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RUSSIA

Russian Issuers May Be Permitted to Place Directly and Trade their Securities Abroad

The Russian Federation ("RF") Federal Commission for the Securities Market ("FCSM") recently prepared and approved a new resolution regarding the placement and the trade abroad of shares issued by Russian companies. In particular, according to this resolution, up to five percent of all issued shares and loan securities issued by Russian companies may be directly placed and traded on exchanges outside of Russia. At present, Russian issuers may place shares and loan securities on foreign exchanges only in the form of American Depository Receipts (ADRs).

The new resolution will prove beneficial, first, to issuers, as costs associated with the direct placement and trade abroad of securities is significantly less than the cost of the issuance of ADRs. However, such securities are not as likely to be as attractive to foreign investors, who tend to favor ADRs issued by foreign banks over securities issued directly by Russian companies.

The resolution would also have an impact on the percentage of shares that may be offered in the form of ADRs. Currently, 75 percent of all registered securities of a Russian company may be placed in the form of ADRs. Under the resolution, this amount would be reduced to 40 percent. In addition, the current procedure for obtaining the permission of the FCSM to issue ADRs will likely be made more stringent. The FCSM forwarded the draft resolution to the RF Ministry of Justice for registration. We will continue to monitor this issue and will report on further developments in future issues of the *CIS Legal Newswire*. ***JO. Titenko***

New Customs Code on the Horizon

The current RF Customs Code, which was first introduced in 1993 (the "1993 Customs Code"), and which was subsequently amended on several occasions, may soon be replaced by new legislation. The 1993 Customs Code has been criticized by Russian businesses, as well as by foreign investors, for its lack of detailed regulations, which leaves decisions on numerous clearance issues to the full discretion of individual customs officers. This situation has been cited by analysts as a leading cause of corruption in Russian customs procedures.

In 1998, the RF Government instructed the RF State Customs Committee to prepare a draft of a new Customs Code (the "Draft Code") in order to reflect certain changes in Russian law. In November 1999, the State Duma approved the Draft Code in its first reading, but the Draft Code passed in its key second reading only on April 18, 2003. Between the first

reading in November 1999, and the second reading, the Draft Code was significantly revised, and by the time of its second reading, the Draft Code represented a compromise among numerous ministries and organizations representing the interests of international shippers, exporters and other businesses engaged in foreign trade. On April 25, 2003, the draft Code was approved by the State Duma in its third and final reading, and is now ready for consideration by the Federation Council. It is expected that the new Customs Code will be enacted as of January 1, 2004.

In preparing the Draft Code, lawmakers attempted to address the issue of "tolling," which has been used by Russian and foreign companies in certain industries to avoid paying customs duties. For example, certain companies "borrow" raw materials used in manufacturing aluminum (bauxite ore and alumina) from offshore companies and then return these products abroad as finished, but without having to pay export duties on the finished product. In the draft of Article 182 of the Draft Code, as submitted for its second reading, there was a specific provision establishing an obligation to pay export duties in the case of the export of finished products after the processing of previously imported raw materials. However, certain interested Russian companies lobbied heavily to block this initiative, and in the course of the second reading, lawmakers failed to support this provision. The Draft Code currently places no restrictions on tolling schemes.

The Draft Code addresses many issues which have long been of concern to Russian and foreign businesses, such as reducing the maximum time for customs clearance from ten days to three days. The Draft Code also attempts to remedy certain problems related to levying duties and taxes, the effective dates for the application of various rates, fluctuation of foreign currency exchange rates, and the computation of customs duties and taxes in the event of a change in the amount of customs payments owed. Furthermore, articles establishing the procedure for determining which parties to the customs clearance process are responsible for making customs payments have become more specific.

Additionally, the chapter of the Draft Code covering collateral for customs payments offers a detailed outline of the procedure covering the payment of deposits for the import of goods. Finally, the Draft Code introduces several new chapters covering the circulation of goods sent by international mail across borders, the transport of goods by individuals and

the disposal of confiscated goods and vehicles by the customs authorities. */S. Volfson*

Reform of the Arbitration System Continues

As a further step in the overall reform of Russian judicial procedures, on February 25, 2003, President Vladimir Putin submitted to the State Duma a draft law "On the Introduction of Changes and Additions to the Federal Law 'On Arbitration Courts in the Russian Federation.'" This draft law seeks to introduce certain key improvements in the Russian appellate court system. Because President Putin himself submitted the draft law, it is almost certain to be adopted. The proposed changes to the appeals court system follows the recent major reform of Russian procedural law, marked by the adoption of the new Criminal Procedural Code in 2001, the new Arbitration Procedural Code in 2002 (*see the October 9, 2002, issue of the CIS Legal Newswire*), and the new Civil Procedural Code in 2002 (*see the February 14, 2003, issue of the CIS Legal Newswire*).

Currently, courts of the first instance and the first level of courts of appeal are located together in the same courthouses and represent different subdivisions of the same arbitration court (*e.g.*, the Moscow City Arbitration Court). Due to the close organizational and physical proximity between these levels of the court system, some have argued that relationships often develop among judges of the respective court levels, resulting in decisions rarely being reversed. This close proximity among the judges arguably hinders parties' rights to challenge the legality of decisions of lower court levels. In fact, parties to a dispute often decide to skip this first level of appeal in an effort to save both time and money, and end up with only one opportunity to appeal lower court judgments (*i.e.*, at the level of the cassation instance).

President Putin's proposal is to separate the courts of appeal from the courts of the first instance by creating ten appeal districts, which would match the current cassation districts. Unlike the cassation system, in which there is only one cassation court in each district, there will be two courts of appeal in each district. The draft law also provides for the possibility of creating special appellate courts located outside of perma-

/continued on page 3

ment courthouses. These special courts might be necessary in remote areas or for arbitration courts in certain districts with substantial case loads.

Under the draft law, the process of establishing new courts of appeal should be concluded by January 1, 2006. In the current year, three new appeal courts should already be established. Two would be created in the Moscow District (with separate courts for the City of Moscow and for the Moscow Region), and one in the Northwestern District (in St. Petersburg).

/A. Kelina

Constitutional Court Confirms the Right of Minority Shareholders to Challenge Interested Party Transactions

On April 10, 2003, the RF Constitutional Court ruled that the right of minority shareholders to challenge interested party transactions entered into by joint stock companies does not contradict the RF Constitution. The issue of interested party transactions was discussed in connection with a complaint brought by OJSC "Priargunskoe," a minority shareholder in the mid-size Russian oil and gas company OJSC "Varyeganneftegas." In particular, the RF Constitutional Court ruled that Section 1 of Article 84 of the RF Law "On Joint Stock Companies" (the "JSC Law"), which allows minority shareholders to challenge interested party transactions, is consistent with the RF Constitution.

Over the past three years, OJSC "Priargunskoe" has challenged, through litigation, the 1997 sale by OJSC "Varyeganneftegas" of the controlling stake in such company to OJSC "Sidanko." Having failed to meet the one-year statute of limitations to challenge voidable transactions, OJSC "Priargunskoe" argued that interested party transactions are void and that therefore, a ten-year statute of limitations for such challenges should apply. Although the court of the first instance held that the transaction between OJSC "Varyeganneftegas" and OJSC "Sidanko" was void, the RF Supreme Arbitration Court disagreed. OJSC "Priargunskoe" then

addressed the issue of interested party transactions to the RF Constitutional Court.

In considering the complaint of OJSC "Priargunskoe," the RF Constitutional Court considered the previous provision of Section 1 of Article 84 of the JSC Law, which provided, in a vague manner, that an interested party transaction can be declared invalid. In practice, two questions have consistently been raised in court proceedings: (i) who has the standing to challenge interested party transactions; and (ii) whether an interested party transaction is void (*i.e.*, invalid from the moment of its conclusion) or voidable (*i.e.*, invalid from the moment at which a court invalidates such transaction).

These issues are addressed in the new version of the JSC Law, which came into effect on January 1, 2002, and which makes clear that a joint stock company or its shareholders can challenge an interested party transaction. The RF Constitutional Court, although relying on the previous version of Section 1 of Article 84 of the JSC Law, confirmed current legal practice with respect to interested party transactions. The RF Constitutional Court recognized that shareholders, including minority shareholders, are entitled to challenge such transactions if they were not duly approved by the appropriate governing body of the company. The RF Constitutional Court also indicated that, by its nature, an interested party transaction is voidable and not void *ab initio*. Finally, the RF Constitutional Court stated in its decision that the recognition of the right of any shareholder to challenge an interested party transaction does not prevent federal legislators from further developing legal protections for shareholders' rights, which would stabilize the business dealings of joint stock companies and prevent shareholders from abusing their rights. /E. Abrossimova

Russian Constitutional Court Stresses Importance of Guarantees in the Forward Currency Market

In its Ruling No. 282-O (the "Ruling"), dated December 16, 2002, the RF Constitutional Court considered a number of issues related to forward currency contracts – which have long

/continued on page 4

been a source of confusion under Russian law – stemming from Russian banks' defaults on a number of such contracts after the August 1998 financial crisis.

The issue was taken to the RF Constitutional Court by the bank "Société Générale Vostok" ("Société Générale") after Société Générale unsuccessfully attempted to enforce payment by several Russian banks under forward currency contracts through litigation in the commercial courts. The Constitutional Court dismissed Société Générale's complaint, resulting in no practical change to the existing judicial position. At the same time, the Court made policy recommendations to the Duma on the matter, stressing the importance of creating a system of protections for the forward currency market.

The legal background for Société Générale's dispute and the Constitutional Court's Ruling is a series of cases in 1998 in connection with attempts to enforce forward currency contracts following the sharp devaluation of the Ruble that occurred in that year. During the 1998 crisis, a number of large Russian banks were unable or refused to perform under forward currency contracts, *i.e.*, to pay amounts in US Dollars at pre-crisis exchange rates. Honoring these forward currency obligations would have resulted in substantial losses to Russian banks.

Russian courts refused to enforce a number of forward contracts on the grounds that the arrangements constituted "gaming transactions" and were unenforceable under the RF Civil Code. The courts were particularly suspicious of non-deliverable forward currency contracts, which did not fall under the traditional categories of "purchase-sale" or "supply" contracts. Also, the absence of a clear risk reduction or commercial purpose, and apparent focus of these transactions on speculative gains, was seen as a fatal flaw by Russian judges.

In considering one 1999 case, in which it affirmed a lower court's treatment of a non-deliverable forward currency contract as a "gaming transaction", the Supreme Arbitration Court specifically pointed to the fact that the transaction had no "entrepreneurial purpose" such as "insuring currency risks" and that "the parties did not intend to carry out an actual transfer of the base assets (hard currency) of the transaction."

Société Générale turned to the RF Constitutional Court following unsuccessful litigation in the Moscow Arbitration Court. Importantly, the disputed forward contracts were not purchase-sale transactions providing for the delivery of cash, but

rather only for the payment of differences between the price of currency, depending upon the fluctuation of the Ruble exchange rate against the US Dollar, *i.e.*, they were non-deliverable forward contracts.

In their typical purchase-sale transaction, a party enters into an agreement to sell, in the future, at an exchange rate agreed now, a certain amount of Rubles and receive payment in a certain amount of Dollars in return. In such an arrangement, performance (payment) is clearly determined in advance and is not conditional on the fluctuation of the exchange rate. In contrast, in a non-deliverable forward contract, the payment obligation is only triggered by deviation of the exchange rate from agreed thresholds, and amounts to be paid are determined by the same uncertain factor.

The Moscow Arbitration court refused to enforce the non-deliverable forward contracts on the ground that they constituted "gaming transactions" under the RF Civil Code and, therefore, were not enforceable. This decision was subsequently upheld at the appellate level of the Moscow Arbitration Court.

In its complaint to the RF Constitutional Court, Société Générale disputed the constitutionality of applying the "gaming" provisions of the RF Civil Code to forward currency contracts.

The RF Constitutional Court dismissed Société Générale's complaint on the grounds that the Civil Code provisions on games and bets as such do not violate Société Générale's constitutional rights. The Court noted that the issue in Société Générale's complaint really only concerned the correctness of applying the Civil Code provisions to forward contracts and that the Court was not in a position to assess the application of substantive law by arbitration courts. The Court stated that the legal characterization of any specific forward currency transaction should be determined by arbitration courts on a case-by-case basis.

Therefore, the Ruling does not improve the existing legal regime for forward contracts and will not improve the position of investors who lost their money in 1998 due to the inability to enforce non-deliverable forward contracts. Nevertheless, it is worth noting the Court's recommendations to the Duma for the future. Specifically the Court stated that "*in carrying out further regulation of relevant relations, the federal legislator should...establish rules of access of participants into the*

/continued on page 5

market of forward obligations, forms and methods of control over such obligations, a system of guarantees and insurance mechanisms based on the level of development of the financial market, State control over it, significance of non-deliverable forward contracts for forming tax revenues, [and] the influence of their performance/non-performance on the stability of the Ruble" (emphasis added).

The Court further stated that the legal regulation of entrepreneurial activity should be based on the principle of freedom of contract as a fundamental civil law principle, meaning that the new framework will need to accommodate the practice of professional market participants. The policy recommendations of the Court for creating an adequate system for currency forwards, backed by guarantees to investors, may be seen as a good starting point. Hopefully, the Court's recommendations and approach will find support in the Duma and the Government, and a viable framework will be put in place in the foreseeable future, accompanied, hopefully, by commercial counterparties receiving adequate court support for liabilities arising under such contracts. */I. Glotin*

UZBEKISTAN

New Law Expands Choice of Forms of Investment in Subsoil-Related Projects

In January of 2003, the new Law "On Subsoil," which was adopted by the Oliy Majlis (the Parliament of Uzbekistan) on December 13, 2002, came into effect (the "New Subsoil Law"). Coupled with the Law "On Production Sharing," adopted by the Oliy Majlis on December 7, 2001 (the "PSA Law"), the legislative regime in Uzbekistan for subsoil projects, including all mineral and hydrocarbon exploration, extraction, and production projects, has improved considerably. The most important improvements concern various licensing and project structuring issues.

Most CIS countries prohibit the transfer of licenses that grant rights to extract and sell underground resources ("subsoil use licenses"), whether by sale to a third party or as part of a lender's security package. However, Article 30 of the New

Subsoil Law explicitly permits such transferability, provided that the transferor undertakes to comply with the terms of such license. Although the New Subsoil Law does not specify that such transferability is permitted in connection with the sale or the enforcement of a security package, the legislation does not appear to restrict the transfer of a license in any manner.

Another important aspect of the New Subsoil Law is particularly important to exploration companies. In the past, Uzbek subsoil legislation gave companies that financed the discovery of mineral or hydrocarbon deposits under an exploration license only a "preferential right" to receive an extraction and production license for such deposit. Article 26 of the New Subsoil Law now makes it clear that such companies have an "exclusive right" to obtain a license to extract and sell the minerals and hydrocarbons in that deposit.

Before the adoption of the New Subsoil Law, the Cabinet of Ministers was the licensing authority for all subsoil projects in Uzbekistan. Although the Cabinet of Ministers often delegated that authority to its Geology Committee, the Cabinet of Ministers was usually heavily involved in discussions and negotiations regarding the license. The New Subsoil Law clearly gives the Geology Committee direct licensing authority over all subsoil resources, with the exception of hydrocarbons, for which the Cabinet of Ministers retains its licensing authority. The PSA Law also gives the Cabinet of Ministers the authority to negotiate production sharing agreements.

Finally, Uzbekistan's subsoil legislation now provides increased flexibility with respect to structuring subsoil projects. Under previous legislation, almost all of the natural resource foreign investments in Uzbekistan (except for a few, but notable, production sharing or other similar arrangements for hydrocarbon projects based solely on contract and contract law) were made in the form of Uzbek legal entities that were joint ventures with Uzbek partners. Although this structure is not required under Uzbek law, many Uzbek government officials were hesitant to consider other structures because Uzbek legislation did not clearly contemplate any structures other than joint ventures and concessions. Because of flaws in the concession law, most foreign investors shied away from pursuing concessions, leaving them with Uzbek legal entity-joint ventures as the only alternative. Because potential Uzbek partners for natural resource investment projects traditionally

/continued on page 6

have had relatively little to contribute to share capital, foreign investors were often required to "carry" their Uzbek partners, which sometimes led to serious negative effects on their projects' rates of return. The PSA Law clearly allows subsoil projects without an Uzbek partner or an Uzbek legal entity. Although the New Subsoil Law does not explicitly refer to the PSA Law or to production sharing structures, it does generally reaffirm the concept of alternative structures. */K. Heimert, J. Askarov*

KAZAKHSTAN

Kazakhstan Adopts New Law on Investment

Kazakhstan adopted a new Law "On Investments" on January 8, 2003 (the "New Investment Law"), which replaces the Law "On Foreign Investments," dated December 27, 1994, and the Law on State Support of Direct Investments, dated February 28, 1997.

The New Investment Law makes several significant changes to the legal regime governing foreign investments and foreign investors in Kazakhstan, including dispute resolution mechanisms and contract stability assurances. Perhaps most significantly, it removes the distinction between domestic and foreign investments in almost all instances – requiring all investors (whether foreign or domestic) to operate on the same terms and conditions.

The scope of the New Investment Law appears to be narrower than its predecessor legislation. The definition of "investments" has been narrowed, to include only property and rights that are contributed to the charter capital of a legal entity or otherwise used to increase fixed assets in connection with an entrepreneurial activity. In the past, the term was broadly defined as all property and rights invested in objects of entrepreneurial activity for the purpose of obtaining a profit. The prior legislation also made it clear that the conclusion and performance of contracts and the granting of loans were investment activities. The New Investment Law does not explicitly include such activities. In fact, the limited definition of "investments" makes it questionable whether such activities will be covered by the New Investment Law at all,

unless they can be tied directly to charter capital contributions or the purchase of fixed assets.

The most controversial provisions of the New Investment Law concern dispute resolution. The New Investment Law made several changes to prior dispute resolution legislation, all of which have caused concern for investors. The prior investment legislation permitted any foreign party to a dispute that arose in connection with a foreign investment to transfer the dispute to any one of several international arbitral tribunals.

The New Investment Law states that disputes may be resolved by international arbitration only if they are "investment disputes" and only if the parties to the dispute previously agreed to international arbitration. The New Investment Law defines "investment dispute" to include only disputes (i) arising out of contractual obligations, (ii) between investors and governmental authorities, and (iii) relating to investment activity. Of course, the narrowing of the definition of "investment" described above also affects the definition of "investment dispute."

These changes mean that, unlike in the past, (i) foreign parties may not have recourse to international arbitration if the parties to the dispute did not previously agree to international arbitration, (ii) disputes between private (*i.e.*, non-State) entities may not be resolved with international arbitration, and (iii) disputes that concern activities other than "investments" may not be resolved with international arbitration.

Moreover, the New Investment Law also provides that disputes that are not related to "investments" must be resolved in accordance with Kazakh law. Kazakhstan's Civil Procedure Code provides that private investors may have recourse to foreign courts to settle disputes, if not otherwise prohibited by Kazakh legislation. It is unclear how this permissive Civil Code provision will be interpreted in conjunction with the more restrictive New Investment Law provision. In addition, the Edict on Petroleum No. 2350, dated June 28, 1995, provides that disputes between subsoil users may be settled by international arbitral tribunals only if the parties to the dispute have agreed on such a dispute resolution mechanism, which may mean that investors in the oil and gas sector may not be able to rely on the more-permissive Civil Code provision.

Bilateral investment treaties may, however, provide comfort

/continued on page 7

to certain investors. For example, the U.S.-Kazakhstan Bilateral Investment Treaty makes it clear that U.S. investors may have access to international arbitral tribunals in several circumstances. As Article 4 of the Kazakh Constitution and Article 2 of the New Investment Law provides that ratified international agreements should prevail over the New Investment Law, U.S. investors should be able to take most disputes to international arbitral tribunals, irrespective of the restrictions in the New Investment Law.

Although the New Investment Law does not provide comprehensive contractual stability, Article 23 makes it clear that, regardless of any other provision of the New Investment Law, any benefits that were granted by an authorized state body by contract prior to the effective date of the New Investment Law will remain valid pursuant to such contract.

However, the New Investment Law weakens the legislative stability guarantees for contracts entered into after its enactment. The previous Kazakh investment legislation provided a guarantee that no adverse changes in Kazakh legislation would be applied to foreign investments for ten years (and, in certain instances, for a longer period of time), except for changes that were required to ensure national defense, national security, environmental security, or public health and morality. The New Investment Law includes a similar guarantee, except that it applies only to contracts entered into between investors and governmental bodies. Another difference between the two legislative regimes is that the previous regime required that the foreign investor be paid "prompt, adequate, and effective contributory compensation" for any damage caused by the change in legislation. The New Investment Law also provides for an indemnification, but it applies only to acts issued by governmental bodies that do not comply with legislative acts issued by Kazakhstan and to unlawful acts by officials of Kazakhstan. */K. Heimert, Y. Zhussupov*

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