individuals holding Ruble bank accounts may see an increase in their holdings as a result of amendments to the RF Tax Code (the "Amendments") which decrease taxes on individuals' Ruble deposits. The Amendments provide that interest paid by Russian banks on Ruble deposits, up to the amount of the RF Central Bank refinancing rate, are tax exempt.

Currently, the RF Tax Code provides that the amount of interest to be paid by Russian banks on individuals' Ruble deposits is tax exempt if the bank's interest rate does not exceed three-fourths of the RF Central Bank refinancing rate (currently 18 percent). If the interest rate paid by a Russian bank exceeds 13.5 percent, then the individual must pay 35 percent personal income tax on the interest earned.

Prior to February 2003, this situation was acceptable both to Russian banks and to their depositors. However, in February, the RF Central Bank decreased its refinancing rate from 21 percent to 18 percent, thereby triggering the taxation of the majority of Ruble deposits, in turn making them less attractive. The Amendments restored the attractive tax benefits associ-

ated with holding Ruble deposits.

The Amendments do not cover the taxation of foreign currency deposits. Foreign currency deposits are still subject to personal income tax at the rate of 35 percent where the interest paid by a Russian bank on the deposit exceeds 9 percent. /E. Korotkova, E. Abrossimova

US Federal Court Finds Improper Influence in Russian Court's Decision

In a recent case before the US District Court of New York (the "District Court") involving a dispute over the ownership of copyrights in certain Soviet era cartoons, the District Court refused to follow a related decision of the RF Supreme Arbitration Court, in part because the District Court concluded that the decision was "strongly influenced, if not coerced, by the efforts of various RF Government officials seeking to promote 'State interests.'"

The District Court case involved a copyright infringement suit brought by Films by Jove ("FBJ"), a California-based company that in 1992 apparently acquired from the successor to *Soyuzmultfilm* the exclusive rights to more than 1,000 Soviet era cartoons, against Joseph Berov, a Brighton Beach video distributor who sold the cartoons in violation of the copyrights. In the midst of the infringement suit, the RF Government created a new entity, which it claimed was the actual successor to *Soyuzmultfilm* and the rightful owner of the copyrights. The newly-created entity joined the infringement suit as a third-party plaintiff, turning a simple copyright infringement case into a complex dispute over the transfer of intellectual property rights during the years of perestroika, in which the District Court had to rule on interpretations of Soviet and Russian law. In August 2001, the District Court upheld FBJ's claim, ruling that FBJ was the lawful owner of the copyrights. Later that year, however, the RF Supreme Arbitration Court ruled, in a decision not fully consistent with previous decisions of the same court, that the entity newly-created by the RF Government, and not FBJ, was the owner of the copyrights. Citing the RF Supreme Arbitration Court's decision, the respondent made a motion for reconsideration of the District Court's decision.

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In the course of ruling on the motion for reconsideration, the District Court was put in the difficult position of having to weigh the decision of the Supreme Arbitration Court, along with significant evidence that the Supreme Arbitration Court had been unduly influenced by several RF ministries who apparently saw the copyright litigation as an opportunity to reacquire the rights to these Soviet era cartoons. In its decision, the District Court found evidence alleging extensive flaws in the Russian judicial system to be "troublesome" but stopped short of a sweeping condemnation of Russia's judiciary. The District Court made clear that its refusal to follow the Supreme Arbitration Court's decision was based on the specific facts of that case, and not on any pervasive corruption allegedly affecting Russia's judicial system.

After extensive consideration of the principles of comity, the District Court ruled that it was not required to defer to the interpretation of Soviet and Russian law provided by the Supreme Arbitration Court, even though it ordinarily would defer to foreign courts in such cases. As the District Court noted, however, this was no ordinary case. Ultimately, the District Court ruled that, because the Supreme Arbitration Court's interpretation of Soviet and Russian law was "clearly erroneous," and because it was apparent that the Supreme Arbitration Court had been "influenced, if not coerced" by RF Government officials, the Supreme Arbitration Court's decision was entitled to no deference. On the basis of expert testimony, other decisions of Russian courts and the facts surrounding the original transfer of the copyrights during perestroika, the District Court ruled that the copyrights had been transferred to the successor of *Soyuzmultfilm* and that entity irrevocably transferred the copyrights to FBJ, making FBJ the current owner of the copyrights.

Although the District Court's decision may be somewhat uncomfortable for the Russian court and the RF Government officials involved, it is unlikely to have much effect on U.S. courts considering interpretations of Russian law put forth by RF courts. The District Court merely found that this particular decision of the Russian Court was unreliable, due to the specific facts involved; and in fact the District Court did rely, to some extent, on the decisions of other RF courts. /P. Webb

The Issuance of Additional Shares Under the Joint Stock Company Law

Ambiguous language in the RF Law "On Joint Stock Companies," dated December 26, 1995 (as amended) (the "JSC Law"), has given rise to several issues. One such issue is whether the authority to approve the issuance of additional shares (within the limit of authorized shares) by a closed subscription may be delegated to the board of directors (the "Board") of a closed joint stock company.

The registration authorities recently conveyed the following view. The general rule is that a general shareholders' meeting of a joint stock company has the competence to increase a company's charter capital by way of the issuance of additional shares. Pursuant to Article 28(2) of the JSC Law, the charter of a joint stock company may authorize a company's Board to authorize an additional issuance. Article 39(3) of the JSC Law establishes a special case in which the decision to issue additional shares must be approved by the company's general shareholders' meeting; namely, the placement of additional shares by a closed subscription. A closed joint stock company is not allowed to issue additional shares by way of an open subscription. Therefore, apparently, the Board in a closed joint stock company may not be authorized to issue additional shares by way of a closed subscription.

The situation mentioned above relates to the issuance of additional shares by a closed subscription (i.e., such additional shares are distributed within, as well as paid for by, a certain category of subscribers). However, in other cases when a closed joint stock company issues additional shares, for example (i) distribution among the company's shareholders of additional shares, paid for by the company's own assets; and (ii) conversion, the Board may be authorized to make a decision regarding issuing additional shares.

Based on our experience with the registration authorities, and in order to avoid any potential problems with the registration authorities, where a closed joint stock company intends to

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authorize the Board to decide on the issuance of additional shares, it is advisable that the charter of the company reflect the issue as discussed above. In particular, the charter should specify that the Board is authorized to decide on the issuance of additional shares only to the extent that the JSC Law does not require such decision be made by the general shareholders' meeting of a company. /E. Korotkova

KYRGYZSTAN

Steps Taken to Strengthen Corporate Governance in Joint Stock Companies

A new Law "On Joint Stock Companies" (the "New JSC Law") came into effect in Kyrgyzstan on April 8, 2003. As compared with the previous Law "On Business Partnerships and Societies," dated November 15, 1996, which governed joint stock companies along with other business formations, the New JSC Law applies only to joint stock companies.

Notably, the New JSC Law strengthens the role of the general shareholders' meeting and board of directors as the governing bodies of a joint stock company, as well as expanding shareholders' rights. Other notable changes include provisions on the liability of shareholders and board members, charter capital requirements, and the status of preferred shares.

Significantly, the general shareholders' meeting has been granted more authority, including the exclusive competence to determine the company's course of action regarding, inter alia: (i) the acquisition of shares in another legal entity with a value of 20 percent or more of the balance value of the company's assets; (ii) the cancellation of decisions adopted by the company which contradict the law; and (iii) approval of the company's annual budget. Moreover, any transaction with an interested party (defined as any director, officer of the company and/or any shareholder holding 20 percent or more of the company's voting shares) requires the approval of the general shareholders' meeting. Interested shareholders, directors or officers are prohibited from voting on such issues.

In addition, the company may pay no dividends if the shareholders unanimously so agree. If the shareholders decide to pay dividends, they may do so only after verifying that such distribution will not render the company insolvent.

The board of directors now has the authority to determine the company's strategic goals and policies, convene and hold the general shareholders' meeting, and make recommendations on the size of dividends. As compared with the previous law, executive officers are now elected by the board of directors, and not by the general shareholders' meeting. Both executive officers and board members are elected for a one-year term and may be re-elected.

Another major change is the new right of shareholders to demand that the company repurchase their shares. This right arises where the company is reorganized or a large-scale transaction is consummated, or if the company's charter is amended or revised in such a way as to impair shareholders' rights, provided that the claiming shareholders voted against the amendment in question. The company must then repurchase such shares at the average share price as of six months prior to the adoption of the decision or amendment.

Along with the expanded rights and authority for shareholders and board members, the New JSC Law sets forth new limitations. For instance, the Kyrgyz Parliament, members of the Kyrgyz Government and other public servants may not serve on the board of directors, executive body or audit committee of any company. Additionally, directors' liability has been increased, as evidenced by a number of provisions regarding transactions in which officers may have an interest, as well as provisions prohibiting shareholders and board members from interfering with the day-to-day management of the company.

The minimum charter capital required for the establishment of a joint stock company has been increased ten times, from 10,000 Soms (approximately US \$230) to 100,000 Soms (approximately US \$2,300), and must now be paid in full when the company files its registration documents (as compared with the requirements of the previous law, according to which the charter capital could be paid in two installments, half before registration and half within one year after registration). The New JSC Law requires that all joint stock companies bring their charters into compliance with the new regulations within one year after enactment of the New JSC Law. /G. Kalikova

UZBEKISTAN

Legal Control over Sale of Oil Products Reformed

On May 19, 2003, the Cabinet of Ministers of Uzbekistan approved Resolution No. 225 "On Further Improvement of the System of Supplying Oil Products and the Mechanism for Settlements in the Course of their Sale" (the "Resolution"). The Resolution provides for the liquidation of local branches of JSC "Uznefteproduct" ("Uznefteproduct") and the transfer of regional petroleum storage stations under the direct control of Uznefteproduct. In order to control and manage such stations, a special regional control department has been established within Uznefteproduct. After restructuring, the petroleum storage stations currently organized as State unitary enterprises will obtain the status of independent legal entities, and will be issued licenses granting them the right to sell oil products.

An exemption will be granted to these new entities from the general rules governing payment for the supply of products. Previously, pursuant to the Presidential Decree "On Measures to Increase the Responsibility of the Heads of Enterprises and Organizations for Timely Settlements under Economic Transactions," dated May 12, 1995, enterprises were not permitted to supply products without an advance payment of at least 15 percent of the value of the products (including work products and services) to be supplied. In addition, non-receipt of payment for goods supplied within 90 days after their actual delivery was deemed a past due receivable.

The Resolution has changed these regulations such that: as of May 23, 2003, a 100 percent mandatory prepayment for automobile petroleum and liquefied natural gas has been established, and a mandatory prepayment for oil products has been established in the amount of at least 30% of the value of the products supplied, with final settlement to be made within 60 days.

The Resolution has also imposed a new rule pursuant to which, in the event of a violation of the established procedure for making payments for oil and gas products within the system of NHC "Uzbekneftegas," a penalty will accrue on the overdue payment in the amount of either 0.07 percent (to be paid by the enterprise) or

0.5 percent (to be paid by a bank), for each day of delay. This penalty will be paid to the State budget.

In addition, the Resolution has changed the procedure for conducting audits by State bodies. Previously, a Presidential Decree, dated November 19, 1998, as amended (the "Presidential Decree") provided that all such audits of the activities of economic entities, irrespective of their form of ownership, could be carried out by the oversight agencies on a regular basis, and no more frequently than once per year, and then only upon a decision of the Republican Council for the Coordination of the Activities of the Controlling Bodies of the Republic of Uzbekistan. The Presidential Decree further provides that audits of certain economic entities may be carried out by the oversight agencies no more frequently than once every two years, provided that such entities (i) pay all taxes, charges and other mandatory payments in full and in a timely manner, (ii) observe other norms and standards, and (iii) have relevant annual audit reports. The new Resolution has granted the Tax Committee, together with financial inspectors, the right to carry out, no more than once every six months, short-term audits of the enterprises of NHC "Uzbekneftegas" and RPG "Boshkomungas" (which are involved in the sale of gas to all types of users) in order to verify whether these entities are observing the procedures for making settlements for oil and gas products. */A. Voronin*

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